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Office of the United States Trustee
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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
TUESDAY MORNING CORPORATION, et al.,	§	**Case No. 20-31476-HDH-11**
	§	
	§	**Jointly Administered.**
	§	
Debtors-in-Possession.	§	

United States Trustee's Objection to Confirmation of Debtors' Revised Second Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (Docket Entry No. 1633)

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To the Honorable Harlin D. Hale,
United States Bankruptcy Judge:

The United States Trustee for Region 6 files this Objection (the "**Objection**") to: (a) the Revised Second Amended Joint Plan of Reorganization of Tuesday Morning Corporation, *et al.*, Pursuant to Chapter 11 of the Bankruptcy Code [Docket No. 1633] (the "**Plan**"), as described in the Disclosure Statement in Support of the Revised Second Amended Joint Plan of Reorganization of Tuesday Morning Corporation, *et al.* Pursuant to Chapter 11 of the Bankruptcy Code (Solicitation Version) [Docket No. 1634] (the "**Disclosure Statement**"); and (b) the Notice of Plan Supplement and Related Documents [Docket No. 1788] (the "**Plan Supplement**"). In support of the relief requested, the United States Trustee respectfully submits as follows:

<u>Summary</u>

The United States Trustee objects to confirmation of the Plan for the following reasons:

a. The Debtors have not demonstrated that the Plan complies with the good faith requirement of 11 U.S.C. § 1129(a)(3). The backstop agreement is sponsored by Osmium Capital ("**Osmium**"), a former member of the Equity Committee (as defined below). Osmium did not resign—or recuse itself—from the Equity Committee before making an offer to increase its equity stake in the reorganized debtors. Only after the United States Trustee learned of Osmium's involvement in the Plan in publicly filed documents, and inquired about its role on the Equity Committee, did Osmium resign from the Equity Committee. The Debtors, the Equity Committee and the Equity Committee professionals must explain the process for securing this backstop agreement. The standard for an equity committee member's activity should be objective to avoid harm to the bankruptcy system, but the parties should disclose whether outside equity holders and others had access to the same financial information as insider equity committee information enjoyed by Osmium so the Court can assess the actual facts.

b. The Debtors have not shown that the Plan meets the absolute priority rule or the best interest of creditors test under 11 U.S.C. § 1129(a)(7). In this regard, the Debtors must clarify two points at the time of confirmation. First, the Debtors will have to demonstrate that timely filed unsecured claimants have unanimously accepted the plan, as they are impaired, and yet equity is receiving a distribution. Second, in the context of unsecured creditors receiving interest, the Debtors will have to explain why they have excluded late filed claimants from a distribution. Under the section 726 waterfall, in a Chapter 7 case late filed claimants receive payment before interest and equity.

c. The Plan has other problematic provisions, including non-consensual third-party releases and overly broad exculpations, described *infra*. Further, in the Plan Supplement, the Debtors revealed details of a management incentive plan ("**MIP**"), which may not comply with Bankruptcy Code requirements. Unless these provisions are amended to comply with decisions of Courts in the Fifth Circuit, confirmation should be denied.

Facts

1. General Background

1. On May 27, 2020 (the "**Petition Date**"), each of the above-captioned debtors (the "**Debtors**") filed a voluntary petition with the United States Bankruptcy Court for the Northern District of Texas – Dallas Division (the "**Court**") under chapter 11 of the Bankruptcy Code. The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in these cases.

2. The Debtors operate under the trade name "Tuesday Morning" and are one of the original "off-price" retailers specializing in providing unique home and lifestyle goods at bargain

values. *See* Disclosure Statement art. IV.A.1. On the Petition Date, the Debtors operated 687 stores in 40 states and distribution centers in Phoenix and Dallas. The Debtors' largest store concentrations are in Texas, Florida, California, Virginia, Georgia, and North Carolina. Post-petition, the Debtors commenced store-closing sales at about 200 store locations and closed their Phoenix distribution facility. *See id.* art. IV.A.2(a).

3. As of April 30, 2020, Tuesday Morning Corporation had 48,010,534 shares of stock outstanding [Docket No. 1].

4. On June 9, 2020, the United States Trustee formed an official committee of unsecured creditors (the "**Creditors Committee**") [Docket Nos. 203 and 206]. The Creditors Committee was originally comprised of five of the Debtors' general unsecured creditors, and now is comprised of three members [Docket No. 1464].

5. On October 5, 2020, the United States Trustee appointed an official committee of equity security holders [Docket No. 1151] (the "**Equity Committee**"). Osmium was one of five appointees to the Equity Committee.

6. Post-petition, the Debtors reopened all of their stores that had been closed due to the COVID-19 pandemic, paid down all but $100,000 of their prepetition secured debt, and have funded their administrative expenses without needing to draw on their DIP loan facilities. *See* Docket No. 1582 ¶ 5.

2. **<u>The Plan</u>**

7. Generally, the Plan proposes to pay class 5 general unsecured claims in full. The Debtors estimate that general unsecured claims will total about $125 million. *See* Docket No. 1582 ¶ 8. The Debtors propose to raise money to pay general unsecured claims by undertaking the rights offering ($40 million) and issuing subordinated secured notes ($25 million). *See id.*;

see also Plan art. IV.E.4 (“The proceeds from the Rights Offerings shall be immediately transferred to the General Unsecured Cash Fund and used to pay holders of Allowed General Unsecured Claims.”) and IV.E.5 (“The proceeds of the Senior Subordinated Notes shall be included in the General Unsecured Cash Fund.”).

8. The Plan generally provides that late-filed unsecured claims receive no payment. Specifically, except as otherwise provided in the Plan or otherwise agreed, all late-filed proofs of claim not allowed as of confirmation “shall be deemed disallowed and expunged as of the Effective Date.” Plan art. VII.E. Creditors are impacted by this provision. For example, the Court has already considered requests to allow late-filed claims and has denied at least one motion [Docket No. 1739 (not permitting late claim as timely); Docket No. 1818 (permitting late claim as timely)].

9. Yet the Plan provides interest to timely-filed unsecured claims and pays equity.

3. Osmium Enters in to Backstop Agreement with Defined Purchase Options While Serving on Equity Committee

10. The Court twice denied equity holders’ requests to the Court for a committee.

11. Relying on factual admissions and developments set forth in the Milestone Stipulation, the Court entered an order directing the United States Trustee to solicit and appoint an equity committee. Order Directing the Appointment of a Committee of Equity Security Holders, pp. 4-5 [Docket No. 892, entered 09/18/2020]. In connection with the United States Trustee’s appointment of the Equity Committee, on September 21, 2020, Osmium submitted a questionnaire to the United States Trustee (the “**Osmium Equity Committee Questionnaire**”). Immediately above the candidate’s signature line, the United States Trustee’s form for expressing interest in joining the equity committee provided:

> If you are appointed to the Official Committee of Equity Security Holders, the United States Trustee may require periodic certifications of your equity holdings while the bankruptcy case is pending. Equity security holders wishing to serve as fiduciaries on an official committee are advised that they may not purchase, sell or otherwise trade in or transfer claims against the debtor while they are committee members absent an order of the court on application of the equity security holder.

12. On October 5, 2020, the equity committee appointment was filed [Docket No. 1151].

13. One month later, on November 3, 2020, Osmium, while serving on the Equity Committee, entered into a backstop commitment letter with Tuesday Morning Corporation and others. *See* Disclosure Statement Exh. 5 at 1.

14. On November 9, 2020, the Debtors filed a rights offering procedure motion [Docket No. 1530] and sought expedited approval. Paragraph 15 of the motion refers to a commitment fee in favor of Osmium.

15. As described in the Disclosure Statement, the Debtors engaged with more than sixty prospective investors regarding a wide range of potential debt and equity investments to raise funds to pay the holders of General Unsecured Claims.

16. According to the Debtors, "[t]he Equity Committee also reached out to various shareholders of Tuesday Morning regarding the possibility of providing additional capital sufficient to ensure payment in full to holders of General Unsecured Claims." Disclosure Statement art. VI.P.

17. Through those efforts, "the Equity Committee was able to place one of its members, Osmium Partners, LLC, in contact with the Debtors and their professionals to discuss a potential transaction. Through those discussions, Osmium Partners, LLC, in conjunction with

Tensile Capital Management, LLC (i.e., the Backstop Parties), reached an agreement with the Debtors to backstop the Rights Offerings." *Id.*

18. In its statement in support of the Disclosure Statement filed on November 6, 2020 [Docket No. 1598] (the "**Equity Committee Response**"), the Equity Committee described its role in obtaining the backstop somewhat differently. Specifically, the "Debtors initially projected that, even with the benefit of the $40 million to be raised through the Rights Offerings, that they would have insufficient cash available to pay holders of Allowed General Unsecured Claims in full on or near the Effective Date by cramming up the unsecured creditors with a $25 million note." Equity Committee Response ¶ 16.

19. According to the Equity Committee, it did not solicit many equity holders. Rather, "the Equity Committee, in an effort to avoid a contested confirmation hearing, reached out to Osmium and Tensile [a manager of Osmium] to discuss terms on which they would extend a $25 million note to the Reorganized Debtors, which then would provide $25 million of cash to the general unsecured creditors so they would not have to take a note." *Id.* ¶ 17.

20. Although "[t]he Debtors also received a number of competing proposals to provide additional exit financing," the Debtors, "in close consultation with the Equity Committee, determined that pursuing the Rights Offerings and the Senior Subordinated Notes to provide the exit financing necessary to pay the Allowed Claims of General Unsecured Creditors in full in a lump sum (with interest) with the reinstatement of equity is in the best interests of the Debtors and their estates." *Id.* ¶ 18.

21. The Equity Committee originally "went to its members to seek to develop a transaction that would raise enough money to pay the General Unsecured Creditors in full so that value could be preserved for equity interest holders. One of the members of the Equity

Committee, [Osmium], stepped up to the plate and provided an offer of a $40 million capital infusion by way of a backstopped rights offering priced near the recent common stock trading price." *Id.* ¶ 2. "After this proposal, Osmium recused itself from the Equity Committee deliberations and all negotiations were completed on a third-party, arms-length basis, among itself, the Debtors, and the Equity Committee." *Id.* n.2 (emphasis added).

22. At the Disclosure Statement hearing, Equity Committee counsel stated that counsel had approached the equity committee members, Osmium had expressed interest, and Osmium was subject to an ethical wall before submitting an offer. *See* Disclosure Statement, Nov. 16, 2020, Tr. 29:23-30:1 [Docket No. 1665]. *But see* Equity Committee Response n.2 (Osmium recused itself after making its proposal).

23. Under the backstop agreement, Osmium received the following benefits:

- $5 million commitment fee, representing five percent, payable in common stock of the Reorganized Debtors [Disclosure Statement Hr'g Tr. 16:16-18];
- 2 million warrants to purchase shares of the Reorganized Debtors' common stock at a purchase price of 150 percent of $1.10 to Osmium as the backstop party; [*Id.* at 16:19-21];
- Professional fee reimbursement up to $600,000 [*Id.* at 16:22-23];
- Three (3) directors selected by the Osmium and (iv) one director selected by the Equity Committee [Plan Supplement, Docket Entry 1788, at 542 of 713]; and
- One Osmium director on every Tuesday Morning board committee [*Id.* at 544 of 713].

24. On November 16, 2020, the Court approved the Debtors' entry into the backstop agreement [Docket No. 1602].

25. On November 18, 2020, the Court approved the Disclosure Statement [Docket No. 1640].

26. On November 24, 2020, Osmium's counsel advised the Assistant United States Trustee that Osmium was resigning from the Equity Committee effective immediately.

27. On November 25, 2020, the United States Trustee filed an amended notice of appointment, accepting Osmium's resignation and removing Osmium from the Equity Committee [Docket No. 1702].

Argument and Authority

A. Proponents Have Not Shown Plan Satisfies Bankruptcy Code's Good Faith Requirements

28. The Debtors have not carried their burden of showing that the Plan has been proposed in good faith. Section 1129(a)(3) requires the Plan to have been "proposed in good faith and not by any means forbidden by law." Good faith is not a defined term in the Code, but "the term 'good faith,' as used in Section 1129(a)(3) [of the Bankruptcy Code], . . . is generally interpreted to mean that there exists a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code." *In re Madison Hotel Assocs.*, 749 F.2d 410, 424-25 (7th Cir. 1984) (other internal quotations omitted; citations omitted); *see also In re Coastal Cable T.V., Inc.*, 709 F.2d 762, 764 (1st Cir. 1983)). The statute provides a basis to designate, without regard to the creditor's motive, where the vote is "solicited or procured" in bad faith. *See In re Quigley Co., Inc.*, 437 B.R. 102, 130-31 (Bankr. S.D.N.Y. 2010). The Fifth Circuit instructs courts assessing good faith to evaluate the totality of the circumstances that led to the plan's development. *See Mabey v. SWEPCO (In re Cajun Elec. Coop, Inc.),* 150 F.3d 503, 519 (5th Cir. 1998) (citations omitted).

29. Courts have long recognized that members of official committees, such as the Equity Committee, are fiduciaries. *See, e.g., Woods v. City Nat. Bank & Trust Co.,* 312 U.S. 262, 268-69 (1941) ("Protective committees . . . are fiduciaries."); *In re First RepublicBank Corp.*, 95 B.R. 58, 61 (Bankr. N.D. Tex. 1988) (members of creditors' committees owe fiduciary duty to all creditors represented by committee); *In re Drexel Burnham Lambert Group, Inc.*, 138

B.R. 717, 722 (Bankr. S.D.N.Y. 1992) (official committees appointed under section 1102 have implied fiduciary duty to constituents); *In re L.F. Rothschild Holdings, Inc.*, 163 B.R. 45, 49 (S.D.N.Y. 1994) (broad scope of authority for official committee under section 1103(c) "implies both a fiduciary duty to committee constituents, and a grant of limited immunity to committee members.") (citing *First RepublicBank Corp.*); *In re Pierce*, 237 B.R. 748, 758 (Bankr. E.D. Cal. 1999) (committee members' duties include duty of undivided loyalty); *In re PWS Holding Corp.*, 228 F.3d 224, 246 (3d Cir. 2000) (endorsing interpretation of section 1103(c) as implying fiduciary duty owed by committee to constituents and holding that section 1103(c) "limits liability of a committee to willful misconduct or *ultra vires* acts."); *In re Pacific Lumber Co.*, 584 F.3d 229, 253 (5th Cir. 2009) ("We agree . . . with courts that have held that 11 U.S.C. § 1103(c), which lists the creditors' committee's powers, implies committee members have qualified immunity for actions within the scope of their duties.") (citing *PWS Holding Corp.*); *In re Washington Mutual, Inc.*, 442 B.R. 314, 350-51 (Bankr. D. Del. 2011) (identifying official committee as example of fiduciary who has served during chapter 11 case); *In re Farrell*, 610 B.R. 317, 322-23 (Bankr. C.D. Cal. 2019) (members of official creditors' committee have fiduciary duties of care, loyalty, and disclosure that are "generally strict and uncompromising in nature[.]"). Official committee members, as fiduciaries, "have obligations of fidelity, undivided loyalty and impartial service in the interest of the creditors they represent. . . . Obviously conflicting interests and services are not allowed." *United Steelworkers of Am. v. Lampl (In re Mesta Mach. Co.)*, 67 B.R. 151, 156 (Bankr. W.D. Pa. 1986).

30. Committee members receive insider, confidential information. They cannot then take advantage of their superior, insider knowledge in business dealings with debtors. *See, e.g.*, *Citicorp Venture Capital, Ltd. v. Committee of Creditors Holding Unsecured Claims (In re*

Papercraft Corp.), 160 F.3d 982 (3d Cir. 1998) (Court considered equitable subordination of fiduciary's claim based on fiduciary's improper use of its superior knowledge about debtor). "A committee member violates its fiduciary duty by pursuing a course of action that furthers its self-interest to the potential detriment of fellow committee members." *Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 256 (3d Cir. 2001); *see also United Steelworkers of Am. v. Lampl (In re Mesta Mach. Co.)*, 67 B.R. at 157 ("A committee member violates his fiduciary duty by using his position to further self interest.").

31. Osmium's duty as a member of the Equity Committee was to maximize the return to existing equity by driving up the price of any new investment in the Debtors. That duty would have conflicted with Osmium's own interest as a potential acquiror in driving down the price of its own new investment.

32. Osmium did not resign from the Equity Committee before making an offer to the Debtors. Rather, Osmium only recused itself after it had already offered to make a $40 million capital contribution. *See* Docket No. 1598 at n.2.

33. On its face, a committee member's involvement as a financier or as a plan proponent suggests self-dealing. In this regard, disclosure is absolutely essential. At least one equity holder declined to serve on the Equity Committee as a precautionary measure because of its possible desire to trade securities or participate in financing. *See* Docket No. 1665 at 24:19-21 (Nov. 16, 2020, Hr'g Tr.) (counsel represented that Eagle Rock (creditor and shareholder) "declined to become a member of the Equity Committee just to avoid this sort of confusion in these dual roles.").

34. Osmium itself promised not buy or sell securities while serving on the Equity Committee. *See* Osmium Equity Committee Questionnaire. Given its fiduciary duties and its

exposure to confidential information, it was incumbent on Osmium to take steps to inform the Court and the United States Trustee *before* it negotiated the backstop agreement.

35. Of itself, Osmium's receipt of confidential information as a member of an official committee and its subsequent participation in the backstop objectively taints confidence in the transparency and fairness of the bankruptcy process. For example, one of the Debtors' main assets, their Dallas real estate, will be realizing significantly higher value under the Plan than originally contemplated. The Debtors' financial projections show a sale-leaseback transaction involving the Dallas real estate for about $58,950,000, but that real estate is now being sold for $70,250,000. *Compare* Disclosure Statement Exh. 3 at 8-9 [Docket No. 1634 at 206-07 of 316] *with* Dec. 11, 2020 Form 8-K.[1]

36. Osmium's dual role is especially problematic in light of indications of interest from other parties. *See*, *e.g.*, Docket No. 616 ¶ 36 (Jeremy Blum's motion for appointment of equity committee) ("I am aware of at least one offer for the company made within three months of the bankruptcy filing."). Further, the Equity Committee's professionals should explain how they solicited backstop offers, including whether they marketed outside the Equity Committee. They should explain whether other bidders were offered the opportunity to select three directors to serve on the board of the reorganized debtors, as Osmium is able to do. *See* Plan Supplement, Agreement, ¶ 1(a), [Docket No. 1788 at 543 of 713].

37. Although the Debtors signed a "fiduciary out" in connection with Osmium's backstop agreement [*see* Disclosure Statement Exh. 5 art. 9.3(e)], the Court should not confirm the Plan unless the Debtors demonstrate that any competing bidders were in fact given a full and

[1] *See* https://www.sec.gov/ix?doc=/Archives/edgar/data/878726/000110465920134769/tm2038334d1_8k.htm (last visited Dec. 16, 2020).

fair opportunity to perform their own diligence and submit competing offers -- using the same information that Osmium had -- in connection with the rights offering.

38. Absent such a showing, the Debtors have not shown that the Plan meets the Code's good faith requirements and accordingly, the Plan cannot be confirmed.

B. <u>Proponents Have Not Shown Plan Satisfies the Bankruptcy Priority Rules and the Best Interest Test</u>

39. The Debtors have also not shown that the Plan satisfies the absolute priority rule and best interest of creditors test, as required for confirmation. The Plan has at least two unusual features. First, the Debtors propose to impair timely filed unsecured creditors, while also providing for a distribution to equity. Second, the Debtors seek to exclude any late filed unsecured creditors from a distribution, without providing a legal basis for this exclusion.

40. The Bankruptcy Code incorporates a form of the absolute priority rule in its provisions for confirming a Chapter 11 plan of reorganization. "Distributions of estate assets at the termination of a business bankruptcy normally take place through a Chapter 7 liquidation or a Chapter 11 plan, and both are governed by priority." *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 983 (2017); *see also Ultra Petroleum Corp. v. Unsecured Creditors' C'tee (In re Ultra Petroleum Corp.)*, 943 F.3d 758, 763-64 (5th Cir. 2019) (referencing section 726 as starting point to defining legal rights in chapter 11); *In re Ditech Holding Corp.*, 606 B.R. 544, 621-625 (Bankr. S.D.N.Y. 2019) (plan did not meet the best interests test requirements because certain consumer claimants would receive less in a Chapter 11 case than in a Chapter 7 case, most notably because their claims would not become the obligation of a buyer under a Chapter 11 plan but would of a buyer in a Section 363 sale).

41. Section 1129(a)(7) of the Bankruptcy Code provides that a plan may not be confirmed unless every holder of a claim or interest has either accepted the plan or will receive

or retain, under the plan, property with a value "that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7" of the Bankruptcy Code. *See* 11 U.S.C. § 1129(a)(7). This is commonly referred to as the "best interest of creditors" test.

42. In this regard, the Debtors must clarify two points. First, the Debtors should show that timely filed unsecured claimants have unanimously accepted the plan, as they are impaired, and yet equity is receiving a distribution. Second, the Debtors have failed to disclose why they have excluded late-filed claimants from a distribution. In a chapter 7 liquidation, late filed claimants would have to be paid before equity. *See* 11 U.S.C. § 726(a)(3) and (6).

C. Court Should Deny Confirmation Because Plan Contains Non-Consensual Third-Party Releases

43. The Plan contains non-consensual third-party releases, as described below. The Court should deny confirmation unless the Plan is modified to remove such non-consensual releases.

44. Article VIII.D of the Plan would cause each "Releasing Party" to release and discharge each "Released Party" for any pre-effective date negligence claims related to the Debtors.

45. The Plan defines "Releasing Party" to include holders of claims or interests who "(b) either (1) abstain from voting or (2) vote to reject the Plan and, in the case of either (b)(1) or (2), [do] not opt out of the voluntary release contained in Article VIII of the Plan by checking the opt out box on the Ballot and returning it in accordance with the instructions set forth thereon[.]" Plan Exh. A at 14.

46. In the Fifth Circuit, releases must be consensual. *See Pacific Lumber*, 584 F.3d at 252 (observing that prior Fifth Circuit authority "seem[s] broadly to foreclose non-consensual non-debtor releases and permanent injunctions").

47. Contract principles govern whether a release is consensual. *In re SunEdison, Inc*., 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017) ("***SunEdison***"). Under the Plan, part (b) of the definition of Releasing Party would create non-consensual releases. Accordingly, the Plan cannot be confirmed unless the definition of Releasing Party is modified by removing part (b).

48. Under subpart (b)(1), creditors who do not return a ballot would be deemed to have consented to the third-party releases, but creditors who do not return a ballot have not taken any action that could provide any type of consent to such releases. *See In re Washington Mutual, Inc.*, 442 B.R. at 355 ("Failing to return a ballot is not a sufficient manifestation of consent to a third party release."); *In re Chassix Holdings, Inc.*, 533 B.R. 64, 80-81 (Bankr. S.D.N.Y. 2015) (creditors entitled to vote but who took no action not treated as consenting to third-party releases where "relatively small recoveries" and widely publicized endorsement of plan by other creditor groups "could easily have prompted an even higher-than-usual degree of inattentiveness or inaction among affected creditors"); *In re SunEdison, Inc.*, 576 B.R. at 458-461 (despite lack of objection, Court refused to impose third-party releases on creditors who were entitled to vote but did not vote to accept; under applicable contract law silence is not consent where no duty to speak exists, and where, despite warnings on ballots, silence is not misleading or indicative of consent); *In re Emerge Energy Services LP*, 2019 WL 7634308 at *18 (Bankr. D. Del. Dec. 5, 2019) ("[A] waiver cannot be discerned through a party's silence or inaction unless specific circumstances are present. A party's receipt of a notice imposing an artificial opt-out requirement, the recipient's *possible* understanding of the meaning and ramifications of such notice, and the recipient's failure to out-out simply do not qualify."); *but see In re Indianapolis Downs, LLC*, 486 B.R. 286, 305-06 (Bankr. D. Del. 2013) (under circumstances of case, releases by creditors who failed to vote or who voted to reject but did not opt out were deemed

consensual). The court in *SunEdison*, applying the laws of New York to opt-out releases, found that they were not sufficient to demonstrate affirmative consent to such releases. *SunEdison*, 576 B.R. at 460. To the extent that the Debtors might argue that the laws of the State of Texas should apply to construction of the opt-out release, the laws of the State of Texas similarly hold that silence does not equal consent except under limited circumstances not applicable in this case. *See Marr-Piper Co. v. Bullis*, 1 S.W.2d 572, 575 (Tex. Comm. App. 1928, judgment adopted) ("[I]n implied contracts as well as express contracts there must be shown the element of mutual agreement. But the only difference is that such agreement is expressly stated, in the one instance, and is inferred from the circumstances, in the other. A contract implied from the facts and circumstances in evidence is as binding as would be an expressed one.").

49. Conspicuous warnings of the effect of silence in the disclosure statement and on the ballots are not enough to transform a creditor's silence into consent. In *SunEdison*, the debtors argued that the warning in the disclosure statement and on the ballots regarding the potential effect of silence gave rise to a duty to speak, and the nonvoting creditors' failure to object to the plan or to reject the plan should be deemed their consent to the release. *SunEdison*, 576 B.R. at 460. The Court rejected this argument because the debtors failed to show that the nonvoting creditors' silence was misleading or that the nonvoting creditors silence signified their intention to consent to the release (finding that silence could easily be attributable to other causes). *Id*. The debtors did not contend that an ongoing course of conduct between themselves and the nonvoting creditors gave rise to a duty to speak. *Id*.

50. As the Court in *SunEdison* observed, parties who are solicited, but do not vote, may have failed to vote for reasons other than an intention to consent to the releases. *SunEdison*, 576 B.R. at 460.

51. Two recent opinions by bankruptcy courts in this district confirm the general principles set forth in *SunEdison*. On June 4, 2019, Judge Mullin specifically referred to *SunEdison* in considering similar opt-out third-party releases in *In re Mac Churchill, Inc.*, Case No. 18-41988-MXM-11 (Bankr. N.D. Tex. June 4, 2019, Hr'g Tr.) (Mullin, B.J.) [Docket No. 156] ("***Mac Churchill***"). Like in *SunEdison*, Judge Mullin found that inaction in connection with an opt-out provision set forth on a plan confirmation ballot is not sufficient an affirmative action on the part of the non-voting creditor to constitute consent. "The courts generally do agree that you have to have an affirmative opt-out and that silence really shouldn't be deemed consent." Judge Mullin adopted the reasoning in the *SunEdison* opinion in toto and sustained the United States Trustee's objection to confirmation. *Id*. at 14:1-8. Judge Mullin observed than an opt-in release would be different "because that's clearly an affirmative action taken on behalf of the creditor" and that, under his reading, the opt-out release would not pass muster as a consensual release under *Pacific Lumber*. *Id.* at 16:9-24.[2]

52. In *In re PHI, Inc., et al.*, 19-30923 (Bankr. N.D. Tex. July 30, 2019, Hr'g Tr.) (Hale, B.J.) [Docket No. 885], this Court examined the opt out provision on a solicitation ballot. When a creditor "votes on a plan and does not opt out," the Court found that this creditor is nonetheless bound by the release. But, "a party who does not vote on the plan one way or the other has not expressed his consent, and this Court does not have the ability to force the release of a non-debtor against another non-debtor." *Id.* at 161:22-25.

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[2] Judge Mullin also distinguished *dicta* from a recent opinion from the Southern District of Texas, *Cole v. Nabors Corp. Serv., Inc. (In re CJ Holding Co.)*, 597 B.R. 597 (S.D. Tex. 2019) ("***CJ Holdings***") that seems to approve of nondebtor third party releases. *See Mac Churchill* at 15:5-10. *CJ Holdings* essentially involved a question of *res judicata* of a confirmation order, rather than an appeal of the confirmation order in the first instance. In a collateral attack to the confirmation order, the creditor in *CJ Holdings* challenged an order enforcing the confirmation order long past the time to appeal the confirmation order, rather than appealing the order confirming a plan in the first place. *CJ Holdings*, 597 B.R. at 602-05.

53. The Fifth Circuit, in the context of an SEC receivership, recently reaffirmed that "[t]he prohibition on enjoining unrelated, third-party claims without the third parties' consent does not depend on the Bankruptcy Code, but is a maxim of law not abrogated by the district court's equity power to fashion ancillary relief measures." *SEC v. Stanford Int'l Bank, Ltd.*, 927 F.3d 830, 842 (5th Cir. 2019) ("***Stanford***"). "No matter the euphemism, a permanent bar order is a death knell intended to extinguish the [third-party] claims, which are a property interest." *Id.* at 848. Construing a creditor's failure to opt out of a release as affirmative consent to the release is as euphemistic as the injunction in *Stanford*.

54. Part (b)(2) of the definition of "Releasing Party" must also be removed from the proposed Plan or it cannot be confirmed, because creditors who vote to reject the Plan have not opted out of the releases. *See In re Chassix Holdings, Inc.*, 533 B.R. at 79 ("If (as prior cases have held) a creditor who votes in favor of a plan ha[s] implicitly endorsed and 'consented' to third party releases that are contained in that plan, then by that same logic a creditor who votes to reject a plan should also be presumed to have rejected the proposed third party releases that are set forth in the plan.") *but see In re Indianapolis Downs, LLC*, 486 B.R. at 305-06 (approving releases by creditors who voted to reject but did not opt out). A vote to reject the Plan is a rejection of the releases in the Plan. Rejecting the releases a second time through an opt-out serves no purpose and should not be required.

55. For the foregoing reasons, the Court should deny confirmation unless part (b) of the definition of Releasing Party is removed.

D. Court Should Deny Confirmation Because Plan Contains Overly Broad Exculpation

56. The Plan cannot be confirmed because it contains exculpation provisions that are overly broad.

57. Article VIII.E of the Plan generally provides for the "Exculpated Parties" to receive exculpation for post-petition, pre-effective date acts and omissions related to these chapter 11 cases, excluding bad faith, actual fraud, willful misconduct, and gross negligence.

58. The Plan defines "Exculpated Parties" to include the Debtors, the "DIP Parties," the "Existing First Lien Parties," and their respective current directors, officers, members, professionals, and others. *See* Plan Exh. A at 8. The Plan defines "DIP Parties" to mean, collectively, "the DIP Term Facility Parties and the DIP Revolving Facility Parties." *Id.* at 5. The Plan defines "Existing First Lien Parties" to mean, collectively, "the Existing First Lien Agent and the Existing First Lien Lenders." *Id.* at 9.

59. The Plan's exculpation provisions are too broad to the extent they exculpate the Debtors' directors and officers, the DIP lender, and the pre-petition first lien lender for prepetition conduct. Such relief is inconsistent with *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009). In that case, the Fifth Circuit disallowed the exculpation of the debtors' officers, directors, and professionals because there was no evidence that they "were jointly liable for any . . . pre-petition debt. They are not guarantors or sureties, nor are they insurers. Instead, the essential function of the exculpation clause . . . is to absolve the released parties from any negligent conduct that occurred during the course of the bankruptcy. The fresh start § 524(e) provides to debtors is not intended to serve this purpose." *Id.* at 252-53.

60. The *Pacific Lumber* Court denied all non-debtor releases except those releasing the unsecured creditors' committee and its members because "its members are the only disinterested volunteers" seeking releases. *Id.* at 253. *See also United Artists Theatre Co. v. Walton (In re United Artists Theatre Co.)*, 315 F.3d 217, 227 (3d Cir. 2003) (holding that plan release provisions did not render moot United States Trustee's appeal of indemnity provisions of

financial advisor's employment agreement); *DropBox v. Thru, Inc.* (*In re Thru, Inc.)*, 2018 WL 5113124 at *23 (N.D. Tex., Oct. 19, 2018) (reversing and remanding bankruptcy court's approval of broad release, injunction, and exculpation provisions as "clear error'). Bankruptcy Courts within the Northern District of Texas have resolved objections to exculpation provisions by replacing such provisions with channeling injunctions. *See* Memorandum Opinion and Order [Docket No. 4614], *In re Pilgrim's Pride Corporation, et al.*, Case No. 08-45664-DML-11 (Jan. 14, 2010); Fourth Amended Joint Chapter 11 Plan of CHC Group Ltd. and its Affiliated Debtors (Section 10.8), [Docket No. 1701] *In re CHC Group, Ltd.*, Case No. 16-31854-BJH-11, United States Bankruptcy Court for the Northern District of Texas, Dallas Division (Feb. 16, 2017).

61. Unless the Plan's exculpation provisions are limited to exclude the Debtors' professionals, the DIP Parties, and the Existing First Lien Parties, confirmation should be denied. In addition, if the Court determines that Osmium's acts or omissions as a member of the Equity Committee were ultra vires or otherwise not consistent with their fiduciary duties, then Osmium should not receive exculpation. *See In re Pacific Lumber Co.*, 584 F.3d at 253 (adopting view that official committee members have qualified immunity for actions taken within scope of their duties).

E. Plan Should Not Seek Court Approval of Post-Effective Date Management Incentive Plan

62. Article IV.N of the Plan provides: "On the Effective Date, the New Board shall adopt the Management Incentive Plan for the Reorganized Debtors." In addition, the Plan Supplement describes a detailed MIP. *See* Plan Supplement, Ex. 12.

63. Despite these provisions, it does not appear that the Debtors are seeking this Court's approval of the MIP. If the Debtors are asking this Court to approve the MIP in connection with confirmation, the MIP must comply with the requirements of section 503(c).

64. Court approval of a key employee retention plan or key employee incentive plan should be subject to separate motion and hearing, and not simply incorporated into a plan. *See, e.g., In re AMR Corp.*, 490 B.R. 158, 169 (Bankr. S.D. N.Y. 2013) (holding debtors could not seek approval of severance payment under § 363 but instead under § 503(c) standards) ("***AMR I***") and *In re AMR Corp*., 497 B.R. 690 (Bankr. S.D.N.Y. 2013) ("***AMR II***"). The debtors in *AMR Corp.* sought approval of a severance plan for insiders.

65. Payments to insiders under the MIP may not be approved under the more general provision of section 1129(a)(4). *See AMR II*, 497 B.R. at 696. "If Section 1129(a)(1)'s instruction that a plan must comply with all applicable provisions of the Bankruptcy Code means anything, the Court cannot approve a payment that is clearly prohibited by another, more specific part of the Bankruptcy Code." *Id*. at 696-97 (citing *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065 (2012) ("***RadLAX***")).

66. In *RadLAX*, the United States Supreme Court held that a bankruptcy court could not confirm a plan that proposed to circumvent a Bankruptcy Code provision giving specific protections to secured creditors by, instead, relying on a more general provision that did not provide those same protections. *RadLAX*, 132 S.Ct. at 2071-72. The Supreme Court noted that "it is a commonplace statutory construction that the specific governs the general," *Id*. 2071 (citations omitted), and that it is "particularly true where . . . Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions." *Id*.

67. This rule applies to the MIP. Section 503(c) was added to the Bankruptcy Code in 2005 to "eradicate the notion that executives were entitled to bonuses simply for staying with the [c]ompany through the bankruptcy process." *AMR II*, 497 B.R. at 696. Indeed, section

503(c)(1) was added to the Bankruptcy Code in response to "glaring abuses" by corporate executives who would line their own pockets at the expense of creditors and parties in interest. *In re Dana Corp.*, 358 B.R. 567, 575 (Bankr. S.D.N.Y. 2006).

68. Because Congress enacted the more specific provision of section 503(c)(1) to address the problem of insider enrichment at the expense of the creditor body, the Debtors must meet their burden of proof under the more specific Bankruptcy Code provision of section 503(c)(1), rather than rely upon the more general confirmation standard. Any post-effective date MIP that the Reorganized Debtors may seek to implement should be a matter between the reorganized company, the MIP beneficiaries, and the company's shareholders. This Court should not wade into post-effective date executive compensation. Accordingly, Article IV.N of the Plan should be stricken from the Plan, or the Court should deny confirmation.

F. Plan Must Comply with *ASARCO*

69. The Plan includes a provision that may not comply with *Baker Botts LLP v. ASARCO LLC*, 576 U.S. 121 (2015).

70. Specifically, Article XII.D of the Plan provides in part: "Subject to any limitations imposed by the Bankruptcy Court in the Confirmation Order, the Reorganized Debtors shall be responsible for paying any fees or expenses incurred by the members of or advisors to the Creditors Committee and the Equity Committee (as applicable) after the Effective Date (including fees and/or expenses incurred [in] preparing and filing final fee applications <u>and obtaining Bankruptcy Court approval of the same)</u> . . . ." (emphasis added).

71. Estate professionals are employed under sections 327 or 1103, their terms of employment may be approved under section 328(a), and they are paid under section 330, subject to sections 326, 328, and 329. Sections 330 and 331 are the exclusive Code provisions

authorizing payments to professionals. *See In re Ferguson*, 445 B.R. 744, 751 (Bankr. N.D. Tex. 2011) ("While section 330(a)(1) makes an award of compensation 'subject to sections 326, 328, and 329,' sections 330 and 331 are the only provisions of the Code which authorize the payment of professionals" employed under sections 327 or 1103.). Section 330(a)(1) "[does not] permit[] a bankruptcy court to award attorney's fees for work performed in defending a fee application in court." *ASARCO* at 124. Issues arising from the plan confirmation process and backstop may result in discovery and fee litigation. Therefore, the confirmation order should clarify that the Reorganized Debtors may not any pay and fees and expenses for obtaining Bankruptcy Court approval of retained professionals' (final) fee applications that include professionals' defense of their fee applications in Court.

G. Post-Effective Date Notices Must Comport with Due Process

72. The Reorganized Debtors should serve post-effective date papers on all known parties whose rights are affected by such papers.

73. Article XII.G of the Plan provides in part:

> After the Effective Date, the Reorganized Debtors have authority to send a notice to Entities that request to continue to receive documents pursuant to Bankruptcy Rule 2002, such Entity must file a renewed request to receive documents pursuant to Bankruptcy Rule 2002. After the Effective Date, the Reorganized Debtors are authorized to limit the list of Entities receiving documents pursuant to Bankruptcy Rule 2002 to those Entities who have Filed such renewed requests.

74. The Reorganized Debtors should serve post-effective date documents on known parties whose rights are affected by such documents—not solely on parties who make a subsequent request to receive notices under Rule 2002. *See, e.g., Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) ("An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated,

under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.”). The confirmation order should so provide.

H. Plan Must Comply with Section 1127(c)

75. The Court should not pre-approve material changes to the Plan without the need to resolicit votes.

76. Article X.A reserves the Debtors’ ability to modify the Plan “whether such modification is material or immaterial, and seek Confirmation consistent with the Bankruptcy Code and, as appropriate, not resolicit votes on such modified Plan.” Section 1127(c) of the Bankruptcy Code provides: “The proponent of a modification shall comply with section 1125 of this title with respect to the plan as modified.” To the extent the Debtors seek to waive the requirements of section 1127(c), the Plan does not satisfy section 1129(a)(2), and confirmation should be denied. The United States Trustee reserves all objections and arguments under sections 1125 and 1127(c) if the Debtors seek to make material modifications to the Plan at or before confirmation.

I. Disbursing Agent Should Be Bonded

77. The Plan’s disbursing agent should be bonded.

78. The Plan provides for the creation of a “General Unsecured Cash Fund” to pay general unsecured claims and a “Class 5 Disputed Claim Reserve” for disputed claims. Article IV.F provides:

> The General Unsecured Cash Fund and the Class 5 Disputed Claim Reserved [sic] shall be placed in an escrow account or trust, which escrow account or trust shall not constitute property of the Debtors or Reorganized Debtors . . . and such escrow account or trust account shall be administered by the Disbursing Agent, Escrow Agent, or Trustee, as applicable, in accordance with the terms of the Plan and the applicable escrow agreement or trust agreement solely for the benefit of the holders of Allowed General Unsecured Claims.

79. Article VI.B of the Plan provides in part: "All distributions under the Plan shall be made by the Disbursing Agent. The Disbursing Agent shall not be required to give any bond or surety or other security for the performance of its duties unless otherwise ordered by the Bankruptcy Court."

80. The disbursing agent should be bonded. The Debtors anticipate paying about $125 million to Class 5 general unsecured creditors. *See* Disclosure Statement at 4. If those funds are no longer the Debtors' or Reorganized Debtors' property, then the Bankruptcy Court may not have jurisdiction to grant relief if the escrow account suffers a loss. General unsecured creditors should not bear the risk of loss, especially given the amount of money that would be put into escrow, absent a record that a bond would be cost-prohibitive. This issue is not academic. *See Howley Law PLLC v. Omni Agent Solutions, Inc.*, *et al.*, 20-50773 (LSS) (Bankr. D. Del.) [Docket No. 1] (complaint alleging that $16 million liquidating trust was almost completely emptied by series of fraudulent wire transfers in March 2020).

J. Debtors, Reorganized Debtors, and Disbursing Agent Should Be Jointly Liable for UST Quarterly Fees

81. The Debtors, Reorganized Debtors, and Disbursing Agent should be jointly and severally liable for United States Trustee quarterly fees under 28 U.S.C. § 1930.

82. Article XII.C of the Plan provides:

> All fees payable pursuant to section 1930(a) of the Judicial Code, as determined by the Bankruptcy Court at a hearing pursuant to section 1128 of the Bankruptcy Code, shall be paid by each of the Reorganized Debtors (or the Disbursing Agent on behalf of each of the Reorganized Debtors) for each quarter (including any fraction thereof) until the Chapter 11 Cases are converted, dismissed, or closed, whichever occurs first.

83. The confirmation order should clarify that the Debtors, Reorganized Debtors, and Disbursing Agent, as applicable, shall be jointly and severally liable for the payment fees under

28 U.S.C. § 1930(a) and any interest thereon pursuant to 31 U.S.C. § 3717. The confirmation order should also be clear that all outstanding amounts owed under 28 U.S.C. § 1930(a) and any interest thereon pursuant to 31 U.S.C. § 3717 shall be paid in full in cash on the effective date. 11 U.S.C. § 1129(a)(12). Finally, the confirmation order should provide that notwithstanding the inclusion of United States Trustee quarterly fees in the definition of "Administrative Claim," the United States Trustee shall not be required to file any proof of claim or request for payment of Administrative Claim.[3]

84. The United States Trustee reserves any and all rights, remedies and obligations to complement, supplement, augment, alter and/or modify this objection, file an appropriate motion or conduct any and all discovery as may be deemed necessary or as may be required, and to object on such other grounds as may become apparent upon further factual discovery.

Conclusion

Wherefore, the United States Trustee requests that the Court deny confirmation of the Plan and grant to the United States Trustee such other and further relief as is just and proper.

DATED: December 16, 2020

Respectfully submitted,

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UNITED STATES TRUSTEE

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[3] Such relief is consistent with the bar date order at Docket No. 504 ¶ 7(d).

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Certificate of Service

I hereby certify that on the 16th day of December, 2020, I sent a copy of the *United States Trustee's Objection to Confirmation of Debtors' Revised Second Amended Joint Plan of Reorganization under Chapter 11 of the Bankruptcy Code (Docket Entry No. 1633)*, to the parties requesting notice via ECF and to the email addresses of parties listed in Order Approving Disclosure Statement as set forth below.

Dated: Dallas, Texas
December 16, 2020

WILLIAM T. NEARY,
UNITED STATES TRUSTEE

By: */s/ Lisa L. Lambert*

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