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The Delaware Bankruptcy Court Confirms That Lenders in Multiple-Level Financing Structures Are Entitled to the Protections of Corporate Separateness

The Delaware Bankruptcy Court has confirmed that in multiple-debtor chapter 11 cases, the cramdown rules set forth in section 1129(a)(10) of the Bankruptcy Code must be applied on a *per debtor* basis as opposed to a *per plan* basis. *See* In re JER/Jameson Mezz Borrower II, LLC, No. 11-13338 (MFW), 2011 WL 6749058 (Bankr. D. Del. Dec. 22, 2011) ("Jameson") and In re Tribune Co., No. 08-13141 (KJC), 2011 WL 5142420 (Bankr. D. Del. Oct. 31, 2011) ("Tribune"). Specifically, chapter 11 debtors may not obtain non-consensual confirmation of a plan of reorganization without obtaining the vote of at least one accepting class of impaired creditors at each debtor.[1] As a practical matter, based on these cases, if a debtor has only one class of creditors, confirmation cannot be imposed on that class without its consent or rendering that class unimpaired, and the vote of an impaired class of creditors of an affiliated debtor will be insufficient.

While these recent decisions may have a significant impact in traditional multiple-debtor cases, their import to chapter 11 cases involving multiple-level financing to special purpose entities ("SPEs") is paramount. In Jameson, the Delaware Bankruptcy Court applied the *per debtor* confirmation requirement in the context of a dismissal of the bankruptcy case of an SPE in a multiple-debtor case because, among other things, the debtor could not demonstrate that it could confirm a chapter 11 plan over the objection of the lender to the SPE.

The Per-Plan Approach

Chapter 11 debtors in multiple-debtor cases have routinely threatened to cram down lenders of one debtor with the affirmative votes of creditors against an affiliated debtor without any showing of the facts required to obtain substantive consolidation of each of the debtors. This argument is based upon essentially three cases: (i) In re Charter Communications, 419 B.R. 221, 270-71 (Bankr. S.D.N.Y. 2009) (permitting debtors to use the accepting impaired class of an unsecured class of creditors to constitute the accepting impaired class of another class of unsecured creditors); (ii) In re Enron, 2004 Bankr. LEXIS 2549 at *234–35 (Bankr. S.D.N.Y. July 15, 2004) (when considering the section 1129(a)(10) issue, deciding that both the plain statutory meaning and "the substantive consolidation component of the global compromise" allowed confirmation of a 177–debtor joint plan when at least one class of impaired claims voted to accept the plan); and (iii) In re SGPA, Inc., 2001 Bankr. LEXIS 2291 at *19 (Bankr. M.D.Pa. September 28, 2001) (confirming a joint plan and holding that it was unnecessary "to have an impaired class of creditors of each Debtor to vote to accept the Plan.") (the "Per-Plan Cases").

It is important to note that each of the Per-Plan Cases involved substantive consolidation, a determination that substantive consolidation would

[1] Under a chapter 11 plan, a debtor is required to separately group its creditors into classes. Creditors holding substantially similar claims may be placed in the same class. For example, first lien secured creditors and general unsecured creditors would be grouped in separate classes.

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not alter recoveries under the plan, no objecting creditors, and/or were mere *dicta*. Accordingly, the viability of the confirmation of a chapter 11 plan on a *per plan* basis over the objection of a disadvantaged creditor was not clear. As discussed below, in light of Jameson and Tribune, non-consensual confirmation of a chapter 11 plan on a *per plan* basis should not be viable.

Jameson

In Jameson, JER/Jameson Mezz Borrower II, LLC ("Mezz II") filed a chapter 11 petition immediately before a scheduled foreclosure by Mezz II's secured lender and sole creditor. Mezz II was a mezzanine borrower within several tiers of secured debt as part of a capital structure to acquire Jameson Inns hotels. Soon after Mezz II's bankruptcy filing, the lender filed motions to dismiss and to lift the automatic stay to proceed with the foreclosure sale. Before the motions were heard, Mezz II's affiliates, including other mezzanine borrowers and the operating entities for the Jameson Inns hotel chain, filed their own chapter 11 petitions.

The Delaware Bankruptcy Court dismissed the bankruptcy case and granted the mezzanine lender relief from the stay because Mezz II failed to establish that its bankruptcy filing was for a valid reorganization purpose. While recognizing that the court must consider the good of the entire business enterprise, the court held that "in the absence of substantive consolidation, Mezz II does not have any chance of confirming a plan." Jameson, 2011 WL 6749058 at *7-8 (citing section 1129(a)(10) of the Bankruptcy Code, Judge Walrath noted that, to confirm a plan, Mezz II must have at least one impaired, accepting class).

Moreover, the court ruled that it need not wait until Mezz II and its affiliated debtors proposed a plan of reorganization to determine if Mezz II's case should be dismissed because one of the grounds for dismissal under section 1112 of the Bankruptcy Code is that the debtor have a reasonable likelihood of rehabilitation. Id. There was no possibility of reorganization because the creditor seeking to dismiss Mezz II's bankruptcy case was Mezz II's only creditor and could block any plan that might be proposed. Id. ("[C]onfirmation of a plan to which [the sole creditor] do[es] not consent is not possible.").

In reaching its decision, the Delaware Bankruptcy Court also determined that there was only one asset, perhaps no unsecured creditors, no ongoing business and employees, that the bankruptcy was filed on the eve of foreclosure as a litigation tactic in a two-party dispute, and there was an insufficient equity cushion to provide adequate protection to the secured lender. Id. at *4-6, 11. As a result, Mezz II's bankruptcy case was dismissed only two months after it was filed, and the lender was scheduled to foreclose on the following day.

Tribune

In Tribune, the Delaware Bankruptcy Court held, among other things, that section 1129(a)(10) of the Bankruptcy Code must be applied on a *per debtor* basis as opposed to a *per plan* basis. In that case, two competing plans covering over a hundred separate debtors had been proposed and each had failed to receive approval of one impaired class for each of the debtors. Recognizing the issue as one of first impression and analyzing the text of section 1129(a)(10), the court found that, absent substantive consolidation, there must be a consenting class for each debtor in a joint plan for it to be confirmed. Tribune, 2011 WL 5142420 at *37-41.

Conclusion

Although borrowers in multiple-debtor cases may still attempt to exact leverage against their creditors under the Per-Plan Cases, courts in all jurisdictions should be reluctant to apply an analysis inconsistent with Jameson and Tribune in light of the easily distinguishing characteristics of each of the Per-Plan Cases. Given the potential for large securitization structures which utilize mezzanine financing to undergo out-of-court restructurings or chapter 11 cases in 2012 due to upcoming maturities, it is critical that lenders in these structures understand the import of Jameson and Tribune and conduct their negotiations and exercise their strategy accordingly. In particular, lenders should be prepared in circumstances when they are the only creditor whose vote could be solicited on a debtor's plan of reorganization to act aggressively. Such lenders such consider, among other things, seeking the immediate dismissal of the debtor's chapter 11 case, relief from the automatic stay, and termination of the debtor's exclusive period to file a chapter 11 plan.

The authors Michael J. Sage (+1 212 698 3503; michael.sage@dechert.com) and Brian E. Greer (+1 212 698 3536; brian.greer@dechert.com) have significant experience in the CMBS market. Mr. Sage and Mr. Greer

are currently representing the Mezzanine B and Mezzanine C lenders which hold an aggregate of approximately $360 million of mezzanine debt in the chapter 11 cases of MSR Resort Golf Course LLC and its affiliates, which cases involve a restructuring of more than $1.4 billion in debt related to the Grand Wailea Resort Hotel & Spa, Doral Golf Resort & Spa, Arizona Biltmore Resort & Spa, La Quinta Resort & Club and the Claremont Hotel Club & Spa. The Mezzanine B and Mezzanine C Lenders obtained a court approved settlement which provided, among other things, for the payment of their claims in cash or for a sale of assets if certain timelines and other requirements were not satisfied under the terms of the settlement.

In addition, Mr. Sage and Mr. Greer represented Lehman ALI on its $238 million mortgage loan se·cured by 19 hotels in connection with the chapter 11 cases of Innkeepers USA Trust and its affiliates, which cases involved a restructuring of more than $1.2 billion in debt and 72 hotels. Lehman ALI ob·tained a recovery far in excess of its stalking horse bid at the conclusion of a court supervised auction.

Practice group contacts

For more information, please contact the authors or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/business_restructuring.

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