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ALERTS

Finance, Insolvency & Restructuring Alert - Supreme Court Leaves Standing Seventh Circuit's Opinion In Favor Of Barnes & Thornburg Lender Client

October 8, 2013 | Atlanta | Chicago | Columbus | Delaware | Elkhart | Fort Wayne | Grand Rapids | Indianapolis | Los Angeles | Minneapolis | South Bend

The Supreme Court of the United States denied a petition for writ of certiorari of the debtor, Castleton Plaza, LP, in *Castleton Plaza, LP v. EL-SNPR Notes Holdings, LLC*, Case No. 12-1422, meaning the prior opinion from the Seventh Circuit Court of Appeals in *In the Matter of Castleton Plaza, LP*, 707 F.3d 821 (7th Cir. 2013), remains intact, protecting creditors who are faced with being shortchanged by a reorganization plan proposed by a debtor that attempts to transfer the future ownership of the debtor to an insider without first putting the ownership stake up for auction. The Seventh Circuit's opinion requires competitive bidding for the new equity interests of a reorganizing debtor in Chapter 11 cases and allows creditors to credit-bid on these interests.

EL-SNPR Notes Holdings, LLC, the senior lender in the case, was represented by Barnes & Thornburg LLP, with a team of bankruptcy and litigation attorneys led by Alan Mills of the firm's Indianapolis office. This case originated in the Bankruptcy Court for the Southern District of Indiana, where Castleton Plaza, LP, the debtor, sought to confirm a plan of reorganization over the objection of EL-SNPR Notes Holdings, LLC. The debtor proposed a reorganization plan whereby it would (i) write down the balance owed to the lender by over $1 million; and (ii) provide that the old equity owner's wife would have the exclusive right to purchase the "new" equity in the reorganized debtor for $75,000 without marketing or competition.

At the confirmation hearing before the bankruptcy court, the lender objected to the debtor's plan on various grounds, including the plan's violation of the absolute priority rule codified at 11 U.S.C. § 1129(b)(2)(B)(ii). This rule prevents equity holders from retaining any benefits on account of their equity ownership unless all classes of unsecured claims objecting to confirmation of the plan are paid in full pursuant to the plan. In other words, if an objecting unsecured creditor class will be shortchanged under the plan, the equity holders must forfeit any interest in the reorganized debtor. Over the lender's objections, the bankruptcy court confirmed the debtor's plan and the lender appealed this decision directly to the Seventh Circuit.

In February of this year, the Seventh Circuit issued an opinion reversing the decision in the bankruptcy court following briefing by Alan Mills, David Powlen, Mike Rosiello, and Jonathan Sundheimer and then oral argument by Alan Mills. The Seventh Circuit, relying on the Supreme Court's decision in *Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999), held that competition is the best way to determine if maximum value is being received for the new equity. "Competition is essential whenever a plan of reorganization leaves

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an objecting creditor unpaid yet distributes an equity interest to an insider." Further, the Seventh Circuit stated, "In this competition, creditors can bid the value of their loans," suggesting that creditors of a debtor may credit-bid at a sale of new equity. This statement provided a substantial right to creditors in the sale of new equity.

The debtor filed a petition for writ of certiorari with the Supreme Court, asking that the Supreme Court review the Seventh Circuit's opinion. The debtor specifically asked for review on three issues: (i) whether the Seventh Circuit's opinion allowed the absolute priority rule to apply to non-holder insiders; (ii) whether the possibility of competing plans satisfies the market test requirement outlined in *LaSalle*; and (iii) whether creditors should be allowed to credit-bid on new equity of a reorganized debtor. In its ruling on October 7, 2013, the Supreme Court denied review on all three issues. As a result, the Seventh Circuit's opinion remains standing. This opinion protects all creditors in a Chapter 11 case, ensuring that an equity holder cannot continue to keep control of the debtor indirectly after confirmation of a plan without first arranging for an auction of that equity. The opinion also allows credit-bidding by creditors, which can allow mortgage lenders and other senior secured lenders to take control of the reorganized debtor, and its property, without having to put forth any new money. The right to credit-bid on new equity puts creditors on par with secured creditors that have an interest in their collateral being sold. As stated in the opinion, "Unpaid creditors normally receive the equity in a reorganized business," and thus this new equity can be viewed as collateral for the unpaid creditors in a debtor's reorganization. Regardless of how this is viewed, the Castleton Plaza opinion, and the Supreme Court's denial of the debtor's petition, should be seen as a boon for secured creditors.

To obtain more information or a copy of the decision, please contact the Barnes & Thornburg attorney with whom you work or the following attorneys: lead counsel Alan Mills at (317) 231-7239 or alan.mills@btlaw.com, David Powlen at (302) 300-3435 or dpowlen@btlaw.com, or Jonathan Sundheimer at (317) 231-7319 or jsundheimer@btlaw.com.