FACT PATTERN – DBIC JANUARY 13, 2015

SinoHog Inc. ("SinoHog") began in the 1990's as a Chinese manufacturer of animal nutrition products. By expanding sales for its animal nutrition operations through hundreds of independent dealers, the business grew rapidly. In 2007 and 2008 it acquired dozens of independent Chinese hog farms and entered the hog breeding and production business. Until 2010, all of SinoHog's operations were in China. In September 2010 it acquired VolHog (Volunteer Hog), LLC ("VolHog"), a large United States hog producer located in Tennessee. As the result of a reverse merger transaction, SinoHog became a public company. SinoHog Holdings ("Holdings") is a Cayman entity wholly owned by Sino Hog and owns all the stock in the Chinese operations which are organized as a SinoHog Corporation of China Limited. SinoHog is the only debtor in this bankruptcy proceeding.

Firm management consisted of both Chinese nationals and U.S. based officers and directors. U.S. based law firms and accountants provided the primary source of both legal and financial advice from the company's initial growth through several stock offerings which were heavily promoted from the 2010 purchase of VolHog through late 2011.

The company had a compelling business pitch. SinoHog would be introducing Western style hog breeding and production into the world's largest protein market. The processes and technology perfected by VolHog would revolutionize the Chinese market.

Unfortunately, the Debtor suffered a series of setbacks. Unknown to the U.S. based officers and directors, certain individuals in the company engaged in a scheme known as "enlarging by faking," which involved overstating asset values in the Chinese hog farms it purchased, overstating accounts receivable in its animal feed division, reducing its allowance for doubtful accounts to a minimum even when business conditions indicated customers were less

likely to pay, and misrepresenting the value of equipment, inventory and cost of goods sold in its legacy hog business in its financial statements which were filed with the SEC.

In late December 2011, SinoHog announced that it would need to withdraw and eventually restate its financials from 2007 through the first two quarters in 2011, as they could not be relied upon. On March 7, 2014, SinoHog filed an 8-K to, among other things, announce "the Company has not completed, and is not working on, its financial statements for the years ended 2013, 2012 or 2011, or its restated financial statements for the year ended December 31, 2010." SinoHog eventually delisted its own common stock to avoid mandatory delisting by the exchange.

The SEC filed a complaint against SinoHog including allegations covering a wide range of federal securities law violations including Sarbanes-Oxley, that SinoHog executives deceived the market, violating Rule 13b2-2 or Section 303(a) of the Sarbanes-Oxley Act.

Once trouble started, law firm Gander and Fern ("G&F") pitched itself to represent the company, directors, and executives in the securities and derivative litigation. G&F holds one of the largest unsecured claims against SinoHog, all for unpaid legal fees. G&F represents SinoHog, E.B. White ("White"), and Garth Williams ("Williams") in the SEC actions. White and Williams are two directors of SinoHog.

On August 4, 2014 (the "Petition Date"), SinoHog filed for protection under chapter 11.

On August 14, 2014, the Office of the United States Trustee formed the Committee. The Committee consists of the following members:

> Templeton Rattus ("Rattus") was a member of the company's board of directors and an audit committee member. Rattus claims she saw problems with the company's accounting almost immediately after joining the board on February 24, 2011. She has a lot of information about the company's finances and the alleged

securities violations discussed in detail below, the disclosure of which would jeopardize the Debtor's reorganization. Rattus resigned on February 14, 2012. Rattus has a claim for certain salary, bonus, and benefits she alleges she did not receive. Her claim is disputed by the Debtor.

Lurvy, Zuckerman, and Arable ("Lurvy") provided CPA services to SinoHog from at least 2007 to November 2010. Joy, Aranea and Nellie replaced Lurvy as SinoHog's independent auditor in late 2011 after the company announced it was withdrawing its financial statements. Lurvy possesses information about the company's finances and alleged securities violations discussed in detail below, the disclosure of which would jeopardize the Debtor's reorganization. Lurvy has a substantial unsecured claim in the case.

Dorian, Int'l ("Dorian"), provided support to SinoHog's management in assessing its internal controls over financial reporting as required by Sarbanes-Oxley. Dorian possesses information about the company's finances and alleged securities violations discussed in detail below, the disclosure of which would jeopardize the Debtor's reorganization. Dorian is a creditor of SinoHog in the bankruptcy.

Each of the Committee members has agreed to reduce its allowed claim by one percent (1%). Additionally, the Committee members have agreed to non-disclosure of their knowledge of the company's pre-petition activities on the condition that each of them receives a full release, including for any pre-petition claims that could be brought against the Committee members in their individual capacities.

The SEC has issued two Wells Notices, notifications from the regulator that it intends to recommend enforcement proceedings be commenced against the prospective respondents. Notices have gone to two directors, Williams and White. The notices reference, in broad-strokes, the securities violations the SEC staff believes have occurred. A Wells Notice allows the prospective defendant to speak directly to the SEC prior to the commencement of regulatory proceedings. As a result of this process, the SEC has settled with Williams. White is now the subject of litigation filed by the SEC in U.S. District Court. G&F has filed an application to serve as special counsel to SinoHog in bankruptcy and continue to represent White and Williams in the litigation.

Boss Hog Farm Credit ("BHFC"), an equity fund, is the only secured creditor and was also instrumental in promoting the stock in the United States. BHFC is known for its work in China but has had mixed results on many of its holdings. BHFC acquired its interest in SinoHog when it provided financing for the VolHog transaction. BHFC also holds a significant unsecured debt position in the form of bonds. BHFC is providing DIP financing.

One of the conditions of DIP financing was that all sales of the Debtor's assets close prior to the end of first quarter 2015 due to the risks attendant with live animal assets and the uncertainty of controls in China over the preservation of other assets.

On the Petition Date, the Debtor filed a motion to sell Holding's assets, the stock controlling the China operations, and to approve Pigs on the Wing, LLC as the stalking horse bidder.

In a spirited auction held in October of 2014, a sufficient price was obtained that resulted in payment in full of all of BHFC's secured claims. The sale closed at the end of October 2014, and BHFC's secured position was paid in full from the proceeds of the sale at closing.

On November 1, 2014, the Debtor filed a plan of reorganization (the "Plan") which includes a sale of its holding company, which has sole control of all operations in the U.S., to SomePig, Ltd. ("SomePig"). The Plan provides that the proceeds from the sale to SomePig will not only pay all creditors 100 cents on the dollar, but bring recovery of twenty cents per share to all current shareholders. BHFC and White have agreed to backstop a rights offering to facilitate the transaction, including funding twenty percent of the unsecured claims pool and the recovery to shareholders. BHFC and White's agreement to backstop the rights offering is conditioned on the Committee members' non-disclosure agreement because continued

litigation would raise projected litigation costs significantly thereby harming the Debtor's ability to reorganize successfully.

The SEC settled its potential action against the Debtor (based on the fraudulent filed financial statements) for an allowed unsecured claim which will be paid in under the terms of the Plan. The SEC will use the proceeds of its claim to administer a fairness fund for shareholders who held the stock prior to SinoHog's announcement to the market that it had filed fraudulent financial statements with the SEC. The fund will provide those aggrieved shareholders with an additional ten cent per share recovery. It is unknown how many of the shareholders who held stock when the fraud took place still hold stock today.

Charlotte A. Cavatica is committee counsel. The Official Committee of Unsecured Creditors consists of Lurvy, Dorian, and Rattus.

Arthur Hoggett ("Hoggett") is the Debtor's counsel. G&F has asked Hoggett for a release for both potential prepetition and post-petition claims and has indicated it will provide a discount on its unsecured claim of fifteen percent of its total prepetition and post-petition bills in exchange for the release. It has also promised to cap its fees for future advancement claims to available insurance.

The Plan provides for certain releases and exculpations, including releases granted by the Debtor to certain parties, including, but not limited to, the Debtor (including its officers and directors), the Committee, the members of the Committee (both in their capacity as members of the Committee and in their individual capacity, including any prepetition activities), G&F, BHFC (in its capacity as a noteholder and secured lender and as one of the parties agreeing to backstop the debtor's rights offering), and White (as a party backstopping the rights offering) (collectively, the "Released Parties"). The Debtor release language, in part, is as follows:

> For good and valuable consideration, including the service of the Released Parties to facilitate the 363 Sale and the filing and implementation of the Plan. . . as of the Effective Date . . . the Debtor and the Estate release, acquit and discharge the Released Parties from any and all actions, claims, interests, obligations, rights, suits, damages, Causes of Action, remedies and liabilities whatsoever.

In addition, the Plan includes non-debtor releases to the Released Parties granted by non-debtor third parties, including, among others, parties holding unimpaired claims who are deemed to accept the Plan and, thus, not entitled to vote on the Plan. Because all of the creditors will be paid in full under the Plan, no creditors are entitled to vote on the Plan, and accordingly, are deemed to give releases to the Released Parties. Further, the Plan does not provide that the shareholders (the only constituency entitled to vote on the Plan) are able to opt-out of the third-party releases. The approved ballot for the class of shareholders does not allow the shareholders to opt-out of these releases.

The third-party release language, in part, is as follows:

> As of the Effective Date. . . in consideration for the obligations under the Plan and the Cash, securities, contracts, instruments, releases and other agreements or documents to be delivered in connection with the Plan, and the benefits provided by Released Parties in the Plan and in the Chapter 11 Case, each present and former holder of a Claim or Interest will be deemed to release forever, waive and discharge any and all Claims, obligations, suits, judgments . . . and liabilities based in whole or in part on any act, omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Debtor, the Chapter 11 Case, the 363 Sale, or the Plan, against any Released Party, except fraud, willful misconduct or gross negligence as determined by Final Order.

Esme Cordelia is the United States Trustee. She has concerns over the releases and directed her trial attorney, Wilbur Zuckerman to prepare an objection. Several aggrieved shareholders have filed individual objections claiming the company was worth far more than the current plan provides and that the plan is a scheme to “wipe all the dirt under the rug.” The

equity in the case is mostly comprised of small investors and day traders, as few institutional investors had the stomach to invest due to the risks attendant with financial business in China.

Equity is the only voting class under the Plan. Slightly less than fifty percent (50%) of the equity class submitted ballots. Except for the objecting shareholders, each equity holder that returned a ballot voted in favor of the Plan.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

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In re:	: Chapter 11
	:
SINOHOG INC.,	: Case No. 14-55555 (J)
	:
Debtor.	:
	: **Re: Docket No. 250**
	: **Hearing Date: January 13, 2015 at 5:30 p.m. (ET)**
	:
-- x	

OBJECTION OF THE UNITED STATES TRUSTEE
TO CONFIRMATION OF THE PLAN OF REORGANIZATION FOR SINOHOG INC.

Esme Cordelia, the United States Trustee for Region 3 (the "**United States Trustee**"), by and through her undersigned counsel, hereby files this objection (this "**Objection**") to confirmation of the Debtor's proposed plan of reorganization [D.I. 250] (the "**Plan**"). In support of the Objection, the United States Trustee respectfully states as follows:

PRELIMINARY STATEMENT

It is axiomatic that a chapter 11 plan may not be confirmed unless the Court finds that a proposed plan complies with the provisions of 11 U.S.C. § 1129(a). A plan proponent bears the burden of proof with respect to each element contained in Section 1129(a). *See Genesis Health Ventures, Inc.*, 266 B.R. 591, 599 (Bankr. D. Del. 2001). However, as outlined below, the proposed Plan's overly broad and legally impermissible releases leave the Debtor far short of the confirmation mark. The United States Trustee therefore respectfully requests that confirmation of the Plan be denied.

JURISDICTION

1. This Court has jurisdiction over the Motion and this Objection under (i) 28 U.S.C. § 1334, (ii) applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a) and (iii) 28 U.S.C. § 157(b)(2).

2. Under 28 U.S.C. § 586, the United States Trustee is charged generally with monitoring the federal bankruptcy system. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that United States Trustee has "public interest standing" under 11 U.S.C. § 307 which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the United States Trustee as a "watchdog").

3. Under section 307 of Title 11 of the United States Code (the "**Bankruptcy Code**"), the United States Trustee has standing to be heard on the Plan and the issues raised in this Objection.

BACKGROUND

A. General Background

4. On August 4, 2011, the Debtor commenced a voluntary case under Chapter 11 of the Bankruptcy Code. The Debtor has operated, and continues to operate, its business as a debtor-in-possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.

5. By order entered on December 9, 2014 [D.I. 325], this Court approved the Debtor's disclosure statement [D.I. 251] (the "**Disclosure Statement**") for the Plan under Chapter 11 of the Bankruptcy Code.

B. **<u>The Plan and the Release Provisions</u>**

6. The Debtor's Plan contains a litany of broad (and impermissible) drafted releases by the Debtor (the "**Debtor Releases**") and third parties (the "**Third Party Releases**"). The Third Party Releases are nonconsensual.

7. Section X(i)(a) of the Plan provides releases by the Debtor and its estate of any "**Released Party**." The Released Parties are defined, in part, as (a) the Debtor, (b) the Official Committee of Unsecured Creditors (the "**Committee**"), (c) the members of the Committee ((i) Lurvy Zuckerman and Arable, (ii) Dorian, Int'l, and (iii) Ms. Templeton Rattus), both in their capacity as Committee members and in their individual capacities and for both their pre and post-petition activities; (c) Gander and Fern ("**G&F**"), (d) Boss Hog Farm Credit ("**BHFC**"), (e) E.B. White ("**White**") and (f) "**Related Persons**" of each of the foregoing. "Related Persons" in turn includes numerous non-debtors, including but not limited to, the Released Parties' affiliates and subsidiaries, current and former officers, directors, principals, employees, managed accounts or funds, management companies, fund advisors, advisory board members, attorneys and other professionals.

8. Article X(i)(b) of the Plan sets forth Third-Party Releases. As with the Debtor Releases, the Third-Party Releases are in favor of the "Released Parties" and any "Related Person" of any Released Party. Further, the Plan provides that the Third Party Releases shall be granted by "each present and former holder of a Claim or Interest." The Plan does not provide that the shareholders (the only constituency entitled to vote on the Plan) are able to opt-out of the Third-Party Releases.

OBJECTION

I. The Debtor Releases and Third-Party Releases are Defective under Applicable Law and Confirmation Therefore Must be Denied

9. The Debtor Releases and Third-Party Releases are deficient and contrary to the standards articulated in controlling precedent in this Court. Accordingly, confirmation of the Debtor's proposed Plan must be denied.

A. The Releases by the Debtor are Impermissible Under Controlling Law in this District

10. Article X(i)(a) of the Plan includes broad releases by the Debtor and its estate of numerous parties, including the Committee, the members of the Committee, both in their capacity as Committee members and in their individual capacities, including any actions arising out of or related to prepetition activities, G&F, BHFC and White and of the foregoing entities' and individuals' affiliates and subsidiaries, current and former officers, directors, principals, employees, principals, managed accounts or funds, management companies, fund advisors, advisory board members, attorneys and other professionals.

11. Pursuant to *In re Washington Mutual, Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011) and *In re Tribune Company,* 464 B.R. 126 (Bankr. D. Del. 2011)*,* among other controlling precedents in this District, the five factors set forth in *In re Zenith Elecs. Corp.,* 241 B.R. 92, 110 (Bankr. D. Del 1999) and *In re Master Mortgage Inv. Fund, Inc.,* 168 B.R. 930, 937-38 (Bankr. W. D. Mo. 1994) should be considered when determining whether, notwithstanding section 524(e) of the Bankruptcy Code, a plan may provide for releases by debtors of non-debtor entities. *See Washington Mutual*, 442 B.R. at 346; *Tribune* 464 B.R. at 186; *In re Spansion, Inc.*, 426 B.R. 114, 142-43, n. 47 (Bankr. D. Del 2010); *In re Coram Healthcare Corp.*, 315 B.R. 321, 335 (Bankr. D. Del. 2004).

12. The *Zenith/Master Mortgage* factors that should be considered are:

i. identity of interests between debtor and non-debtor release, so that a suit against a non-debtor will deplete the estate's resources (e.g. due to debtor's indemnification of non-debtor);

ii. substantial contribution to the plan by non-debtor;

iii. necessity of release to the reorganization;

iv. overwhelming acceptance of plan and release by creditors; and

v. payment of all or substantially all of the claims of the creditors and interest holders under the plan.

Washington Mutual, 442 B.R. at 346 (citing *Zenith*, 241 B.R. at 110) (citing *Master Mortgage,* 168 B.R. at 937)). *See also Tribune*, 464 B.R. at 186 (citing *Zenith* for the same five factors to be considered with respect to debtor releases of non-debtor parties). The aforementioned factors are neither exclusive nor conjunctive requirements, but simply provide guidance in the Court's determination of fairness. *Tribune* 464 B.R. at 186, citing *Washington Mutual*, 442 B.R. at 346.

13. The Debtor has the burden to establish whether the *Zenith/Master Mortgage* factors have been met as to each of the Released Parties and all of the Related Persons who are the beneficiaries of the Debtor Releases. In this case, the Debtor has failed to bear the burden with respect to each party released pursuant to the Debtor Releases.

14. With respect to the release of the Committee and its members, although the Debtor may be able to demonstrate that the *Master Mortgage/Zenith Factors* are met with respect to a release of the Committee *in its capacity as a Committee in these Chapter 11 cases*, the Debtor cannot demonstrate that the Committee members, *as individual creditors of the Debtor*, share a common interest with the Debtor. Further, while the Committee has made a substantial contribution to this Chapter 11 Case and any suit against the Committee would in essence be paid for by the Debtor, the same is not true for the Committee members in their

individual capacities. *See, e.g.*, *Washington Mutual*, 442 B.R. at 348 (refusing to grant releases of a creditors committee and its members, indicating instead that a committee and its members could receive an exculpation with respect to the role played in the bankruptcy process so long as there was an exception for willful misconduct and gross negligence).

15. The release of G&F also is defective. G&F is a retained professional and the holder of one of the largest unsecured claims of the Debtor. The Disclosure Statement describes that G&F is providing the Debtor with a fifteen percent discount on its unsecured claim and post-petition bills in exchange for its release. Yet, this Court has required that creditors *waive* claims in order to sanction a debtors' release of a creditor -- not just discount them. *See, e.g.*, *Washington Mutual*, 442 B.R. at 347 (finding that the released parties' *waiver* of their proofs of claim would both free the estate from the largest claim in the case as well as permit use of estate property free of competing claims to ownership). Furthermore, the Debtor has filed to offer any evidence that: (i) G&F has made a substantial contribution in this Chapter 11 Case or (ii) that the Debtor will need G&F to provide substantial services to them after the Plan is confirmed.

16. Turning to BHFC and White, the United States Trustee challenges the releases of BHFC and White and the Debtor's claim in the Disclosure Statement that BHFC and White have made substantial contributions under the Plan in connection with their agreement to backstop a rights offering to facilitate the sale transaction and therefore are entitled to the releases provided for them under the terms of the Plan. *See, e.g., Indianapolis Downs*, 486 B.R. 286, 303-04 (Bankr. D. Del. 2013) (finding substantial contribution where released parties either permitted performance or actually performed post-petition services for the debtors without compensation). The United States Trustee leaves the Debtor to its proof on this issue.

17. Finally, the release of the Related Parties is overbroad and therefore impermissible. The *Washington Mutual* court did not allow third-party releases of affiliates, stating that there is no evidence of who the affiliates are or why they should get a discharge without filing their own bankruptcy cases. *See Washington Mutual*, at 354. Nor is there any indication in the Disclosure Statement or the Plan that the Related Persons released by the Debtors pursuant to the Debtor Related Party Releases contributed any consideration to the Plan, or otherwise made any contribution to the Plan. Accordingly, the proposed releases provided for in the Plan to non-debtor affiliates and subsidiaries are impermissible pursuant to applicable law and should be denied.

18. In sum, each of the Debtor Releases are overbroad and impermissible under controlling law. The Plan therefore may not be confirmed.

B. <u>The Third-Party Releases are Impermissible</u>

19. Article X(i)(b) of the Plan sets forth the Third-Party Releases. As was the case with the Debtor Releases, the Third-Party Releases are in favor of the "Released Parties" and all "Related Persons." The Plan provides that Third-Party Releases in the Plan will be given by "each present and former holder of a Claim or Interest." *See* Plan Article X(i)(b). This fact is egregious given the fact that, as drafted, the Plan does not provide the shareholder class [which is the only class entitled to vote on the Plan] with the ability to opt-out of the Third-Party Releases. Accordingly, the Third-Party Releases are nonconsensual.

20. Pursuant to the relevant case law in this District, third-party releases of non-debtors should be allowed only if they are consensual. *See In re Washington Mutual, Inc.*, 442 B.R. 314, 352 (Bankr. D. Del. 2011), *citing, inter alia, In re Coram Healthcare Corp.,* 315 B.R. 321, 335 (Bankr. D. Del. 2004) (holding that the "Trustee (and the Court) do not have the

power to grant a release of the Noteholders on behalf of third parties," and that such release must be based on consent of the releasing party); *In re Zenith Electronics Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999) (release provision had to be modified to permit third parties' release of non-debtors only for those creditors who voted in favor of the plan); *In re Exide Technologies*, 303 B.R. 48, 74 (Bankr. D. Del. 2003) (approving releases which were binding only on those creditors and equity holders who accepted the terms of the plan).

21. In *Gillman v. Continental Airlines (In re Continental Airlines),* 203 F.3d 203 (3d Cir. 2000), the Third Circuit surveyed cases from various circuits as to when, if ever, a non-consensual third party release is permissible. The Court acknowledged that a number of Circuits do not allow such non-consensual releases under any circumstances. *See id*. at 212. Other Circuits, the Court found, "have adopted a more flexible approach, albeit in the context of extraordinary cases," such as mass tort cases. *See id.* at 212, *citing Securities and Exchange Commission v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992); *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 640, 649 (2d Cir. 1988). *See also*, *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141 (2d Cir. 2005) (third party release may be granted "only in rare cases").

22. The Third Circuit in *Continental Airlines* ultimately determined that the proposed releases in that case, which enjoined shareholder lawsuits against debtors' directors and officers, did "not pass muster under even the most flexible test for the validity of non-debtor releases." *Continental*, 203 F.3d at 214. Therefore, the Court determined that it "need not speculate on whether there are circumstances under which we might validate a non-consensual release that is both necessary and given in exchange for fair consideration." *Id.* at 214, n.11. However, the

Court did describe the "hallmarks of permissible non-consensual releases" to be "fairness, necessity to the reorganization, and special factual findings to support these conclusions." *Id.* at 214.

23. In *In re Genesis Health Ventures,* Inc., 266 B.R. 591, 608 (Bankr. D. Del 2001), the Court evaluated whether a non-consensual release fit the "hallmarks" discussed in *Continental Airlines*, by considering whether: (i) the non-consensual release was necessary to the success of the reorganization, (ii) the releasees have provided a critical financial contribution to the debtor's plan, (iii) the releasees' financial contribution is necessary to make the plan feasible, and (iv) the release is fair to the non-consenting creditors, i.e., whether the non-consenting creditors received reasonable compensation in exchange for the release. *Id*. at 607-08. *See also In re Spansion, Inc.*, 426 B.R. 114, 144 (Bankr. D. Del 2010) (applying same factors).

24. In the present case, there is nothing in the record to indicate that the high threshold necessary for approval of non-consensual third-party releases has been met. In fact, the record in this case is devoid from any information indicating how the four (4) factors set forth in *Genesis* are met with respect to any of the "Released Parties" or "Related Persons" that would be the recipients of these non- consensual releases. It is hard to imagine what "critical financial contribution" to the Debtor's Plan was given by any of the "Released Parties" or "Related Persons."

25. The Courts in both *Continental* and *Genesis* found that the directors and the officers of the debtors in those cases did not satisfy the requirements to be entitled to a nonconsensual third-party release. *See Continental,* 203 F.3d at 215 ("[W]e have found no evidence that the non-debtor D&Os provided a critical financial contribution to the Continental Debtors' plan that was necessary to make the plan feasible in exchange for receiving a release of

liability"); *Genesis*, 266 B.R. at 606–07 ("[T]he officers, directors and employees have been otherwise compensated for their contributions, and the management functions they performed do not constitute contributions of 'assets' to the reorganization.").

26. The Debtor should not be allowed the unfettered discretion to force creditors to discharge non-debtors from liability, because a permanent injunction limiting the liability of non-debtor parties is a rare thing that should not be considered absent a showing of exceptional circumstances. *See Continental*, 203 F.3d at 213, n. 9, and cases cited therein.

27. Moreover, there are certain non-debtors that will be released by way of the Third- Party Releases that are not entitled to such a release even if such releases were consensual. The Court in *Washington Mutual* disallowed even consensual third-party releases in favor of four categories of non-debtor entities who will be the beneficiaries of consensual and non-consensual Third-Party Releases in these cases: the Debtors' directors and officers, the Debtors' non-debtor affiliates and subsidiaries, the Committee and the Plan Administrator.

28. In addressing third party release of the debtors' officers and debtors in *Washington Mutual*, the court held as follows:

> [T]here is no basis for granting third party releases of the Debtors' officers and directors, even if limited to post-petition activity. The only 'contribution' made by them was in the negotiation of the Global Settlement and the Plan. Those activities are nothing more than what is required of directors and officers of debtors in possession (for which they have received compensation and will be exculpated); they are in sufficient to warrant such broad releases of any claims third parties may have against them.

442 B.R. at 354. The same is true here.

29. In addition, the *Washington Mutual* court did not allow third-party releases of affiliates, stating that there is no evidence of who the affiliates are or why they should get a discharge without filing their own bankruptcy cases. *See Washington Mutual*, at 354. The

Third-Party Releases in this Plan provide for the releases of the Debtors' non-debtor affiliates and subsidiaries, which pursuant to applicable law is impermissible and should be denied and stricken from the Debtor's Plan.

30. Under *Washington Mutual,* the Third-Party Releases in the present case should not extend to the Debtor's directors and officers, the Debtor's affiliates or subsidiaries, or any other non-debtor person or entity that did not make a substantial contribution to the Plan, or otherwise provide consideration for their release.

31. The release of the creditors committee and its members was also disallowed by the Court in *Washington Mutual*. Rather than allowing for a release, the Court in *Washington Mutual* indicated that the committee and its members could receive exculpation with respect to role they played in bankruptcy process, as long as there was an exception for willful misconduct or gross negligence. *Id.* Here, the Committee and its members are included in the exculpation clause in Article X(E) of the Plan; they do not need, and should not receive, a release as well.

32. Thus, even if the creditors and interest holders consented to the Third-Party Releases, such releases should not extend to the Debtor's directors and officers, the Debtor's subsidiaries or affiliates, or Committee and its members, for the reasons set forth in *Washington Mutual*.

33. The Debtor has the burden of justifying the validity of the Third-Party Releases, whether consensual or non-consensual, for each and every party to be released. Because an evidentiary predicate is necessary to approve the Third-Party Releases, the United States Trustee reserves argument on this issue until the record at the confirmation hearing is closed.

Conclusion

34. As detailed above, the Debtor's Plan is not confirmable because it contains releases that are contrary to applicable law in this District.

35. The United States Trustee leaves the Debtor to its burden and reserves any and all rights, remedies and obligations to, *inter alia*, complement, supplement, augment, alter and/or modify this Objection, file an appropriate Motion and/or conduct any and all discovery as may be deemed necessary or as may be required and to assert such other grounds as may become apparent upon further factual discovery.

WHEREFORE, the United States Trustee requests that this Court issue an order denying confirmation of the Plan, and/or granting such other relief as this Court deems appropriate, fair and just.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re SinoHog Inc., Debtor.	Chapter 11 Case No. 14-55555 (J) **Hearing Date: January 13, 2015 at 5:30 p.m.** **Objections Due: January 12, 2015 at 4:00 p.m.**

JOINT MEMORANDUM OF LAW OF THE DEBTORS AND THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS IN SUPPORT OF CONFIRMATION OF THE JOINT PLAN OF REORGANIZATION

The Debtors and Debtors-in-Possession in the above-captioned chapter 11 cases (collectively, the "Debtors") and the Official Committee of Unsecured Creditors (the "Committee"), together, hereby submit this memorandum of law and brief (the "Memorandum") in support of confirmation of the Joint Plan of Reorganization pursuant to section 1129 of title 11 of the United States Code (11 U.S.C. §§ 101 *et. seq.*, the "Bankruptcy Code").

PRELIMINARY STATEMENT

This case has been a remarkable success which was achieved only through the extraordinary efforts of all parties involved. Notwithstanding the bleak outlook on the Petition Date, the parties' exhaustive efforts have brought home the bacon and creditors will be paid in full, with equity to receive a twenty to thirty cent per share distribution.

The releases set forth in the Plan were integral to the formulation of the Plan and bringing this case to as efficient a conclusion as possible, which efficiencies inure to all of the creditors of this estate. Against the legal and factual backdrop here, there can be no dispute that the releases are appropriate and should be approved.

BACKGROUND

SinoHog Inc. ("SinoHog") began in the 1990's as a Chinese manufacturer of animal nutrition products. By expanding sales for its animal nutrition operations through hundreds of independent dealers, the business grew rapidly. In 2007 and 2008 it acquired dozens of independent Chinese hog farms and entered the hog breeding and production business. Until 2010, all of SinoHog's operations were in China. In September 2010 it acquired VolHog (Volunteer Hog), LLC ("VolHog"), a large United States hog producer located in Tennessee. As the result of a reverse merger transaction, SinoHog became a public company. SinoHog Holdings ("Holdings") is a Cayman entity wholly owned by Sino Hog and owns all the stock in the Chinese operations which are organized as a SinoHog Corporation of China Limited. SinoHog is the only debtor in this bankruptcy proceeding.

Firm management consisted of both Chinese nationals and U.S. based officers and directors. U.S. based law firms and accountants provided the primary source of both legal and financial advice from the company's initial growth through several stock offerings which were heavily promoted from the 2010 purchase of VolHog through late 2011.

The company had a compelling business pitch. SinoHog would be introducing Western style hog breeding and production into the world's largest protein market. The processes and technology perfected by VolHog would revolutionize the Chinese market.

Unfortunately, the Debtor suffered a series of setbacks. Unknown to the U.S. based officers and directors, certain individuals in the company engaged in a scheme known as "enlarging by faking," which involved overstating asset values in the Chinese hog farms it purchased, overstating accounts receivable in its animal feed division, reducing its allowance for doubtful accounts to a minimum even when business conditions indicated customers were less

likely to pay, and misrepresenting the value of equipment, inventory and cost of goods sold in its legacy hog business in its financial statements which were filed with the SEC.

In late December 2011, SinoHog announced that it would need to withdraw and eventually restate its financials from 2007 through the first two quarters in 2011, as they could not be relied upon. On March 7, 2014, SinoHog filed an 8-K to, among other things, announce "the Company has not completed, and is not working on, its financial statements for the years ended 2013, 2012 or 2011, or its restated financial statements for the year ended December 31, 2010." SinoHog eventually delisted its own common stock to avoid mandatory delisting by the exchange.

The SEC filed a complaint against SinoHog including allegations covering a wide range of federal securities law violations including Sarbanes-Oxley, that SinoHog executives deceived the market, violating Rule 13b2-2 or Section 303(a) of the Sarbanes-Oxley Act.

Once trouble started, law firm Gander and Fern ("G&F") pitched itself to represent the company, directors, and executives in the securities and derivative litigation. G&F holds one of the largest unsecured claims against SinoHog, all for unpaid legal fees. G&F represents SinoHog, E.B. White ("White"), and Garth Williams ("Williams") in the SEC actions. White and Williams are two directors of SinoHog.

On August 4, 2014 (the "Petition Date"), SinoHog filed for protection under chapter 11.

On August 14, 2014, the Office of the United States Trustee formed the Committee. The Committee consists of the following members:

> Templeton Rattus ("Rattus") was a member of the company's board of directors and an audit committee member. Rattus claims she saw problems with the company's accounting almost immediately after joining the board on February 24, 2011. She has a lot of information about the company's finances and the alleged

securities violations discussed in detail below, the disclosure of which would jeopardize the Debtor's reorganization. Rattus resigned on February 14, 2012. Rattus has a claim for certain salary, bonus, and benefits she alleges she did not receive. Her claim is disputed by the Debtor.

Lurvy, Zuckerman, and Arable ("Lurvy") provided CPA services to SinoHog from at least 2007 to November 2010. Joy, Aranea and Nellie replaced Lurvy as SinoHog's independent auditor in late 2011 after the company announced it was withdrawing its financial statements. Lurvy possesses information about the company's finances and alleged securities violations discussed in detail below, the disclosure of which would jeopardize the Debtor's reorganization. Lurvy has a substantial unsecured claim in the case.

Dorian, Int'l ("Dorian"), provided support to SinoHog's management in assessing its internal controls over financial reporting as required by Sarbanes-Oxley. Dorian possesses information about the company's finances and alleged securities violations discussed in detail below, the disclosure of which would jeopardize the Debtor's reorganization. Dorian is a creditor of SinoHog in the bankruptcy.

Each of the Committee members has agreed to reduce its allowed claim by one percent (1%). Additionally, the Committee members have agreed to non-disclosure of their knowledge of the company's pre-petition activities on the condition that each of them receives a full release, including for any pre-petition claims that could be brought against the Committee members in their individual capacities.

The SEC has issued two Wells Notices, notifications from the regulator that it intends to recommend enforcement proceedings be commenced against the prospective respondents. Notices have gone to two directors, Williams and White. The notices reference, in broad-strokes, the securities violations the SEC staff believes have occurred. A Wells Notice allows the prospective defendant to speak directly to the SEC prior to the commencement of regulatory proceedings. As a result of this process, the SEC has settled with Williams. White is now the subject of litigation filed by the SEC in U.S. District Court. G&F has filed an application to serve as special counsel to SinoHog in bankruptcy and continue to represent White and Williams in the litigation.

Boss Hog Farm Credit ("BHFC"), an equity fund, is the only secured creditor and was also instrumental in promoting the stock in the United States. BHFC is known for its work in China but has had mixed results on many of its holdings. BHFC acquired its interest in SinoHog when it provided financing for the VolHog transaction. BHFC also holds a significant unsecured debt position in the form of bonds. BHFC is providing DIP financing.

One of the conditions of DIP financing was that all sales of the Debtor's assets close prior to the end of first quarter 2015 due to the risks attendant with live animal assets and the uncertainty of controls in China over the preservation of other assets.

On the Petition Date, the Debtor filed a motion to sell Holding's assets, the stock controlling the China operations, and to approve Pigs on the Wing, LLC as the stalking horse bidder.

In a spirited auction held in October of 2014, a sufficient price was obtained that resulted in payment in full of all of BHFC's secured claims. The sale closed at the end of October 2014, and BHFC's secured position was paid in full from the proceeds of the sale at closing.

On November 1, 2014, the Debtor filed a plan of reorganization (the "Plan") which includes a sale of its holding company, which has sole control of all operations in the U.S., to SomePig, Ltd. ("SomePig"). The Plan provides that the proceeds from the sale to SomePig will not only pay all creditors 100 cents on the dollar, but bring recovery of twenty cents per share to all current shareholders. BHFC and White have agreed to backstop a rights offering to facilitate the transaction, including funding twenty percent of the unsecured claims pool and the recovery to shareholders. BHFC and White's agreement to backstop the rights offering is conditioned on the Committee members' non-disclosure agreement because continued

litigation would raise projected litigation costs significantly thereby harming the Debtor's ability to reorganize successfully.

The SEC settled its potential action against the Debtor (based on the fraudulent filed financial statements) for an allowed unsecured claim which will be paid in under the terms of the Plan. The SEC will use the proceeds of its claim to administer a fairness fund for shareholders who held the stock prior to SinoHog's announcement to the market that it had filed fraudulent financial statements with the SEC. The fund will provide those aggrieved shareholders with an additional ten cent per share recovery. It is unknown how many of the shareholders who held stock when the fraud took place still hold stock today.

Charlotte A. Cavatica is committee counsel. The Official Committee of Unsecured Creditors consists of Lurvy, Dorian, and Rattus.

Arthur Hoggett ("Hoggett") is the Debtor's counsel. G&F has asked Hoggett for a release for both potential prepetition and post-petition claims and has indicated it will provide a discount on its unsecured claim of fifteen percent of its total prepetition and post-petition bills in exchange for the release. It has also promised to cap its fees for future advancement claims to available insurance.

The Plan provides for certain releases and exculpations, including releases granted by the Debtor to certain parties, including, but not limited to, the Debtor (including its officers and directors), the Committee, the members of the Committee (both in their capacity as members of the Committee and in their individual capacity, including any prepetition activities), G&F, BHFC (in its capacity as a noteholder and secured lender and as one of the parties agreeing to backstop the debtor's rights offering), and White (as a party backstopping the rights offering) (collectively, the "Released Parties"). The Debtor release language, in part, is as follows:

> For good and valuable consideration, including the service of the Released Parties to facilitate the 363 Sale and the filing and implementation of the Plan. . . as of the Effective Date . . . the Debtor and the Estate release, acquit and discharge the Released Parties from any and all actions, claims, interests, obligations, rights, suits, damages, Causes of Action, remedies and liabilities whatsoever.

In addition, the Plan includes non-debtor releases to the Released Parties granted by non-debtor third parties, including, among others, parties holding unimpaired claims who are deemed to accept the Plan and, thus, not entitled to vote on the Plan. Because all of the creditors will be paid in full under the Plan, no creditors are entitled to vote on the Plan, and accordingly, are deemed to give releases to the Released Parties. Further, the Plan does not provide that the shareholders (the only constituency entitled to vote on the Plan) are able to opt-out of the third-party releases. The approved ballot for the class of shareholders does not allow the shareholders to opt-out of these releases.

The third-party release language, in part, is as follows:

> As of the Effective Date. . . in consideration for the obligations under the Plan and the Cash, securities, contracts, instruments, releases and other agreements or documents to be delivered in connection with the Plan, and the benefits provided by Released Parties in the Plan and in the Chapter 11 Case, each present and former holder of a Claim or Interest will be deemed to release forever, waive and discharge any and all Claims, obligations, suits, judgments . . . and liabilities based in whole or in part on any act, omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Debtor, the Chapter 11 Case, the 363 Sale, or the Plan, against any Released Party, except fraud, willful misconduct or gross negligence as determined by Final Order.

Esme Cordelia is the United States Trustee. She has concerns over the releases and directed her trial attorney, Wilbur Zuckerman to prepare an objection. Several aggrieved shareholders have filed individual objections claiming the company was worth far more than the current plan provides and that the plan is a scheme to “wipe all the dirt under the rug.” The

equity in the case is mostly comprised of small investors and day traders, as few institutional investors had the stomach to invest due to the risks attendant with financial business in China.

Equity is the only voting class under the Plan. Slightly less than fifty percent (50%) of the equity class submitted ballots. Except for the objecting shareholders, each equity holder that returned a ballot voted in favor of the Plan.

ARGUMENT

Releases in Chapter 11 Plan

I. Debtor Releases

A debtor may release non-debtor third parties under a plan pursuant to section 1123(b)(3)(A) if the release is a valid exercise of the debtor's business judgment, is fair, reasonable and in the best interests of the estate. *In re Aleris Int'l, Inc*., 2010 Bankr. LEXIS 2997 at *64 (Bankr. D. Del. May 3, 2010) (*citing In re Spansion, Inc.*, 426 B.R. 114, 143 (Bankr. D. Del. 2010)). Where such releases are an active part of the plan negotiation and formulation process it is a valid exercise of a debtor's business judgment to include a settlement of any claims a debtor might own against third parties as a discretionary provision of a plan. *Id.*

With respect to releases by a debtor under a plan, courts in the District of Delaware have applied a five-factor test, first articulated in *In re Master Mortgage Inv. Fund Inc.*, 168 B.R. 930, 937 (Bankr. W.D. Mo. 1994) and adopted by *In re Zenith Elecs. Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999):

> 1. An identity of interest between the debtor and the third party, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate;
>
> 2. Substantial contribution by the non-debtor of assets to the reorganization;

> 3. The essential nature of the injunction to the reorganization to the extent that, without the injunction, there is little likelihood of success;
>
> 4. An agreement by a substantial majority of creditors to support the injunction, specifically if the impaired class of classes "overwhelmingly" votes to accept the plan; and
>
> 5. A provision in the plan for payment of all or substantially all of the claims of the class or classes affected by the injunction.

See, e.g., *In re Indianapolis Downs, LLC*, 486 B.R. 286, 303 (Bankr. D. Del. 2013). Delaware courts do not hold this list to be exclusive, however, but instead view the factors as "helpful in weighing the equities of the particular case after a fact-specific review." *Id.* (citing *Master Mortgage*, 168 B.R. at 935 and finding the debtor release appropriate under the *Master Mortgage* factors because three of the five were satisfied); *see also Spansion*, 426 B.R. at 143 (noting the *Master Mortgage* factors, but approving the debtors' release of certain parties under the plan without engaging in a factor-by-factor analysis, instead reasoning that four of five voting creditor classes overwhelmingly approved the plan and the record reflected no pending litigation that would be discontinued by the release, such that it was a valid exercise of the debtors' business judgment).

Turning to the *Master Mortgage* factors, the "identity of interest" factor requires "an identity of interest between the debtor and the third party, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate." *Id.* (citing *Spansion*, 426 B.R. 114, n.47 (Bankr. D. Del. 2010)); *In re Washington Mutual, Inc.*, 442 B.R. 314, 347 (Bankr. D. Del. 2011) (finding that competing claims to the debtors' assets by the released parties, combined with the fact that a suit against them could be viewed as a suit against the debtors based on successorship law, supported a finding that the first *Zenith* factor was met). An identify of interest exists, when, among other things, the debtor has a duty to indemnify the

non-debtor receiving the release. *Id.* (citing *Washington Mutual* in finding that the first *Zenith* factor was met because the debtors' organizational documents required the debtors to indemnify the non-debtor party being released and each of the non-debtor parties being released had asserted indemnification claims against the debtors' estates). A shared goal between the debtor and the released party to achieve plan confirmation and implementation may support an identity of interest as well. *See In re Tribune Co*., 464 B.R. 126, 153 (Bankr. D. Del. 2011) (noting although identity of interest between the debtors and certain lenders and agents based on indemnification claims was unclear, approving debtors' release of those parties under the plan because, *inter alia,* they had an identity of interest based on their common goal of having a jointly proposed plan confirmed and implemented).

A released party's continued provision of services to the debtor may satisfy the second *Zenith* factor, whether the released party has made a substantial contribution to the plan, post-petition. *See Indianapolis Downs*, 486 B.R. at 303-04 (finding substantial contribution where released parties either permitted performance or actually performed post-petition services for the debtors without compensation). The waiver of proofs of claim against the debtors may also constitute a substantial contribution. *Washington Mutual*, 442 B.R. at 347 (finding that the released parties' waiver of their proofs of claim would both free the estate from the largest claim in the case as well as permit use of estate property free of competing claims to ownership). However, the fact that creditors are receiving a substantial recovery under the plan does not support a finding of substantial contribution where the released party did not contribute cash or anything else of a tangible value nor provided an extraordinary service. *See Washington Mutual*, 442 B.R. at 348-49 (rejecting debtors' release of the Committee, its members, the Indenture

Trustees and noteholders because they did not demonstrate they did "anything other than fulfill their fiduciary duties").

With respect to the third *Zenith* factor, the essential nature of the debtor's release may be established where competing claims between the debtor and the released party are such that the debtor could not propose a plan that did not resolve those claims. *Washington Mutual*, 442 B.R. at 347 (indicating given the released parties' competing claims to virtually every asset in the debtors' estates, their substantial contributions to the plan and the numerous lawsuits spawned by the bank's failure, finding the release essential and it unsurprising that they insisted on it as a condition to their settlement of claims). It may also be established where the release is a condition of a related settlement that is integral to implementation of the plan. *Tribune*, 464 B.R. at 153 (approving release of certain lenders and agents, but rejecting release of "related persons" because there was no basis in the record that they had made a substantial contribution or that the release of related persons was necessary to the reorganization, despite the released parties' acceptance by a majority of creditors).

Although the fourth *Zenith* factor contemplates an agreement from creditors to support the injunction, creditors overwhelmingly voting for the plan satisfies this prong even absent a specific agreement with respect to the release. *Indianapolis Downs*, 486 B.R. at 304; *Washington Mutual*, 442 B.R. at 348; *Tribune*, 464 B.R. at 154.

Finally, with respect to the fifth *Zenith* factor, payment of all or substantially all claims of creditors and interest holders under the plan, the Delaware courts do not appear to view satisfaction of this factor as critical to whether the release will be approved, particularly with respect to equity holders. *Compare Indianapolis Downs,* 486 B.R. at 304 (acknowledging the factor was not satisfied but approving the release) *with Washington Mutual*, 442 B.R. at 348

(finding release appropriate and noting that under the plan all creditors except the lowest subordinated class would receive payment in full, and although equity holders were not projected to recover anything, litigation against the released parties was unlikely to change that result).

II. Third Party Releases

A. Overview

Third party releases can be divided into two categories: (i) voluntary, where the party has consented, usually by some affirmative or implied act, to the imposition of a third party release and (ii) involuntary, where a non-debtor party is made to release its claims without its consent.

The Delaware courts have consistently held that a vote accepting a chapter 11 plan is a sufficient manifestation of consent to the giving of a voluntary third-party release to another non-debtor. *See Zenith*, 241 B.R. at 111 (approving non-debtor releases for creditors that voted in favor of plan); *Spansion*, 426 B.R. at 144 (recognizing that "[c]ourts have determined that a third party release may be included in a plan if the release is consensual and binds only those creditors voting in favor of the plan"); *In re Coram Healthcare Corp.*, 315 B.R. 321, 336 (Bankr. D. Del. 2004) (stating that plan "is a contract that may bind those who vote in favor of it...to the extent creditors or shareholders voted in favor of [the plan], which provides for the release of claims they may have against the Noteholders, they are bound by that").

The Delaware decisions are split on the issue of whether a creditor can provide voluntary implied consent. Certain decision have found that affirmative consent is necessary and implied consent (failure to return a ballot, being in a class that is deemed to accept the plan, or receiving a distribution under the plan) is insufficient to make such third party releases binding. *See Zenith*, 241 B.R. at 111; *In re Coram Healthcare Corp.*, 315 B. R. at 336; *Washington Mutual, Inc.*, 442 B.R. at 351. Other decisions have found implied consent where unimpaired

creditors failed to raise any objections to the releases. *See Spansion*, 426 B.R. at 143-44. And a more recent ruling found that impaired creditors can provide implied consent by failing to vote for or against the plan and by failing to opt out of the release after being provided an opportunity to do so. *See Indianapolis Downs*, 486 B.R. at 304-06.

The Delaware decisions are similarly split on the issue of whether non-consensual third party releases are permissible. Some decisions have held that the court cannot grant such releases. *See Zenith*, 241 B.R. at 111; *Washington Mutual, Inc.*, 442 B.R. at 351. Conversely, other decisions have found that such releases can be granted in extraordinary cases. *See In re Genesis Health Ventures*, 266 B.R. 591, 607-08 (Bankr. D. Del. 2001) (non-consensual releases by a non-debtor of other non-debtor third parties are to be granted only in "extraordinary circumstances."); *In re Exide Techs.*, 303 B.R. 48, 72 (Bankr. D. Del. 2003) (same); *Spansion*, 426 B.R. at 145.

B. Case Law

In *Zenith*, the plan included a third party release that would be binding on those creditors that (i) accepted the plan, (ii) were in a class that accepted the plan, or (iii) were to receive a distribution under the plan. *Zenith*, 241 B.R. at 111. The court found that such a release was impermissible absent the affirmative agreement of the creditor affected. *Id.* Therefore, the court held that the plan was required to be modified such that the third party releases were binding only on those creditors that actually voted in favor of the plan. *Id.* The fact that a creditor was a member of class that accepted the plan or that the creditor was to receive a distribution did not create the requisite affirmative consent. *Id.*

Thereafter in *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 213-14 (3d Cir. 2000), the Third Circuit faced the issue of the permissibility of non-consensual third party releases in a chapter 11 plan. The Third Circuit analyzed the case law and

found that the releases provided for in the case before it could not stand under "even the most flexible tests for the validity of non-debtor releases." Therefore, the Third Circuit found that it need not establish its "own rule regarding the conditions under which non-debtor releases and permanent injunctions are appropriate or permissible." *Id.* The Third Circuit left open the possibility that some small non-consensual third-party releases may be permissible where the release "is both necessary and given in exchange for fair consideration." *Id.* at 214, n.11. The Third Circuit identified the "hallmarks" of a permissible non-consensual third-party release as "fairness, necessity to the reorganization, and specific factual findings to support these conclusions[.]" *Id*. at 214.

In *Genesis Health*, the court noted that *Continental Airlines* left open the possibility that some small non-consensual third-party releases may be permissible and found that the determination of whether such a release was appropriate required an evaluation of the "hallmarks" of permissible non-consensual releases, namely whether: (i) the non-consensual release is necessary to the reorganization; (ii) the releasees have provided a critical financial contribution to the debtor's plan; (iii) the releasees' financial contribution is necessary to make the plan feasible; and (iv) the release is fair to the non-consenting creditors, *i.e.*, whether the non-consenting creditors received reasonable compensation in exchange for the release. *Genesis Health*, 266 B.R. at 607-608.

In *Exide Techs*. the court determined that the self-titled release provision was consensual because it was only binding on those creditors and equity holders that voted to accept the terms of the plan. *Exide Techs.*, 303 B.R. at 74. However, the court found that the so-called exculpation provision could be read to include third party releases by creditors that had not voted to accept the terms of the plan. *Id.* at 75. The court noted the four factors set forth in the

Genesis Health decision used to determine whether a case was an "extraordinary" case justifying the approval of non-consensual releases. *Id.* (citing *Genesis Health*, 266 B.R. at 607-08); *accord In re Tribune Co.*, 464 B.R. 126, 203-04 (Bankr. D. Del. 2011) (applying the *Continental Airlines*, *Genesis Health* test in determining whether non-consensual releases were appropriate). The court found that the proposed releasees had offered a small tip to the unsecureds and that such a contribution was not a substantial contribution that would permit approval of non-consensual releases by (i) impaired unsecureds or (ii) by creditors or interest holders that were not to receive any distribution under the plan and were deemed to reject. *Id.* at 75.

The issue of third party releases was revisited in *Coram Healthcare*. In *Coram Healthcare*, the proposed plan provided for payment in full in cash of all creditors (except to the holders of the debtors' outstanding unsecured notes) and for a substantial distribution to the shareholders (at least $40 million). *Coram Healthcare*, 315 B.R. at 335. The distributions were made possible by the substantial contribution (of $56 million) by the unsecured noteholders to the plan funding. *Id.* The plan provided releases to the noteholders, which they required as part of the funding. *Id.* The plan was overwhelmingly accepted by all creditors who voted on the plan and although the shareholder class rejected the plan, the majority of shareholders that did vote accepted the plan. *Id.* Notwithstanding the fact that creditors were to be paid in full and that the court found the releases to be fair and equitable, the court held that it did not have the power to grant a release of claims against the non-debtor noteholders on behalf of third parties. *Id.* However, the releases were binding on those parties that voted in favor the plan and the third party releases contained therein. *Id.* at 336 (holding that a plan "is a contract that may bind those who vote in favor of it … to the extent creditors or shareholders voted in favor of [the plan], which provides for the release of claims they may have against the Noteholders, they are bound

by that”). Once again, the court found that it was insufficient that a creditor was a member of class that accepted the plan or that the creditor was to receive a distribution. *Id.*

The issue of third party releases was revisited in *Spansion*. In *Spansion*, the proposed third party releases were binding upon, among others, (i) any creditor that voted to accept the plan, and (ii) any creditor that was unimpaired and presumed to have accepted the plan. *Spansion*, 426 B.R. at 143. There were no objections to the releases as they related to creditors that voted to accept the plan and the court noted that such releases were permissible. *Id.* at 144.

The United States Trustee objected to the third party releases to the extent they were binding upon parties that did not affirmatively consent to the release, including those creditors that were unimpaired and deemed to accept. *Id.* With respect to the unimpaired class, the court noted that no creditor or interest holder in that category objected to the plan and that “the silence of the unimpaired classes on this issue [was] persuasive.” *Id.* Because the unimpaired classes were being paid in full and did not object to the third party release, the court found that those parties received adequate consideration for the release and were thereby bound. *Id.*

The third party releases were also binding upon objecting creditors that were not entitled to any distributions under the plan. The court found that the contributions by the releasees did not rise to the critical financial contribution contemplated in *Continental* and *Genesis* that was needed to obtain approval of non-consensual releases and therefore denied the non-consensual third party releases. *Id.* at 145.

In *Washington Mutual* the court struck down the imposition of third party releases on creditors who did not submit a ballot. In *WaMu*, the debtors’ ballots contained an opt out

provision for third party releases, yet the plan provided that creditors would grant the releases regardless of their choice to opt out because the releases were essential to the global settlement that formed the basis of the plan. *Washington Mutual, Inc.*, 442 B.R. at 351. The court found that such a plan provision would not have been permissible. *Id* at 352.

In the face of almost all parties objecting, the *WaMu* debtors modified the plan so that creditors were given the choice to opt out of the third party releases, but those who opted out would not be entitled a distribution. *Id.* Moreover, creditors who did not submit a ballot would be deemed to have approved the third party releases. *Id.* at 355. The court found that the third party releases could not be binding on parties that did not return a ballot or were not entitled to vote on the plan. *Id.* The court stated that this default approval of the releases for those who did not return a ballot could not pass muster, "[f]ailing to return a ballot is not a sufficient manifestation of consent to a third party release." *Id.* (citing *Zenith*, 241 B.R. at 111 (finding that a release provision had to be modified to permit third parties' release of non-debtors only for those creditors who voted in favor of the plan)). The court therefore concluded that any third party release would be effective only with respect to those who affirmatively consented to it by voting in favor of the plan and not opting out of the third party releases. *Id.*

In the recent decision in *Indianapolis Downs*, the debtors' proposed chapter 11 plan contained third party releases that applied to parties who: (i) voted on the plan but did not opt out of the releases, (ii) had unimpaired claims and were deemed to accept the plan, or (iii) who were entitled to vote and did not submit a ballot or otherwise opt out of the releases. *Indianapolis Downs*, 486 B.R. at 304-05. The objecting parties argued that the releases were unenforceable absent the creditor's affirmative consent to such releases. *Id.* The United States

Trustee objected to the plan and argued that the third party releases were unenforceable absent affirmative consent. *Id.* at 305.

The court rejected the objecting parties' argument, stating that courts take a more flexible approach in determining whether third party releases are consensual and have approved third party releases even where returning a ballot was not a requirement for the releases or where impaired creditors abstained from voting or did not opt out of the releases. *Id.* The third party releases in question applied to certain unimpaired creditors who were deemed to accept the plan, and the court found that those creditors were bound by the releases because they received consideration for the releases based on the fact that their claims were being paid in full. *Id.* at 306; *accord Spansion, Inc.*, 426 B.R. at 144 (finding that a release was not overreaching to the extent it bound unimpaired classes deemed to accept the plan since those creditors were being paid in full and had received adequate consideration of the release)).

The third party releases also bound certain impaired creditors who abstained from voting on the plan, or who voted to reject the plan and did not otherwise opt out of the releases. *Id.* The court noted that the plan provided creditors with detailed instructions how to opt out of the third party releases. *Id.* The court found that those impaired creditors had an opportunity to opt out and their knowing failure to do so made the third party releases consensual. *Id.*

Notably, the third party releases in *Indy Downs* were not binding on creditors deemed to reject the plan and the court was therefore not required to rule on the permissibility of the releases as to those creditors. *Id.* at 304.

The Releases Sought Under the Joint Plan are Appropriate

I. <u>Debtor Releases are a Valid Exercises of the Debtors' Business Judgment</u>

The Plan will pay unsecured creditors in full as well as a recovery of twenty cents per share to all current shareholders.[1] All the requested releases therefore meet the fifth factor of *Master Mortgage* test (as adopted by the District in *Zenith*) under the facts and circumstances of the instant case. Additionally, because the vast majority of stakeholders in the case are unimpaired, there is a substantial majority of creditors that support the injunction, fulfilling the fourth *Master Mortgage* factor as well.

A. G&F

The Debtor's release of G&F is appropriate under the facts and circumstances of the case. G&F has served as the Debtor's corporate counsel throughout the financial turmoil and troubled times and has performed admirably in reducing the roadblocks on the path to a successful reorganization. Its activities both pre and post-petition have been integral to the exceptional result in the case.

G&F through its work in facilitating the successful reorganization has an identity of interest with the Debtor under the first *Master Mortgage* factor.

G&F through its representation of the Debtor has been instrumental in resolving issues with the SEC that would have derailed any attempt at a reorganization. The settlement G&F helped broker for the Debtor with the SEC will allow shareholders to make an additional ten cent per share recovery from a fairness fund. Additionally this arduous work was often uncompensated as G&F has substantial unsecured claims all for unpaid legal fees. Despite the increasing risk of nonpayment G&F was willing to continue as special counsel for the Debtor. G&F further benefitted the estate by agreeing to a discount of fifteen (15) percent on its

[1] The Debtor in conjunction with its corporate counsel G&F has also reached a settlement with the SEC that will allow for an additional 10 cent per share recovery for share holders affected by the inaccurate financial statements made prior to the bankruptcy case.

unsecured prepetition claims and on its administrative expense post-petition bills as well. Additionally, G&F has agreed to cap its fees for future advancement claims to available insurance. The Debtor also expects to continue utilizing G&F's services going forward. By doing all of the above G&F has made a substantial contribution of assets to the reorganization fulfilling the second factor of the *Master Mortgage* test as described in *Indianapolis Downs* and other cases in the District.

B. Garth Williams

As a current director of the Debtor there is an identity of interests between Mr. Williams and the Debtor to fulfill the first prong of the *Master Mortgage* test. A suit against Mr. Williams would likely include a derivative claim against the Debtor and would therefore deplete assets of the estate if the release was not granted.

Additionally, Mr. Williams has made a substantial contribution to the assets of the reorganization by settling the SEC's enforcement action against him which held the potential to prevent a successful reorganization.

C. E.B. White

Mr. White like Mr. Williams is a current director of the Debtor and therefore shares an identity of interests to fulfill the first prong of the *Master Mortgage* test.

Mr. White while not settling litigation with the SEC has also made a substantial contribution in the case by agreeing to provide backstop funds to ensure funding of the unsecured claims pool and the recovery to shareholders. The provision of backstop funds meets the second prong of the *Master Mortgage* test.

D. BHFC

BHFC shares an identity of interest with the Debtor, as the terms of the DIP loan facility require the Debtor to indemnify BHFC for all expenses in concerned with the extension of the financing, and the terms of the original secured loan contained a similar provision. A suit against BHFC would deplete the estate's assets as the Debtor will be faced with paying for litigation in connection with the case brought against BHFC, therefore the first factor of the *Master Mortgage* test is met.

Additionally like Mr. White, has also made a substantial contribution in the case by agreeing to provide backstop funds to ensure funding of the unsecured claims pool and the recovery to shareholders. The provision of backstop funds meets the second prong of the *Master Mortgage* test. BHFC also provided DIP financing which funded the successful sales process that has created the value to pay all unsecured creditors in full as well as provide for a substantial recovery to shareholders.

E. Rattus

Rattus shares an identity of interest with the Debtor in connection with her pre-petition service as a member of the Debtor's board of directors. The terms of her agreement with the Debtor, require the Debtor to indemnify Rattus for all expenses, including attorneys' fees, for any suit, cause of action, or claim brought against Rattus in connection with being a member of the board of directors. A suit against Rattus would deplete the estate's assets as the Debtor will be faced with paying for litigation and any damages in connection with the case brought against Rattus, therefore the first factor of the *Master Mortgage* test is met.

Additionally Rattus, is her capacity as a member of the Committee, has made a substantial contribution in the case by negotiating a 100% recovery for general unsecured

creditors and agreeing to reduce any claim ultimately allowed by 1%. Rattus has also agreed that if she is granted a release, she will not to disclose any information she has about the company's pre-petition activities, a precondition of BHFC and White's agreement to backstop the rights offering. These contributions satisfy the second prong of the *Master Mortgage* test.

F. Lurvy

Lurvy shares an identity of interest with the Debtor in connection with its pre-petition service as the Debtor's CPA. The terms of Lurvy's engagement letter with the Debtor require the Debtor to indemnify Lurvy for all expenses, including attorneys' fees, for any suit, cause of action, or claim (other than for gross negligence or willful misconduct) brought against Lurvy in connection with its CPA services. A suit against Lurvy would deplete the estate's assets as the Debtor will be faced with paying for litigation and any damages in connection with the case brought against Lurvy, therefore the first factor of the *Master Mortgage* test is met.

Additionally Lurvy, is it capacity as a member of the Committee, has made a substantial contribution in the case by negotiating a 100% recovery for general unsecured creditors and agreeing to reduce any claim ultimately allowed by 1%. Lurvy has also agreed that if it is granted a release, it will not to disclose any information it has about the company's pre-petition activities, a precondition of BHFC and White's agreement to backstop the rights offering. These contributions satisfy the second prong of the *Master Mortgage* test.

G. Dorian

Dorian shares an identity of interest with the Debtor because any suit against Dorian would implicate the Debtor. The Debtor holds all records related to Dorian's support of the Debtor's assessment of internal controls and financial reporting as the Debtor required that Dorian perform its services onsite using the Debtor's network. Any suit against Dorian would

deplete the estate's assets as the Debtor will be faced with expensive third party discovery, therefore the first factor of the *Master Mortgage* test is met.

Additionally Dorian, is it capacity as a member of the Committee, has made a substantial contribution in the case by negotiating a 100% recovery for general unsecured creditors and agreeing to reduce any claim ultimately allowed by 1%. Dorian has also agreed that if it is granted a release, it will not to disclose any information it has about the company's pre-petition activities, a precondition of BHFC and White's agreement to backstop the rights offering. These contributions satisfy the second prong of the *Master Mortgage* test.

III. The Third Party Releases are Appropriate as the Extraordinary Circumstances of the Case Warrant Non-Consensual Third Party Releases

There are extraordinary circumstances for granting a non-consensual third party release. Unimpaired classes have received adequate consideration. Unsecured creditors are being paid 100 cents and equity is in the money.

Like in *Spansion* the facts of this case include a large number of unimpaired classes that have not objected to the Third Party Release provisions of the plan. Those unimpaired classes have received adequate consideration for the release and should therefore be bound under the terms of the plan. The analysis in *Indianapolis Downs* also supports the conclusion that the Third Party Releases be binding on the unimpaired creditors. Additionally, those who have abstained from voting or voted to reject without otherwise opting out of the releases are bound following the holding of *Indianapolis Downs*. Here no class has been deemed to reject the plan, and as such only those voting to reject the plan should not be bound by the terms of the Third Party Releases.

In examining the *Genesis Health* factors, the third-party releases are necessary to the reorganization as subsequent litigation by shareholders that have remained silent throughout

the plan process will work to put the success of the Debtor's reemergence from bankruptcy in jeopardy. The potential for greater liability in connection with litigation that the Debtor would be an indispensable party to, will hang like the sword of Damocles above the Debtor's head. Under the second factor, all the Third Party releases involve parties that provided critical financial contributions to the plan either through backstop funding, reductions in the amount of their claims, or by reducing contingent liability to a liquidated amount through crucial settlements. Those critical contributions also were essential to the plan's feasibility as they fund the recovery of key constituencies and provided a fixed universe of claims. Finally, the fourth factor is also fulfilled as the unsecured creditors are being paid in full and equity is receiving a substantial distribution as well, a fair result under any definition.

For the reasons stated above the non-consensual Third Party Releases are appropriate in this extraordinary case.