

Lack of Transparency in Plan Process Leads to Appointment of Examiner

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Is the debtor's plan a disguised "new value" plan that violates the absolute priority rule? Was the plan proposed in good faith as required by §1129(a)(3) of the Bankruptcy Code? Questions such as these are routinely vetted and resolved during the plan confirmation process. As debtor's counsel, you may be looking at confirmation objections, related discovery, heated negotiations, contested hearings—all standard fare, right? Not so fast.



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Under the right (or perhaps more accurately, *wrong*) circumstances, you also could be looking at the appointment of an examiner. This is precisely the unanticipated outcome ordered by the bankruptcy court

in the pending chapter 11 proceedings of *TCI 2 Holdings LLC, et al.*, Case No. 09-13654 (Bankr. D. N.J.).

The chapter 11 cases of the *TCI 2* debtors were filed on Feb. 17, 2009.¹ The debtors' basic capital structure includes (1) a \$486 million first-lien position held by Beal Bank (Beal) and (2) the second-lien position of secured noteholders of upwards of \$1.25 billion. The debtors' disclosure statement states that their entire enterprise value is about \$456 million.

At some point after the filing of the chapter 11 cases, the debtors asked Beal and the *ad hoc* committee of the holders of certain senior secured notes (the *ad hoc* committee) to submit proposals that could form the basis for the debtors' plan of reorganization. As this process went forward, the debtors sought and received a 45-day extension (from its original expiration date of June 17, 2009, to the extended date of Aug. 3, 2009) of their exclusive period to propose a plan. On Aug. 3, 2009, the debtors filed a proposed plan of reorganization

¹ Unless otherwise indicated, the following recitation of facts are those set forth by Judge Judith H. Wismur on the record in connection with her disposition of the relevant motions filed in the *TCI 2* case and discussed herein. See *TCI 2*, Transcript of Aug. 27, 2009 Hearing at p. 85-86 (Docket No. 621).

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that adopted the terms of a joint offer submitted by Beal and Donald Trump. The Beal/Trump plan provides for: (1) a restated credit agreement with Beal extending the maturity date by eight years (to 2020), (2) a cash infusion to the debtors of \$100 million in exchange for the issuance to Beal and Trump of all of the equity in the reorganized debtors and (3) no recovery to the noteholders or unsecured creditors.

In response, the *ad hoc* committee filed its Motion of the *Ad Hoc* Committee of Holders of the 8.5 percent Senior Secured Notes Due 2015 for

areas of inquiry warranted investigation by an independent examiner:

1. the debtors' motivation and rationale for continuing to pursue, and refusing to settle, certain litigation "crafted by Mr. Trump" that, in the *ad hoc* committee's view, was costing the debtors' estates more than any underlying or associated value that could be realized (see Examiner Motion at p. 2-3 and p. 9-13);
2. the facts and circumstances surrounding "the purported renunciation of Mr. Trump's partnership interest" in the debtor Trump Entertainment Resorts Holdings and whether it was done for the purpose of, or would result in, transference of certain tax liabilities from Trump to the debtors' estates (see Examiner Motion at p. 3 and p. 13-14); and
3. the facts and circumstances surrounding (1) the debtors' adoption of the Beal/Trump plan, (2) the

Straight & Narrow

Appointment of Examiner, pursuant to §1104(c) of the Bankruptcy Code (the Examiner Motion), dated Aug. 11, 2009 (Docket No. 531).² In the Examiner Motion, the *ad hoc* committee's overriding theme was that "[u]nrestrained by the oversight of a trustee or official creditors committee, and apparently still in the thrall of Donald Trump, the Debtors have engaged in conduct detrimental to the Debtors' estates and in possible violation of their fiduciary duty to creditors." See Examiner Motion at p. 2. In support of its position, the *ad hoc* committee alleged that the following

² Contemporaneously with the Examiner Motion, the *ad hoc* committee also filed its Emergency Motion of the *Ad Hoc* Committee of Holders of 8.5 percent Senior Secured Notes Due 2015 for an Order (A) Terminating the Debtors' Exclusive Periods in Which to File a Plan of Reorganization and Solicit Acceptances Thereof, and (B) Adjourning the Hearing to Approve the Debtors' Disclosure Statement for Debtors' Joint Plan of Reorganization (the motion to terminate exclusivity), dated Aug. 11, 2009 (Docket No. 530). The primary bases for the motion to terminate exclusivity were twofold: (1) the Trump/Beal plan, which provides for a \$100 million contribution from Beal and Trump in exchange for 100 percent of the new equity in the reorganized debtors, constitutes an insider "new value" plan that had not been adequately market tested as required by the Supreme Court case of *Bank of America National Trust and Savings Assoc. v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999) (hereinafter, *LaSalle*); and (2) by its wholesale adoption of the Trump/Beal plan, the debtors had "abdicated their duty to formulate a plan of reorganization of their own or meaningfully attempt to foster consensus." See Motion to Terminate Exclusivity at p. 16-18.

evaluation process of the Beal/Trump plan and the determination that such plan was superior to the *ad hoc* committee's proposal, and (3) the role of Trump with respect to the foregoing; in this regard, the *ad hoc* committee pointed to what it characterized as "Mr. Trump's past domination and control of the Debtors (through multiple prior bankruptcy proceedings), the Debtors' repeated failure to negotiate with the *Ad Hoc* Committee, the Debtors' insistence that the *Ad Hoc* Committee negotiate only with Mr. Trump and his daughter, and the Debtors' apparent misrepresentations about how they were really conducting the 'plan process' [.] (see Examiner Motion at p. 3 and p. 5-9). The legal basis of the Examiner Motion was §1104(c) of the Bankruptcy Code, which provides:

If the court does not order the appointment of a trustee under

continued on page 80

Straight & Narrow: Lack of Transparency Leads to Examiner Appointment

from page 18

this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States Trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor or by current or former management of the debtor, if—

- (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or
- (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services or taxes, or owing to an insider, exceed \$5,000,000.

The legal standard under §1104(c), as articulated by the *ad hoc* committee in the Examiner Motion, thus mandates the appointment of an examiner upon satisfaction of four factors: (1) the debtor must still be in possession of the estate and a trustee must not have been appointed; (2) a plan must not have been confirmed; (3) a party-in-interest or the U.S. Trustee must request the appointment; and (4) one of the conditions set forth in §1104(c)(1) or (c)(2) must be satisfied—that is, either the appointment of the examiner is in the best interests of the creditors or the specified unsecured debts exceed \$5 million. *See* Examiner Motion at p. 15-16, and the cases cited therein.

In its objection to the Examiner Motion, the debtors countered the *ad hoc* committee's allegations as follows:

1. The debtors' position in and valuation of pending litigation is privileged and inappropriate for investigation. Regardless of the *ad hoc* committee's view of the litigation's value or the handling thereof, "it would be highly inappropriate to require the Debtors

to waive privilege so that an examiner can investigate the basis for the Debtors' legal positions and then publicly report on such findings." *See* Debtors' Objection to the Motion of the *Ad Hoc* Committee of Holders of 8.5 percent Senior Secured Notes Due 2015 for Appointment of Examiner Pursuant to §1104(c) of the Bankruptcy Code and Joinder Thereto (the debtors' objection), dated Aug. 21, 2009 (Docket No. 564) at p. 2. This concern is compounded by the fact that the *ad hoc* committee's plan proposal contemplates a sale of certain assets to, and settlement with, one of the parties to the pending litigation. *See id.*

Digging deeper, one can glean the subtext of the court's concerns—that is, the expectation that a debtor will engage in a "fair and open" plan process that facilitates and builds consensus among the parties, as opposed to arguably siding with one key constituency over another.

2. The facts and circumstances surrounding Trump's abandonment of his partnership interest in Trump Entertainment Resorts Holdings more appropriately would be the subject of discovery by the *ad hoc* committee than investigation by an examiner. "In any event, the Debtors have considered the tax implications of Trump's abandonment and currently believe that the abandonment is not expected to result in any additional cost to the Debtors." *See* Debtors' Objection at p. 2 and 13.

3. After months of negotiations and several failed attempts to broker a consensual plan between the *ad hoc* committee on the one hand and Trump/Beal on the other, "the Debtors determined that they had to choose between the two sides in

order to move its chapter 11 case forward." *See* Debtors' Objection at p. 6. The debtors then asked each side to submit its best proposal. *Id.* Both proposals were analyzed by the debtors' financial advisors and presented to the debtors' board of directors. *Id.* Based on the opinions and advice of the debtors' financial advisors, and after lengthy discussions by the Board regarding each proposal, the Board decided that the debtors should file a chapter 11 plan based on the Beal/Trump proposal. *See id.* at p. 6-7.

The debtors also disputed the *ad hoc* committee's interpretation and application of §1104(c). Highlighting the phrase "as is appropriate" in the statute, the debtors argued that appointment of an examiner is not invariably mandated simply because the elements of §1104(c)(2) are met. Rather, the court could and should exercise its discretion and refuse to appoint an examiner where, for example, the examiner's investigation would be duplicative of other efforts in the bankruptcy case, the request for an examiner appears to be part of a party's litigation strategy, or the information sought could be developed via discovery by the moving party. *See* Debtors' Objection at p. 14-16 and cases cited therein.

The stage was set for the bankruptcy court's consideration of the Examiner Motion. The hearing took place on Aug. 27, 2009. The bankruptcy court first took up the *ad hoc* committee's motion to terminate exclusivity. After a full hearing on the legal merits and consideration of certain undisputed facts, the bankruptcy court granted the motion to terminate exclusivity. The bankruptcy court found that termination of exclusivity was warranted (1) because "there is a real issue about whether [the Beal/Trump plan] is a new value plan" and thus subject to the requirements of *LaSalle*,³ and (2) because of the "potential benefit to the estate of producing some return to a very large

³ "[W]e understand that issue because of Mr. Trump's previous association with the debtors. Not because there is any assumption on my part that there is anything untoward that happened, any undue influence, any exertion of improper forces in connection with the submission of this plan, but rather with the recognition that...Mr. Trump was chairman of the board and held the most substantial portion of shares of this company up until four days before the filing. And the serious questions, which I don't resolve either, about whether those interests were actually abandoned...but in any event, it seems to be recognized that Mr. Trump continues to be an equity security holder of some portion of the debtors' shares. If it is a new value[] plan, it might certainly run afoul of 203 North LaSalle." *See* Hearing Transcript at p. 88-89.

group of creditors who would be wiped out completely by the plan that is presently offered by the debtors.” See Hearing Transcript at p. 88 and 92. The bankruptcy court also stated that the “need to have a fair and open process” outweighed any potential detriment to the debtors’ estates that would result from terminating exclusivity. See *id.* at p. 94. These themes would be significant to the ultimate disposition of the Examiner Motion.

With respect to the Examiner Motion, the bankruptcy court agreed with the *ad hoc* committee in that §1104(c) is mandatory, and as such, the only question would be *not* whether an examiner should be appointed, but what (if any) of the issues presented by the *ad hoc* committee were appropriate areas of inquiry or investigation for an examiner. See Hearing Transcript at p. 107-8. Stated differently, if the appropriate subject matter for investigation is identified, the appointment of an examiner is mandatory under §1104(c)(2) without consideration of any “discretionary” factors such as cost to the estate, whether the moving party can gather the relevant facts in discovery, or any alleged litigation “gamesmanship.” Having determined that the statutory test for mandatory appointment of an examiner had been satisfied, the bankruptcy court then considered which, if any, of the areas identified by the *ad hoc* committee were appropriate for investigation:

1. With respect to the debtors’ motivation and rationale for continuing to pursue and refusing to settle certain litigation, the bankruptcy court found that appointment of an examiner would not be appropriate. In making this determination, the court’s primary concern appeared to be the protection of litigation strategies and privileged information. See Hearing Transcript at p. 109. Judge Wizmur did, however, indicate that the value of the litigation and whether that value

is reflected in the debtors’ enterprise valuation would be an appropriate area of inquiry in the context of plan confirmation and related discovery. *Id.* 2. With respect to the facts and circumstances surrounding Trump’s motive for abandoning his partnership interest in Trump Entertainment Resorts Holdings, the bankruptcy court—after some vacillation—ultimately concluded that this subject, likewise, was not appropriate for investigation by an examiner. The factor that seemed to weigh most heavily into the court’s decision in this regard is §1104(c)’s language providing that “the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate[.]” See 11 U.S.C. §1104(c) (emphasis added). Judge Wizmur agreed with the position that because the statute permits appointment of an examiner to investigate actions only “of the debtor,” an investigation of Trump’s motives would be outside the scope of §1104(c). See Hearing Transcript at p. 124. She did indicate that “Mr. Trump’s motivations and [the] reasons for abandonment are perfectly appropriate in the context of discovery and focusing on objections to confirmation.” *Id.*

3. Although the *ad hoc* committee suffered setbacks with respect to the foregoing issues, it ultimately prevailed on its most significant point of contention—that is, the facts and circumstances surrounding the proposal of the Beal/Trump plan. In this regard, the bankruptcy court ruled that an examiner should be appointed to investigate and render findings in connection with “the negotiating process on the selection of the Beal/Trump plan, on the considerations of the debtor[s] in terms of the desirability of that plan over the noteholders’ plan, how that process

went forward and the role of Mr. Trump in that context.” See Hearing Transcript at p. 124. See also Order Granting Examiner Motion, entered Sept. 15, 2009 (Docket No. 679).

Although not specifically addressed in the context of her ruling, remarks made by Judge Wizmur in the course of the hearing reveal her belief that the appropriateness of appointing an examiner was tied to the necessity of (1) determining whether the Beal/Trump plan was proposed in good faith and (2) establishing the nature of Trump’s relationship with the debtors for purposes of analysis under *LaSalle*.⁴ These issues arguably lend themselves more suitably to being vetted and resolved through discovery and in the course of contested confirmation proceedings. Judge Wizmur herself indicated as much.⁵ Why then, did she take the dramatic step of appointing an examiner?

Digging deeper, one can glean the subtext of the court’s concerns—that is, the expectation that a debtor will engage in a “fair and open” plan process that facilitates and builds consensus among the parties, as opposed to arguably siding with one key constituency over another. Failing in this expectation—or furthering a process that creates a perception that the expectation will not be met—opens the door to accusations of a lack of transparency in the plan process. This actual or perceived lack of transparency, in turn, could leave the debtor vulnerable to the cost and distraction attendant to appointment of an examiner. ■

⁴ See Hearing Transcript at p. 109-10 (Judge Wizmur said, “[T]he role of Mr. Trump and the debtors before the filing and after the filing...how all of that flushes out, coupled with the negotiation process that led the debtors to select his plan, indeed, seem[] to go to the issues that we’ve just been discussing, is this a new value[] plan? If control is to be considered, what are we talking about? What influence, if any, did Mr. Trump [have] with regard to the board of directors? You know, these questions are directly relevant to issues of good faith and issues of the impact of *LaSalle* on these circumstances.”) (emphasis added).

⁵ See Hearing Transcript at p. 107 (Judge Wizmur said, “[M]any of the issues that are going to be raised at confirmation are going to be difficult ones, interesting ones. I’m not sure about whether they’ll be novel, but they will require factual presentation and legal considerations, questions of law. Neither of which are answerable by an examiner, in my opinion.”).