

NEW VALUE PLANS

Insider Advantage and New Value Plans

Existing equity holders (often the same entrenched management already in control) could retain control over objections of the creditors by contributing "new value" under a cramdown plan in Chapter 11

Exclusivity allows them to file a Chapter 11 cramdown plan in which the insiders alone set the amount of the new value contribution

Typically give themselves the exclusive right to purchase all of the new equity, with the least amount of new money down, as much restructured debt as possible (creating leverage)

Creditors are deprived of the competitive benefits of testing the economic sufficiency of entrenched management's "new value" contribution and outside bidders are deprived of the opportunity to bid

The New Value Exception To The Absolute Priority Rule

The Absolute Priority Rule prevents the cramdown of a plan in which the holder of equity retain any property interest by virtue of their pre-petition interests, over the objection of a dissenting class of impaired unsecured creditors (or secured creditors, for that matter).

Many courts have held that in those instances where the equity holders inject new value into the reorganized debtor, the equity holders may retain their interest in property of the debtor to the extent that new value is added.

The Supreme Court has now decided that a plan violates the Absolute Priority Rule if it grants exclusively to prebankruptcy equity holders the opportunity to receive ownership interests in the reorganized debtor, over the objection of an impaired class. See *In re LaSalle Partnership* below.

"Although the Debtor's exclusive opportunity to propose a plan under section 1121(b) is not itself 'property' within the meaning of subsection (b)(2)(B)(ii), the respondent partnership in this case has taken advantage of this opportunity by proposing a plan under which the benefit of equity ownership may be obtained by no one but the old equity partners ... At the moment of the plan's approval the Debtor's partners necessarily enjoyed an exclusive opportunity that was in no economic sense distinguishable from the advantage of the exclusively entitled offeror or option holder. This opportunity should, first of all, be treated as an item of property in its own right."

In re: LaSalle Street Partnership (SC)

Case involved a contested confirmation of a Chapter 11 plan by a partnership which owned an office building in downtown Chicago

Facts: first mortgagee undersecured by \$38m+

Plan: limited partners proposed a new value plan in which they obtained 100% of the new equity

First mortgagee objected

Partnership sought cramdown confirmation (the "new value" exception to the absolute priority rule)

Prepared by Chand Sooran 10/15/11

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Outcome: plan confirmed by the Bankruptcy Court

Appeal: first mortgagee appealed to the Seventh Circuit, Bankruptcy Court decision affirmed

Second Appeal: first mortgage appealed to the Supreme Court

Supreme Court reversed the Seventh Circuit and denied confirmation of the plan

Without deciding whether the "new value exception" survived the enactment of the Bankruptcy Code

Held that equity holders could not retain the exclusive opportunity to contribute new capital over the objection of a senior class of impaired creditors without allowing anyone else either to compete for that equity or to propose a completing plan

Held that the best way to determine economic sufficiency was by exposure to the marketplace

If the equityholders' new value plan was best, it did not need the benefit of exclusivity

Implication: before existing equity holders can cram down a Chapter 11 plan during the exclusive period in order to retain control by contributing new value, it must test the economic sufficiency of such new value by exposing it to the marketplace

This can be done by allowing for bids from non-insiders

Alternatively, terminating exclusivity to entertain competing plans

