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Blackjewel and *Hartshorne*: Overcoming § 1129(a)(9) Obstacles

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In recent months, there has been confirmation of two unique liquidation plans for two different coal companies in their chapter 11 bankruptcy cases. On Feb. 17, 2021, in *In re Hartshorne Holdings LLC*,[2] the U.S. Bankruptcy Court for the Western District of Kentucky confirmed the debtors' liquidation plan. On March 22, 2021, the U.S. Bankruptcy Court for the Southern District of West Virginia confirmed the proposed liquidation plan in *In re Blackjewel LLC*.[3]

While Blackjewel and Hartshorne were both coal companies, the cases share another critical similarity. The debtors were unable to pay all administrative and priority creditors in full on the effective date of their respective plans as required by § 1129(a)(9) of the Bankruptcy Code. Notwithstanding what would have once been a fatal flaw, Blackjewel and Hartshorne were able to successfully achieve confirmation. Their plans preserved the priority of administrative-expense and priority claims, and provided for payment of such claims in strict accordance with the Code's priority scheme. The critical aspect of these plans was that the payment of such claims was dependent on, and limited by, the future availability of funds recovered by the liquidation trust established under each plan.

The outcome in these cases is particularly instructive for debtors facing the possibility of administrative insolvency or the lack of liquidity sufficient to satisfy all administrative expense claims in full on a plan's effective date. This was particularly the case for both Blackjewel and Hartshorne, in which the debtors and virtually all creditors in both cases agreed that the non-cash assets remaining in each estate would be monetized at a higher value, thereby yielding greater recoveries for creditors through a liquidation trust rather than a chapter 7 liquidation.

In this situation, a debtor should confront the restrictive requirements of § 1129(a)(9) to satisfy the debtor's charge to maximize the value of its assets for the benefit of all creditors, including administrative creditors, of the estate. This article focuses on § 1129(a)(9), the facts and circumstances that Blackjewel and Hartshorne faced in satisfying § 1129(a)(9), and the manner in which the Blackjewel and Hartshorne debtors resolved their issues.

Section 1129(a)(9)

Section 1129 sets forth the requirements that must be satisfied for a chapter 11 plan to be confirmed. One of those requirements is § 1129(a)(9)(A), which generally requires that claims entitled to priority under § 507(a)(2) and (3) of the Bankruptcy Code be paid in full in cash on the plan's effective date, unless each holder has agreed to a different treatment of its claim.[4] Section 507(a)(2) concerns administrative-expense claims allowed under §§ 503(b) of the Bankruptcy Code; § 507(a)(3) relates to otherwise-unsecured claims that are allowed under § 502(f) (claims incurred post-petition in an involuntary case). In *Blackjewel* and *Hartshorne*, only §§ 507(a)(2) and 503(b) were implicated because the debtors in both cases filed voluntary petitions.

In most chapter 11 cases, § 1129(a)(9) is satisfied by the debtor paying all of its allowed administrative claims in full in cash on or before the plan's effective date. However, there are instances that have become increasingly common in recent years where a debtor is unable to pay 100 percent of administrative claims in cash on the effective date. Under those circumstances, the debtor can only satisfy § 1129(a)(9) if all of the relevant claimholders have "agreed to a different treatment of [their administrative expense] claim." The key to satisfying § 1129(a)(9) under these circumstances is providing the court with evidence sufficient to demonstrate that such holders have agreed to accept treatment other than payment in full in cash on the effective date. This is generally a tall order, especially in cases involving a substantial number of unpaid administrative-expense claims.

Demonstrating Holders of Administrative-Expense Claims Have Agreed to Different Treatment

How can a debtor demonstrate that administrative creditors have agreed to treatment other than payment in full in cash on the plan's effective date? Despite a growing body of case law on

1 Squire Patton Boggs served as lead restructuring counsel to both Blackjewel and Hartshorne in their chapter 11 proceedings.
2 No. 20-40133 [Docket No. 881] (Bankr. W.D. Ky. Feb. 17, 2021).
3 No. 19-30289 [Docket No. 3147] (Bankr. S.D. W.Va. March 22, 2021).
4 Section 1129(a)(9)(B), (C) and (D) provides that claimants holding other types of priority claims, such as unsecured claims of governmental units associated with certain taxes and duties (or penalties related thereto) or unpaid wages and employee benefit claims earned within 180 days before the petition date (up to a $12,475 cap), are entitled to be paid in full unless such claimant consents to different treatment. The strategies discussed herein apply equally to all outstanding priority claims.

the topic, there is no clear consensus as to how a debtor can make this necessary showing. The most obvious and uncontroversial path is to obtain affirmative, written consent from each affected claimholder. Examples of how to achieve this include (1) providing administrative creditors with a specific consent form and asking that it be returned, and (2) creating a comprehensive administrative expense claim settlement protocol.

In *In re Barneys New York Inc.*,[5] the U.S. Bankruptcy Court for the Southern District of New York confirmed a plan where the debtors sought consent from administrative creditors using a straightforward consent form. In response to the Barneys debtors soliciting consent forms from holders of administrative-expense claims and priority claims, (1) 93 claimants affirmatively consented to receive less than full payment on account of their priority claims; (2) 17 claimants initially withheld consent to the proposed treatment (with nine of these claimants later deciding to support the plan); and (3) all other nonconsenting votes were either expunged pursuant to the Barneys debtors' omnibus claims objections or were determined to not be holders of an allowed administrative-expense claim. The court held that any other claimant's failure to object to the plan or to return the consent form was deemed to be such holder's consent to the proposed claim treatment under the plan.

In *In re Southern Foods Group LLC*,[6] the U.S. Bankruptcy Court for the Southern District of Texas confirmed the debtors' plan where administrative claimants were permitted to elect to receive less than the full amount of their asserted administrative-expense claim pursuant to a court-approved administrative-expense claim settlement protocol. The *Southern Foods* debtors received five § 1129(a) objections, which led them to accept that such objectors did not consent to receive a distribution less than the full amount of their asserted claims. Thus, the *Southern Foods* debtors agreed that such claimants would be paid the full amount of their claim in cash upon the later of the effective date or when the claim was allowed.

Otherwise, pursuant to the court's previous order approving the claim-settlement protocol, the *Southern Foods* debtors were permitted to pay administrative claimants 80 percent of their claims, which was accepted by hundreds of administrative claimants. The court held that any administrative claimant that did not respond to the claim-settlement protocol notices or otherwise failed to object to the plan was deemed to have consented to the proposed plan treatment.

Seeking affirmative consent can be risky. The failure of a single administrative claimholder to agree to different treatment could lead to (1) a rejection of the proposed different treatment, and/or (2) an objection under § 1129(a)(9), therefore resulting in a denial of confirmation. If a creditor rejects the request for consent and/or objects to the plan, the debtor must either resolve the objection through negotiation or object to the underlying claim (if a valid basis for objection exists). Alternatively, parties that receive the request to consent to a different treatment might simply fail to respond. The failure to respond or object to different treatment raises the question of whether consent may be implied.

Some courts have found that an administrative claimant's failure to either object to confirmation or return an election form can be deemed to constitute consent to different treatment. In both *Barneys* and *Southern Foods*, the courts held that those parties that did not respond or otherwise object to their treatment under the proposed plan had provided implied consent. This same implied consent construct is also how the debtors' plans were confirmed in *In re Specialty Retail Shops Holding Corp.*[7] and *In re Toys "R" Us Inc.*[8]

Section 1129(a)(9) Objections

Numerous holders of administrative-expense and priority claims filed objections to the proposed Blackjewel and Hartshorne liquidation plans based on the failure to satisfy § 1129(a)(9). Neither debtor obtained the affirmative consent of all holders of administrative-expense and priority claims.

In *Blackjewel*, 13 creditors filed formal objections to the liquidation plan before the confirmation hearing. Of the 13 objections, eight objections alleged, in part, that the debtors could not satisfy § 1129(a)(9). With respect to these eight objections, five objectors asserted administrative-expense claims earlier in the cases, and three objectors, including the Office of the U.S. Trustee, did not file an administrative expense application in the cases or otherwise demonstrate how or why it had a post-petition claim that should be granted administrative priority. The eight objectors asserted a combined total of hundreds of millions of dollars of purported administrative liabilities (most of which the Blackjewel debtors disputed), and included the Kentucky Energy and Environment Cabinet, the Kentucky Labor Cabinet, the U.S. Government and the sureties that had posted the debtors' reclamation bonds.

In *Hartshorne*, only one creditor, the debtor-in-possession (DIP) financing lender, objected to the debtors' liquidation plan due to the debtors' inability to pay its superpriority administrative expense arising from its DIP-financing claim in full and in cash on the effective date. As a result of extensive discussions between the Hartshorne debtors and holders of purported administrative-expense and priority claims prior to the plan-confirmation vote, no other creditor objected to Hartshorne's liquidation plan on § 1129(a)(9) grounds.

Confirming a Plan Despite § 1129 Issues

In *Blackjewel*, the debtors took a proactive approach to resolve concerns raised by the court and the objecting creditors regarding § 1129(a)(9). The Blackjewel debtors first undertook an effort to consensually resolve the objectors' § 1129(a)(9) objections. Next, and reminiscent of the approach in *Barneys*, the debtors sought court approval to solicit affirmative consent from all administrative-expense and priority creditors.

After the confirmation-objection deadline had passed and following concerns raised by the court regarding implied consent in general, the Blackjewel debtors request-

5 No. 19-36300 (CGM) (Bankr. S.D.N.Y. Feb. 5, 2020).
6 No. 19-36313 (DRJ) (Bankr. S.D. Tex. March 17, 2021).
7 No. 19-80064 (TLS) (Bankr. D. Neb. June 11, 2019).
8 No. 17-34665 (KLP) (Bankr. E.D. Va. Nov. 21, 2018).

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ed court approval to send administrative-expense and priority tax claimants a notice explaining the requirements of § 1129(a)(9), the proposed treatment under the plan, and a consent form to be completed by each claimant acknowledging the claimant's agreement with the plan's treatment of the claim. The consent form included a section for claimants to affirmatively state whether they accepted or rejected the treatment of their claims under the debtors' proposed liquidation plan. The court approved the consent form and related procedures.

Over the next month and a half, Blackjewel and its advisors received completed consent forms and answered creditor questions. While the majority of creditors who returned consent forms agreed to the treatment of their claims under the plan, several creditors returned consent forms rejecting the treatment of their claims. Blackjewel conducted lengthy negotiations with the objectors, which required the debtors to adjourn the confirmation hearing several times. Blackjewel eventually reached agreements with all objectors who asserted administrative-expense and priority claims to withdraw their § 1129(a)(9) objections to the plan and change their consent form responses to agree to the proposed treatment under the plan. Lastly, Blackjewel argued that objectors, such as the U.S. Trustee, who did not allege that they had administrative-expense and priority claims, did not have standing to assert § 1129(a)(9) objections and that their consent was not required.

At the outset of the Blackjewel confirmation hearing, the court echoed its previous § 1129(a)(9) reservations, stating that the *Blackjewel* cases presented "almost insurmountable nonbankruptcy issues, in addition to difficult issues under the Bankruptcy Code," and that "the standards of § 1129(a)(9) ha[d] troubled the court throughout the case" and "implied consent is acceptable in limited circumstances." But due to the Blackjewel debtors' success in resolving all § 1129(a)(9) objections, and the court finding that "the potentially largest priority claims have affirmatively consented to treatment and in fact support confirmation," the court held that all "creditors holding claims governed by § 1129(a)(9) have agreed to the treatment provided in the plan," and therefore were deemed to have consented to accept less than payment in full on the effective date.

In connection with the Blackjewel debtors' efforts to resolve, among other issues, the § 1129(a)(9) obstacles, the court noted that the "[d]ebtors' professionals and fiduciaries were faced with extraordinary circumstances, and the court commend[ed] them on the efforts they have made restructuring, and the resulting plan as amended in the proposed confirmation order." Several minutes later, after stating that "the affected constituencies and the major constituencies holding [administrative-expense and priority claims] have better prospects under confirmation of a liquidating plan," the court confirmed Blackjewel's liquidation plan.

In *Hartshorne*, which involved only one § 1129(a)(9) objection, the debtors decided that it was unnecessary to seek approval of a consent procedure. Instead, the debtors successfully negotiated a global resolution with the objecting lender, resulting in the withdrawal of the objection. Aided by the fact that the solicitation versions of the liquidation plan and disclosure statement were served on creditors more than four months before the final confirmation hearing and that no other party opposed confirmation, the court found that the record established the implied consent of all other administrative-expense and priority creditors, and held that each had agreed to the different treatment provided in the plan.

Key Takeaways

Section 1129(a)(9) promises to continue being a thorny issue for many chapter 11 debtors. In the wake of the COVID-19 pandemic, government support of businesses will fade in the coming months. As a result, full cash distributions to holders of administrative-expense and priority claims upon plan confirmation will remain challenging. However, the *Blackjewel* and *Hartshorne* cases show a path forward. Admittedly, § 1129(a)(9) issues can be difficult to resolve and can threaten to derail confirmation of a debtor's plan, especially in situations where the debtor has significant, unliquidated assets that need to be, or would be best to have them be, liquidated in a post-confirmation environment.

The *Blackjewel* and *Hartshorne* cases also demonstrate that there is no one-size-fits-all solution for how to satisfy § 1129(a)(9). Rather, practitioners must consider the varied approaches that have had some level of success and the relative strengths and weaknesses of each approach (*e.g.*, a court might be unwilling to imply consent from creditors that do not specifically agree to the proposed treatment under the plan, and/or the very process of attempting to receive consent from creditors can lead to an increase in the number of § 1129(a)(9) objections that need to be resolved). Most importantly, however, practitioners facing a § 1129(a)(9) dilemma must remain flexible and creative to construct a feasible solution that allows the court to determine that the proposed plan is confirmable. While the court will ultimately determine whether § 1129(a)(9) is satisfied by a debtor, the outcomes in both *Blackjewel* and *Hartshorne* demonstrate that a plan can be confirmed despite an inability to pay administrative claims in full on the plan's effective date. abi