UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK		Hearing Date: June 7, 2021 Hearing Time: 11:00 a.m.
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In re	:	Chapter 11
KG WINDDOWN, LLC, *et al.*,	:	Case No. 20-11723 (MG)
	:	Jointly Administered
Debtors.	:	
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UNITED STATES TRUSTEE'S OBJECTION TO THE DEBTORS' MOTION FOR ENTRY OF ORDERS (I) AUTHORIZING THE DEBTORS TO MAKE DISTRIBUTIONS TO ALLOWED ADMINISTRATIVE EXPENSE CLAIMS; (II) DISMISSING THE DEBTORS' CHAPTER 11 CASES; (III) ESTABLISHING PROCEDURES WITH RESPECT TO FINAL FEE APPLICATIONS; (IV) AUTHORIZING THE DEBTOR ENTITIES TO BE DISSOLVED IN ACCORDANCE WITH APPLICABLE STATE LAW; AND (V) GRANTING RELATED RELIEF

William K. Harrington, the United States Trustee for Region 2 (the "**United States Trustee**"), in furtherance of the duties and responsibilities set forth in 28 U.S.C. §§ 586(a)(3) and (5), hereby respectfully files his objection (the **"Objection"**) to the Motion for Entry of Orders (I) Authorizing the Debtors to Make Distributions to Allowed Administrative Expense Claims; (II) Dismissing the Debtors' Chapter 11 Cases; (III) Establishing Procedures with Respect to Final Fee Applications; (IV) Authorizing the Debtors Entities to be Disallowed in Accordance with Applicable State Law; and (V) Granting Related Relief (the "**Dismissal Motion**"), in the KG Winddown, LLC and its affiliated debtors and debtors in possession in the above-captioned chapter 11 cases (each a "**Debtor**" and collectively, the "**Debtors**"). ECF Doc. No. 480. In support of this Opposition, the United States Trustee respectfully states as follows:

INTRODUCTION[1]

As discussed below, the Dismissal Motion must fail for a number of reasons. First and foremost, this motion is premature. Approximately half of these cases are admittedly not ready to be dismissed, and even after dismissal of some of the cases, the Court is being asked to retain jurisdiction for claim review as well as for other case administrative matters. Second, the Dismissal Motion improperly requests this Court to issue what amounts to a comfort order with respect to the payment of administrative claims. The payment of administrative claims is governed by provisions of the Bankruptcy Code and the Debtors need no specific unusual order of this Court in order to pay administrative claims. Third, this Court lacks the authority to dissolve a corporate debtor in accordance with state court law. Fourth, these Debtors are not going to reorganization, are not going to file a plan or plans of reorganization and lack the funds to make distributions to their priority to unsecured creditors. Under these circumstances, there is no reason which would favor the imposition of nonconsensual releases upon priority and unsecured creditors. Fifth, there is no support for applying the protections of Section 349 of the Bankruptcy Code over every order that has been issued in this case. Under section 349 of the Bankruptcy Code, only certain orders survive the dismissal of a case and each such order that does survive needs to be justified on the facts of each order. In short, a party does not get a blanket reservation of all orders in the case. And finally, the protection of the Court does not extend to professionals hired in dismissed cases. For these reasons, the Dismissal Motion must fail, and these cases should either be dismissed by simple order without the numerous “bells and whistles” that the Debtors have included in their proposed staggered dismissal orders or in the alternative, converted to Chapter 7 cases.

[1] Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the Motion.

BACKGROUND

I. General

1. On July 28, 2020 (the "**Petition Date**") and July 31, 2020, K.G. IM, LLC and its affiliated debtors filed voluntary petitions for relief under chapter 11 of title 11 of the United States. ECF No. 1.

2. No trustee, examiner or official committee of unsecured creditors has been appointed to date in these cases.

II. The Debtor in Possession Financing

3. On October 12, 2020, the Debtors filed its Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Postpetition Financing and to Use Cash Collateral, (II) Granting Adequate Protection to Prepetition Secured Lenders, (III) Confirming the Debtors' Authority to Use PPP Funds to Fund Particular Budgeting Items, (IV) Scheduling a Final Hearing, and (V) Granting Related Relief (the "**DIP Motion**"). ECF No. 209.

4. On November 12, 2020, the Bankruptcy Court entered its order approving the DIP Motion on a final basis in the amount of $3.1 million (the "**Final DIP Order**"). ECF No. 304.

5. As part of the terms of the Final DIP Order, the Debtors stipulated to a release of their rights or basis to challenge or object to the validity, enforceability, priority, or nonavoidability of the Prepetition Secured Lenders' liens. *See* Final Dip Order at § E(xiii).

6. Moreover, under the Final DIP Order, any party in interest was provided the opportunity to challenge the validity, enforceability, priority, perfection and amount of the Secured Lender's liens on substantially all of the Debtors assets, by filing a Challenge Action (as defined in the Final DIP Order) by November 16, 2020, except that Gerald Katzoff's deadline to file a Challenge Action was November 23, 2020. *See* Final DIP Order ¶31 (c).

7. No Challenge Action was filed in these Chapter 11 Cases.

III. <u>Sale of the Debtors' Assets</u>

8. On October 12, 2020, the Debtors filed their Motion for Entry of an Order (I) Establishing Bidding Procedures and Section 365 Procedures, (II) Approving the Sale of Substantially all of the Debtors' Assets, (III) Authorizing the Entry into and Performance under the Stalking Horse under the Stalking Horse Asset Purchase Agreement, (IV) Granting Related Relief, (the "**Bid Procedures Motion**"). ECF No. 21.

9. On October 23, 2020, the Bankruptcy Court approved bid procedures governing the Sale process (the "**Bid Procedures Order**"). ECF No. 260.

10. On December 11, 2020, the Debtors filed their Notice of Cancellation of Auction and, pursuant to the Bid Procedures Order, sought confirmation of the sale of substantially all of the Debtors assets, pursuant to the Stalking Horse APA to the Purchaser, as defined therein. ECF No. 351.

11. On December 22, 2020, this Court entered the Order (I) Approving Asset Purchase Agreement Among Sellers and Buyer, (II) Authorizing Sale of Substantially All of the Debtors' Assts Free and Clear of Liens, Claims, Interest, and Encumbrances, (III) Authorizing Assumption and Assignment of Certain Executory Contracts and Leases in Connection Therewith, and (IV) Granting Related Relief (the "**Sale Order**"). ECF. No. 392.

12. The Sale Order approved the sale (the "**Sale**") of substantially all of the Debtors' assets pursuant to that certain Asset Purchase Agreement (the "**APA**"), dated December 24, 2020, by and among the Debtors, and BSP Agency LLC, Providence Debt Fund III L.P., Benefit Street Partners SMA-C L.P., Benefit Street Partners SMA LM L.P., Providence Debt Fund III

Master (Non-US) Fund L.P., and Benefit Street Partners SMA-C SPV L.P. (together with their permitted successors, designees and assigns, collectively, the "**BSP**"). *Id.*

13. The Sale Order provided, in pertinent part:

> 34. **Exculpation of Buyer**. Effective upon the Closing, and to the maximum extent available under applicable Law, neither the Buyer nor any of its members, partners, employees, Affiliates, successors, assigns, advisors, or representatives shall have or incur any Liability to, or be subject to any action by, the Debtors, their estates, or any of their predecessors, successors or assigns, including any trustee or examiner appointed in these cases or upon a conversion of these cases to chapter 7 of the Bankruptcy Code, any official committee of unsecured creditors, other fiduciaries that are or may be appointed in these cases, or any Persons or entities, arising from, based on, or related in any way to the negotiation, documentation, or due diligence in respect of, or the performance or consummation of the Asset Purchase Agreement and any related agreements entered into in connection therewith, the Debtors, their estates, and the conduct of their business prior to the Closing, and the entry into and consummation of the Sale Transaction, other than (with respect to the Buyer only) the Buyer's obligations under this Order or the Asset Purchase Agreement or any related agreements entered into in connection with the Sale Transaction; provided that, to the extent that a claim or cause of action by the Debtors, their estates, or any of their predecessors, successors, or assigns is determined by order of this Court or any court of competent jurisdiction to have resulted from fraud, gross negligence, or willful misconduct of the Buyer, such claim or cause of action shall not be released against the Buyer.

See the Sale Order, ¶ 34.

14. The Purchase Price for substantially all of the Debtors' assets consisted of: (a) a credit bid in an amount equal to the sum of (i) $2 Million, consisting of a portion of the outstanding liabilities under the DIP Facility as of the Closing Date; and (ii) $16 Million, consisting of a portion of the liabilities arising under the IL Mulino Prepetition Credit Documents; (b) a $100,000 cash payment reserved for distribution to holders of allowed general unsecured claims (the "**GUC Sale Proceeds**"); (c) a payment or other satisfaction of all Cure

Amounts in cash; and (d) the assumption of Assumed Liabilities under the Stalking Horse APA by the Stalking Horse Purchaser. ECF No. 396, Ex. 1, APA § 2.5(i).

IV. <u>The Dismissal Motion</u>

15. The Debtors allege the following in the Dismissal Motion:

- As of the date of this Motion, the Debtors have approximately $1.1 million of cash on hand (the "**Cash Balance**"). *See* Boucher Decl. ¶ 15, and Ex. A.

- If the Debtors' First Omnibus Objection to Claims (Dkt. No. 469) with respect to certain claims arising under section 503(b) of the Bankruptcy Code ("**Administrative Claims**") is granted, the estimated total amount of administrative expense claims against the Debtors' estates will exceed $1.1 million.

- The Debtors assert that $0.9 million in claims under the DIP Facility remain unsatisfied. *See* Boucher Decl. ¶ 18.

- Each of the Debtors' retained professionals have filed or will soon file final fee applications (the "Final Fee Applications") for payment of compensation and reimbursement of expenses in connection with services provided to the Debtors in these Chapter 11 Cases (the "**Professional Fees**").

- In connection with the Sale, three of the Debtors (the "**TSA Debtors**" and the remaining Debtors, the "**Non-TSA Debtors**") entered into the Amended Transition Services Agreements [] with Purchaser [] in connection with the transition of liquor licenses and related permits to Purchaser. According to the Debtors, that transition is not expected to be complete with respect to the TSA Debtors for at least six months and therefore, the Chapter 11 Cases of the TSA Debtors cannot be dismissed until the transition is completed.

See Dismissal Motion, ¶¶ 2 through 4.

16. The Debtors seek to implement the following procedures as set forth in the Dismissal Motion:

- Notice of this Motion and the Dismissal Procedures (the "**Dismissal Notice**") shall be provided to all creditors and equity security holders of the Debtors.

- Upon the resolution of the Debtors' First Omnibus Objection to Claims, the Debtors shall file a schedule of all valid and allowed Administrative Claims (the "**Allowed Administrative Claims**") on the docket, as well as a reconciliation to Exhibit A attached to the Boucher Declaration.

- The Debtors shall be authorized to pay all Allowed Administrative Claims and all allowed Professional Fees in connection with the Final Fee Applications, subject to the limitations set forth herein (the "**Allowed Professional Fees**"); provided that prior to payment of Allowed Administrative Claims and Allowed Professional Fees, the Debtors shall calculate and reserve amounts necessary to satisfy any related U.S. Trustee Fees.

- The Debtors shall be authorized to file a certification of counsel requesting dismissal of the Chapter 11 Cases of the Non-TSA Debtors, certifying that: (a) all Allowed Administrative Claims have been paid; (b) all Allowed Professional Fees have been paid; and (c) all U.S. Trustee fees and monthly operating reports relating to the Non-TSA Debtors' Chapter 11 Cases have been paid.

- Certifications [] requesting dismissal shall only be served on the Master Service List approved pursuant to the Case Management Order (Dkt. No. 113) entered in these Chapter 11 Cases (which includes the Office of the United States Trustee, counsel to BSP, and all other persons and entities that have formally appeared and requested service in these Chapter 11 Cases).

- All funds remaining after payment of all Allowed Administrative Claims, Allowed Professional Fees, and U.S. Trustee Fees arising from the Non-TSA Debtors' Chapter 11 Cases shall be reserved (the "**TSA Debtors Winddown Reserve**") for the payment of U.S. Trustee Fees arising from the TSA Debtors' Chapter 11 Cases, and any other expenses of the Non-TSA Debtors, including the fees and expenses of professionals, which the CRO shall be authorized to pay in the ordinary course of business, provided, however, the fees and expenses of professionals shall be subject to the prior approval of BSP or an order of the Court.

- The Debtors shall be authorized to file a Certification requesting dismissal of any of the TSA Debtors' Chapter 11 Cases upon the termination of the Amended Transition Services Agreement with respect to such TSA Debtor.

- The Debtors shall be authorized to remit any funds remaining in the TSA Debtors Winddown Reserve after dismissal of all of the TSA Debtors' Chapter 11 Cases to the DIP Lenders in accordance with the DIP Agreement.

See Dismissal Motion, ¶ 5.

17. The Debtors set forth the following provisions, in part, in an initial proposed Order for the Dismissal Motion:

- Notwithstanding section 349 of the Bankruptcy Code, all prior Orders of this Court entered in the Chapter 11 Cases shall remain in full force and effect and shall survive the dismissal of the Chapter 11 Cases, shall continue in full force and effect and the Court retains jurisdiction to enforce the same. *See,* the initial proposed order, ¶ 2.

- After Final Fee Applications have been heard, Allowed Professional Fees have been paid, and U.S. Trustee fees have been calculated and reserved, the Debtors (i) are authorized to distribute payments to holders of Allowed Administrative Claims, and (ii) shall file all monthly operating reports and pay all U.S. Trustee fees with respect to the NonTSA Debtors in full. *Id*. at ¶ 4.

- Upon entry of the Dismissal Order set forth in paragraph 5, the TSA Debtors shall be authorized to engage professionals and pay related fees and expenses in the ordinary course of business without further order of this Court, subject to the prior approval of BSP, or an order of this Court, with respect to the payment of any professional fees and expenses. *Id*. at ¶ 7.

- From and after the date of this Order, none of the Debtors shall have or incur any liability to any person for any good faith act taken or omitted to be taken in connection with or related to the formation, preparation, dissemination, implementation, confirmation or consummation of the Motion or this Order (other than in contravention of the Motion or the implementation of this Order), or any contract, instrument, release or agreement or document created or entered into, or any other act taken or omitted to be taken in connection with the Motion or this Order. *Id*. at ¶ 13.

See the initial proposed order to the Dismissal Motion.

18. The Debtors set forth the following provisions, in part, in a final proposed Order for the Dismissal Motion:

- Notwithstanding anything to the contrary, including, without limitation, section 349 of the Bankruptcy Code, all prior orders, releases, stipulations, settlements, rulings, orders and judgments of this Court made during the course of the Chapter 11 Cases, including, without limitation, the Sale Order and the Final DIP Order, shall remain in full force and effect, shall be unaffected by the dismissal of these Chapter 11 Cases, are specifically preserved for purposes of finality of judgment and res judicata unless expressly amended or overruled by a subsequent stipulation, settlement, order or judgment of this Court, as applicable, and this Court retains and reserves jurisdiction to enforce the same. *See*, the proposed order, ¶ 3.

- As soon as reasonably practicable after entry of this Order, without the need for further action on the part of this Court and without the need for further corporate action or action of the manager of the Dismissing Debtors, to the extent not previously dissolved, the Dismissing Debtors are authorized to dissolve their corporate entities in accordance with applicable state law, and the Dismissing Debtors shall not be required to pay any taxes or fees to cause such dissolution. The CRO is authorized to execute and file or cause to file on behalf of the Dismissing Debtors all documents necessary and proper to effectuate and consummate the dissolution of the Dismissing Debtors in accordance with applicable law. *Id*. at ¶ 4.

See the proposed order to the Dismissal Motion.

ARGUMENT

As stated above, there are at least five reasons why the Dismissal Motion must fail. First and foremost, this motion is premature. These cases are not ready to close until certain licensing and other issues relating to the sale of the Debtors' assets must be completed before all the cases can be closed. Second, the Dismissal Order improperly seeks a comfort order regarding the payment of administrative claims. The Bankruptcy Code governs payments to administrative creditors and there is no need for a specific order in this regard over and above the requirements of the Bankruptcy Code. Third, the bankruptcy court has no authority to dissolve these debtors in accordance with state court law. Once these cases are dismissed, state law will govern their dissolution. Fourth, where these debtors will not reorganize, will not confirm a plan, and will make no distributions to priority to unsecured creditors, there no reason why nonconsensual releases should be imposed upon priority and unsecured creditors. Fifth, under section 349 of the Bankruptcy Code only certain orders survive the dismissal of a case. Each such order that does survive must be supported on its facts. The Debtors are not entitled to a a blanket reservation of all orders in the case. And finally, in a dismissed case, professionals cannot be hired without court approval.

I. Dismissal of These Cases Is Premature

Following resolution of its First Omnibus Objection to Claims, the Debtors propose to (i) pay all allowed Professional Fees and all Allowed Administrative Claims, (ii) request dismissal of certain of the debtors (the Non-TSA Debtors), reserve a Winddown Reserve for the remaining debtors (the TSA Debtors), and then finally file a certification requesting dismissal of the TSA Debtors Chapter 11 Cases once certain transition actions have been completed with respect to those remaining debtors. The Debtors' proposal for a two-step dismissal process, whereby the Court will first enter an order authorizing the dismissal of the Non-TSA Debtors, which also approves various distributions, resolution of claims and other necessary steps to prepare the cases for dismissal, and then dismiss the TSA Debtors upon a resolution of the transfer of certain liquor licenses, is untenable.

If the Debtors seek to dismiss these cases, they should so move only after the Debtors have completed the wind-down of their estate, which includes any time needed to transfer the liquor licenses. Moreover, there is no need or authority for this Court to authorize post-dismissal procedures, such as dissolution of the Debtors.

If these cases are not converted to Chapter 7 cases, the Debtors should be required to comply with the Bankruptcy Code, Bankruptcy Rules and Local Rules to conduct the orderly and efficient wind-down of their estates and seek dismissal at the appropriate time.

II. **Plan Relief Cannot Be Achieved Through Bells and Whistles Attached to A Dismissal Order.**

A fundamental purpose of the bankruptcy laws is to bring about an equitable distribution of the bankrupt's estate. *Begier v. Internal Revenue Service*, 496 U.S. 53, 58 (1990). The administration of a corporate debtor's estate is accomplished either through a proceeding commenced under Chapter 7 or Chapter 11 of the Bankruptcy Code. Chapter 11 of the Bankruptcy Code includes many protections for creditors and equity holders. Primary among those protections is the right of creditors and equity holders to vote for or against the proposed plan, along with the prohibition against soliciting acceptances or rejections of a proposed plan prior to transmitting "a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information." 11 U.S.C. § 1125(b). "Adequate information" is defined as "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records . . . that would enable . . . a hypothetical investor of the relevant class to make an informed judgement about the plan." 11 U.S.C. § 1125(a).

Chapter 11 contains numerous other protections to ensure that the plan is fair. *See e.g.* 11 U.S.C. §§ 1123 (contents of a plan); 1126 (right to vote on a plan); 1129 (confirmation requirements, including that plan be proposed in good faith and be fair and equitable to any rejecting class).

The Dismissal Motion – although providing for dismissal of some of the cases now, some at a later time – is not a simple motion dismissing these cases. In addition to the provisions that pertain to dismissal of these cases, there are significant material provisions contained in the Dismissal Order. In effect, the Dismissal Order is simply a disguised confirmation order – without a plan of reorganization or a disclosure statement. Specifically, the Debtors are seeking an order that provides for (a) an end-of-case distribution scheme of the estates' assets; (b) the establishment that all prior orders, judgments and stipulations remain binding and unaffected by dismissal; (c) an exculpation that is essentially the equivalent of non-consensual third-party releases and injunctions; (d) a staggered dismissal of the TSA Debtors and Non-TSA Debtors; and (e) this Court's authority to dissolve of the Debtors, all without even serving the motion itself on all creditors, without providing adequate information, and without soliciting acceptances or rejections.

The parties who have received service of the Dismissal Motion have not received a court-approved disclosure statement containing "adequate information" to enable such party to make an informed decision. Further, creditors and equity holders do not have the ability to simply vote to make their voices heard, rather, they must file and prosecute an objection if they do not accept any of the conditions or provisions contained in the order.

The Debtors, recognizing the Supreme Court's recent decision in *Czyzewski v. Jevic Holding Corp.*, 137 S.Ct. 973 (2017), submit that their end-of-case distribution scheme and related bells and whistles can be approved because the "Dismissal Procedures provide for distributions that are strictly compliant with the priority scheme set forth in sections 507(a), 724 and 726 of the Bankruptcy Code." See Dismissal Motion, ¶ 62. However, the scheme proposed herein is much different than that commonly referred to as a structured dismissal, and whether there is compliance with sections 507(a) and 726 does not end the inquiry.

In short, the dismissal orders that the Debtors seek contain significantly greater relief than merely approving a distribution scheme that comports with the priority scheme required by the Bankruptcy Code. The proposed plan-like relief "circumvents the Bankruptcy Code's procedural safeguards" and should be denied. *Id.* at 986 (citing with approval cases that denied approval of sales and other transactions that short circuited the requirements of Chapter 11).

The Supreme Court recognized that it cannot "alter the balance struck by the statute" even in rare cases. *Jevic*, at 987. The Bankruptcy Code balances the interests of the Debtors to remain in possession and restructure or control its liquidation with the rights of creditors and equity holders by requiring that distributions of estate assets in Chapter 11 be effected pursuant to a confirmed Chapter 11 plan.

In the present case, the Debtors seek court approval to wrap-up their estates without the procedural protections afforded to creditors by the Bankruptcy Code. Moreover, they have included provisions that benefit the Debtors and certain creditors that stretch beyond the statutory permission of 11 U.S.C. § 349. This type of remedy ignores the distribution scheme embodied in the Bankruptcy Code and the limits imposed by Congress on relief that can accompany case dismissal.

III. The Dismissal Order Includes Impermissible Provisions

A. The Debtors Are Not Entitled to a Discharge

There is no provision in the Bankruptcy Code that permits a debtor to obtain a discharge upon dismissal. To the contrary, the Bankruptcy Code provides that the dismissal restores the *status quo ante*. See 11 U.S.C. § 349.

Even if the Debtors in this case were to confirm a plan, they would not be entitled to a discharge. Section 1141(d)(3) of the Bankruptcy Code states:

The confirmation of a plan does not discharge a debtor if-

> (A) the plan provides for the liquidation of all or substantially all of the property of the estate;
>
> (B) the debtor does not engage in business after consummation of the plan; and
>
> (C) the debtor would be denied a discharge under Section 727(a) of this title if the case were a case under chapter 7 of this title.

Section 727(a)(1) provides: “The court shall grant the debtor a discharge, unless the debtor is not an individual . . .”.

Here, the Debtors are not individuals, they have liquidated substantially all of the property of their estates, and they will not engage in any business. Thus, the Debtors would not be entitled to a discharge even if they were otherwise able to confirm a chapter 11 plan of liquidation.

The proposed initial Dismissal Order provides:

> From and after the date of this Order, none of the Debtors shall have or incur any liability to any person for any good faith act taken or omitted to be taken in connection with or related to the

> formation, preparation, dissemination, implementation, confirmation or consummation of the Motion or this Order (other than in contravention of the Motion or the implementation of this Order), or any contract, instrument, release or agreement or document created or entered into, or any other act taken or omitted to be taken in connection with the Motion or this Order.

See, the initial Dismissal Order *Id*. at ¶ 13.

This provides the equivalent of a partial discharge to the Debtors on any claim, obligation, suit, judgment, damage, demand, debt, right, cause of action, remedy, loss, and liability for any claim created in connection with the Chapter 11 Cases. The Debtors would not be entitled to such relief in a Chapter 11 plan, and thus, cannot receive such relief through a dismissal.

B. The Proposed Order Includes Improper Releases

The proposed order includes a release for the Debtor and further, provides that all prior orders, releases, stipulations, settlements, rulings, orders and judgments of this Court made during the course of the Chapter 11 Cases, including, without limitation, the Sale Order and the Final DIP Order, shall remain in full force and effect, shall be unaffected by the dismissal of these Chapter 11 Cases. The Sale Order provides an exculpation of BSP. None of the Debtors' creditors or equity holders have consented to any releases. Such releases should not be granted in the context of a dismissal. To the extent case law exists allowing the imposition of third-party releases, it generally is found in the context of plan confirmation. The court should not countenance the Debtors' attempt to gain these advantages through Section 349 and Section 1112(b). The releases will not serve the best interests of creditors and the estates.

Debtors usually rely upon *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142-43 (2d Cir. 2005) to permit non-consensual third party releases under a plan. If *Metromedia* is being used to impose non-consensual third-party releases, a disclosure statement and a plan of liquidation should explain in a clear and succinct manner what releases are being imposed on creditors and interest holders and what support is found in the Bankruptcy Code and elsewhere for those broad third-party release provisions.

To the extent third party releases will be imposed on any party, the Disclosure Statement and Plan must set forth a basis for the Debtors' apparent belief that this Court has subject matter jurisdiction to impose the third-party releases. It is settled, binding law that a court may **not** approve releases and exculpations under the Plan unless the Court has subject matter jurisdiction. *In re Johns-Manville Corp.*, 517 F.3d 52 (2d Cir. 2008) ("*Manville II*"), *vacated & remanded on other grounds*, 557 U.S. 137 (2009), *aff'g in part & rev'g in part*, 600 F.3d 135 (2d Cir. 2010) and *Metromedia*, 416 F.3d at 141; *accord In re Dreier LLP*, 429 B.R. 112, 132 (Bankr. S.D.N.Y. 2010); *In re Metcalfe & Mansfield Alternative Invs.*, 421 B.R.685, 695 (Bankr. S.D.N.Y. 2010).

More specifically, a bankruptcy court must assess whether it has jurisdiction to enjoin a third-party dispute. "[T]he question is not whether the court has . . . jurisdiction over the attempts to enjoin the creditors' unasserted claims against the third party." *In re SunEdison, Inc.*, 576 B.R. 453, 461 (Bankr. S.D.N.Y. 2017) (*citing Manville II*, 517 F.3d 52, 65). "[T]he touchstone for bankruptcy jurisdiction [over a non-debtor's claim] remains whether its outcome might have any 'conceivable effect' on the bankruptcy estate." *SunEdison*, 576 B.R. at 461 (*citing Marshall v. Picard (In re Bernard L. Madoff Inv. Sec. LLC)*, 740 F.3d 81, 88 (2d Cir. 2014). The party asserting that the Court has subject matter jurisdiction has the burden of proving by a preponderance of the evidence that jurisdiction exists. *SunEdison*, 576 B.R. at 461 (citations omitted).

In *Manville II*, the Second Circuit held that "a bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the res of the bankruptcy estate."

Manville II, 517 F.3d at 66; *see also Dreier*, 429 B.R. at 133 (because the court lacks jurisdiction to enjoin claims that do not affect property of the estate or the administration of the estate, non-debtor third-party releases must be limited to claims that are derivative of the debtors). A bankruptcy court does not acquire subject matter jurisdiction "to enjoin claims brought against a third-party non-debtor solely on the basis of that third-party's financial contribution to a debtor's estate." *Manville II*, 517 F.3d at 66. Otherwise, "a debtor could create subject matter jurisdiction over any non-debtor third-party by structuring a plan in such a way that it depended upon third-party contributions." *Id.* (*quoting In re Combustion Eng'g, Inc.*, 391 F.3d 190, 228 (3d Cir 2004)).

Here, the equivalent of third-party releases are to be given to BSP. As stated above, the proposed order will bestow broad releases upon a myriad of third parties. Whether this Court has subject matter to bestow such broad releases is a material issue and an issue that should normally be addressed by the Debtors in a Disclosure Statement so that interested creditors can determine (i) exactly what release are being imposed and on which creditors and (ii) the likelihood of Debtors' success of confirming a plan with such broad releases. The Motion provides no notice or explanation regarding third party releases and injunctions that will be imposed upon affected third parties.

In *Metromedia*, the Second Circuit held that non-debtor third-party releases are proper only in "rare cases." *Metromedia*, 416 F. 3d at 142. The Second Circuit articulated at least two reasons for its reluctance to approve these releases:

> First, the only explicit authorization in the Code for non-debtor releases is 11 U.S.C. § 524(g), which authorizes releases in asbestos cases when specified conditions are satisfied, including the creation of a trust to satisfy future claims. [and]
>
> Second, a non-debtor release is a device that lends itself to abuse. By it, a non- debtor can shield itself from liability to third parties. In form, it is a release; in effect it may operate

> as a bankruptcy discharge without a filing and without the safeguards of the Code. The potential for abuse is heightened when releases afford blanket immunity.

Id. at 142.

The Second Circuit held that "[i]n bankruptcy cases, a Court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the Debtors' reorganization plan." Id. at 141 (*quoting SEC v. Drexel Burnham Lambert Group, Inc.* (*In re Drexel Burnham Lambert Group, Inc*.), 960 F.2d 285, 292 (2d Cir. 1992)). The appellate court cautioned, however, that a non-debtor third-party release is not considered to be adequately supported by consideration simply because the non-debtor contributed something to the reorganization and the enjoined creditor took something out. *Metromedia* at 143. Rather, "[a] non-debtor third-party release should not be approved absent a finding by the court that 'truly unusual circumstances' exist that render the release terms important to the success of the plan." *Id*.

Subsequent cases further clarify the *Metromedia* requirements. For example, in *In re Aegean Marine Petroleum, Inc.*, the Court would not grant third party releases sought by the debtors in their plan, noting that third-party nonconsensual releases are extraordinary, and finding that the Court lacked personal jurisdiction over certain relevant parties and furthermore, challenged whether the Court had subject matter jurisdiction. *In re Aegean Marine Petroleum, Inc.*, 2019 Bankr. LEXIS 1076 (S.D.N.Y. 2019). Likewise, the Court could not agree to take a third party's property without any hearings on the merits and without any discovery or having the ability for litigants to pursue rights that they would usually have. *Id.* at 11-12. Finally, the Court held that no particular third-party claims were identified that, if pursued, would undermine the restructuring and the deals that are part of the restructuring. *Id*. at 23-24.

Also, in *In re DBSD North America, Inc.*, the Court stated:

> As the Second Circuit's decision in Metromedia and my earlier decision in Adelphia provide, exculpation provisions (and their first cousins, so-called "third party releases") are permissible under some circumstances, but not as a routine matter. They may be used in some cases, including those where the provisions are important to a debtor's plan; the claims are "channeled" to a settlement fund rather than extinguished; the enjoined claims would indirectly impact the debtor's reorganization by way of indemnity or contribution; the released party provides substantial contribution; and where the plan otherwise provides for full payment of the enjoined claims.

In re DBSD N. Am., Inc., 419 B.R. 179, 217 (Bankr. S.D.N.Y. 2009) (emphasis in original) (footnotes omitted); *In re Motors Liquidation Co.*, 477 B.R. 198, 220 (Bankr. S.D.N.Y. 2011) ("Although (since the Code is silent on the matter) third-party releases aren't 'inconsistent with the applicable provisions of this title,' the Second Circuit has ruled that they're permissible only in rare cases, with appropriate consent or under circumstances that can be regarded as unique, some of which the Circuit listed. But where those circumstances haven't been shown, third-party releases can't be found to be appropriate.").

In the present case, no consideration is being provided by BSP in exchange for the release, and rare circumstances justifying non-consensual releases do not exist – particularly here were no plan will be confirmed. Because the releases are nonconsensual, there is no consideration being provided for them, and there will not be a plan of reorganization, the exculpation provision essentially providing release and injunction protection in the proposed order is impermissible.

C. The Debtors have not Established "Cause" Under Section 349

The proposed order provides that, notwithstanding section 349 of the Bankruptcy Code, all prior Stipulations and Orders shall remain in full force and effect and survive dismissal of these cases.

Section 349(b) provides:

> Unless the court, for cause, orders otherwise, the dismissal of a case other than

> under section 742 of this title –
> . . .
> (2) vacates any order, judgment, or transfer ordered, under section 522(i)(1), 542, 550 or 553 of this title . . . .

The Debtors' Motion does not establish "cause" for the court to order otherwise. Absent an evidentiary record establishing such cause for each order, the Motion should be denied.

D. <u>Dismissal under 11 U.S.C. § 305(a) is not warranted</u>

The Debtors alternatively move to dismiss their case under Section 305(a), entitled Abstention, of the Bankruptcy Code. Section 305(a) of the Bankruptcy Code provides

> The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if –
>
> (1) The interests of creditors and the debtor would be better served by such dismissal or suspension; . . .

The Debtors attempt for relief under this section is not proper. This rather ordinary chapter 11 situation – an administratively insolvent liquidating chapter 11 – does not justify the use of abstention. Further Debtors cannot ask the court to abstain from jurisdiction under Section 305(a)(1) while at the same time proposing that the court exercise and retain jurisdiction to impose broad releases and exculpation and enforce all prior orders entered in the case.

Dismissal under Section 305(a) is an extraordinary remedy. *In re AMC Investors, LLC,* 406 B.R. 478, 487-88 (Bankr. D. Del. 2009). "Granting an abstention motion pursuant to § 305(a)(1) requires more than a simple balancing of harm to the debtor and creditors; rather, the interests of both the debtor and its creditors must be served by granting the requested relief." *Id.*

Debtors have not met the heightened burden for dismissal under § 305.

WHEREFORE, the United States Trustee respectfully requests that the Court sustain the foregoing Objection and grant such other and further relief as the Court may deem just and proper.

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WILLIAM K. HARRINGTON
UNITED STATES TRUSTEE

By: */s/ Shannon Anne Scott*
Shannon Anne Scott
Trial Attorney
201 Varick Street Suite 1006
New York, New York 10004
Tel. No. (212) 510-0500