UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	
	:	Chapter 11
TRANS WORLD AIRLINES, Inc., *et al*	:	
	:	Case Number 01-0056 (PJW)
	:	
Debtors.	:	Jointly Administered
	:	**Hearing Date: 3/21/2002 at 10:30 a.m.**
	:	**Objection Deadline: 3/1/2002 at 4:00 p.m.**

UNITED STATES TRUSTEE'S OBJECTION TO CONFIRMATION OF DEBTORS' THIRD AMENDED JOINT LIQUIDATING PLAN OF REORGANIZATION (D.I. 2890)

In support of his Objection to Confirmation of the Debtors' Third Amended Joint Liquidating Plan of Reorganization (the "Plan"), Donald F. Walton, Acting United States Trustee for Region 3 ("UST"), by undersigned counsel, avers as follows:

1. This Court has jurisdiction to hear the above-referenced Objection.

2. Pursuant to 28 U.S.C. § 586, the UST is charged with overseeing the administration of Chapter 11 cases filed in this judicial district, including, at the UST's discretion, monitoring plans filed in Chapter 11 cases and filing comments in connection with hearings on such plans pursuant to 28 U.S.C. § 586(a)(3)(B). This duty is part of the UST's overarching responsibility to enforce the bankruptcy laws as written by Congress and interpreted by the courts. *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 UST 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 UST as a "watchdog").

3. Pursuant to 11 U.S.C. § 307, the UST has standing to be heard with regard to the above-referenced Objection.

BASIS FOR RELIEF

Relevant Procedural Law

4. "After notice, the court shall hold a hearing on confirmation of a plan." 11 U.S.C. § 1128(a).

5. "A party in interest may object to confirmation of a plan." 11 U.S.C. § 1128(b).

6. An objection to confirmation is governed by Rule 9014 and "shall be filed and served on the debtor, the trustee, the proponent of the plan, any committee appointed under the Code and any other entity designated by the court, within a time fixed by the court." FED. R. BANKR. P. 3020(b)(1).

7. The court shall rule on confirmation of the plan after notice and hearing as provided in Rule 2002. If no objection is filed, the court may determine that the plan has been proposed in good faith and not by any means forbidden by law without receiving evidence on such issues." FED. R. BANKR. P. 3020(b)(2). Even if no objection is filed, however, the Court has an obligation to determine that a plan complies with the appropriate sections of the Bankruptcy Code. *In re Fesq*, 153 F. 32 113, 120 (3d Cir. 1998) *citing In re Szostek*, 886 F.2d 1405, 1414 (3d Cir. 1989).

Relevant Substantive Law

8. The Court may confirm a plan under Chapter 11 only if each of the thirteen enumerated requirements of 11 U.S.C. § 1129(a) are met. A limited exception is made if the requirements of 11 U.S.C. §1129(a)(8) (requiring acceptance by all impaired classes of claims or

interests) is not met, permitting confirmation under 11 U.S.C. § 1129(b) (the so-called cram-down provisions) if the provisions of that subsection are met.

9. The UST objects to the Plan on the grounds that it is unconfirmable on its face, failing to meet several requirements of 11 U.S.C. § 1129(a).

10. First and most important, the Plan does not meet the requirements of 11 U.S.C. § 1129(a)(9).[1]

(a) The Plan specifically provides that on the effective date of the Plan, holders of administrative expense claims will not be paid in full as required under section 1129(a)(9), but will receive only a *pro rata* distribution of cash available for that purpose. Thereafter, they will receive periodic distributions as cash availability permits, either until

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[1] Section 1129(a)(9) of the Bankruptcy Code permits confirmation only if:

> Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that— "
>
> (A) with respect to a claim of a kind specified in section (507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;
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> (B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7), of this title, each holder of a claim in such class will receive —
>
> (i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim;
>
> (ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and
>
> (C) with respect to a claim of a kind specified in section (507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

their claims are paid in full or until the assets of the post-confirmation estate are exhausted. Administrative expense claims will be paid in full only if the "high recovery liquidation" projections, set forth in Exhibit C to the Disclosure Statement, hold true. If the "low recovery liquidation" projection prevails, administrative expense claimants will not be paid in full. Administrative expense claims are not classified and holders of such claims were not permitted to vote to accept or reject the plan.

(b) The Plan provides that priority tax claimants will receive similar treatment after establishment of sufficient reserves for administrative expense claims, *i.e.*, they will receive an initial *pro rata* distribution of cash, followed by periodic distributions as and when funds are available until their claims are paid in full or until the assets of the post-confirmation estate are exhausted. It appears from Exhibit C to the Disclosure Statement that priority tax claims will not be paid in full under any circumstances. Priority tax claims are not classified and holders of such claims were not permitted to vote to accept or reject the plan.

(c) The Plan provides that other priority claimants will also receive an initial *pro rata* distribution of cash, followed by periodic distributions as and when funds are available until their claims are paid in full or until the assets of the post-confirmation estate are exhausted. It appears from Exhibit C to the Disclosure Statement that other priority claims also will not be paid in full under any circumstances; the Debtors' "high recovery liquidation" scenario projects a maximum distribution of 18% on account of such claims. Other priority claims are listed in the Plan as Class 3 claims. Because the Debtors deem Class 3 claims to be unimpaired, holders of such claims were not permitted

to vote to accept or reject the plan; the Debtors assert that those holders are deemed to have accepted the Plan under 11 U.S.C. § 1126(f).

(d) The Debtors' Plan imposes the foregoing treatment of holders of administrative and priority claims by providing that their failure to object to confirmation of the Plan "shall be deemed to be such Holder's agreement to receive treatment for such Claim that is different from that set forth in 11 U.S.C. §1129(a)(9)."

(i) Indeed, the Debtors have deprived holders of Class 3 claims of the ability to vote to accept or reject the plan by cobbling together a chain of tenuous "deemer" provisions: Class 3 claims are deemed to be unimpaired and therefore not entitled to vote because the holders of such claims are deemed to have agreed to treatment different from that required under Section 1129(a)(9).

(e) The requirements of 11 U.S.C. § 1129(a)(9) are mandatory; they do not require any action on the part of administrative and priority claimants to receive the treatment to which they are statutorily entitled. The failure of a holder of an administrative or priority claim to object to plan confirmation cannot be deemed an agreement to such treatment; rather, the Debtors must provide the Court with evidence that each affected claimant has individually and affirmatively agreed to the adverse treatment. *In re Digital Impact*, 223 B.R. 1, 7 (Bankr. N.D. Okla. 1998).

(f) In an attempt to shift the burden to administrative and priority claimants, Debtors relied at the disclosure statement hearing, and will doubtless rely at the confirmation hearing, on a number of inapposite authorities, only one of which even addresses section 1129(a)(9) and all but two of which are Chapter 13 cases. *In re Ruti-*

Sweetwater, Inc., 836 F.2d 1263 (10th Cir. 1988), involved the treatment of a secured creditor, not an administrative or priority claimant. The Code expressly provides that the plan may modify the rights of secured creditors, as the debtor in *Ruti-Sweetwater* did without objection. *See* 11 U.S.C. §1123(b)(5). In contrast, no such statutory authority exists with respect to administrative or priority claims.

(g) Furthermore, the issue before the court in *Ruti-Sweetwater* was a voting issue as to an impaired class, not a distribution issue as to a type of claim that statutorily may not be impaired without the individualized consent of each party affected. The solitary holding of *Ruti-Sweetwater* was that the impaired class (of which the nonvoting, non-objecting creditor was the sole member) would be deemed to have accepted the plan for purposes of section 1129(a)(8) of the Code, so that a cramdown hearing was not required. In *Digital Impact, supra*, which does expressly address section 1129(a)(9), the court distinguished *Ruti-Sweetwater* on precisely this ground.

(h) The UST further notes that *Ruti-Sweetwater* is not even persuasive authority within the boundaries of its holding. Numerous courts have distinguished or refused to follow *Ruti-Sweetwater*, disagreeing with its expansive concept of a "deemed acceptance." *See In re Jim Beck, Inc.*, 207 B.R. 1010, 1013 (Bankr. W.D. Va. 1997) (criticizing *Ruti-Sweetwater* on the ground that it "ignores Code analysis and is, basically, result orientated [sic]"); *In re 7th Street & Beardsley Partnership*, 181 B.R. 426 (Bankr. D. Ariz. 1994) (finding *Ruti-Sweetwater* not to be the law in the Ninth Circuit); *In re Higgins Slacks Co.*, 178 B.R. 853, 856 (Bankr. N.D. Ala. 1995) (rejecting the Tenth Circuit's ruling in *Ruti-Sweetwater* as "result oriented" and "clearly a case of the tail

wagging the dog"); *In re Friese*, 103 B.R. 90, 92 (Bankr. S.D.N.Y. 1989) (rationale of *Ruti-Sweetwater* is "faulty").

(i) Debtors also cite *Behles-Giddens v. Raft (In re K.D. Company)*, 254 B.R. 480 (B.A.P. 10th Cir. 2000), which held that an although a plan did not comply with section 1129(a)(9), an administrative claimant could not collaterally attack the plan by moving to revoke the confirmation order after the plan was confirmed without objection. *Behles-Giddens* is distinguishable in that it involved a collateral attack on an already-confirmed plan, not an objection asserted before confirmation.

(j) Debtors cite five Chapter 13 cases, *In re Anderson*, 179 F.3d 1253 (10th Cir. 1999); *Szostek, supra*; *In re LaForgia*, 241 B.R. 351 (Bankr. M.D. Pa. 1999); *In re Facciponte*, 1992 WL 722289 (Bankr. N.D.N.Y. October 7, 1992); and *In re Herbert*, 61 B.R. 44 (Bankr. W.D. La. 1986). All five of those cases are inapposite for reasons set forth in plain language in the Third Circuit's opinion in *Szostek*. The confirmation requirements for Chapter 13, found at section 1325(a) of the Code, are not mandatory, unlike the corresponding requirements for Chapter 11. As the Court of Appeals stated clearly in *Szostek*:

> Review of a comparable bankruptcy section, one dealing with the confirmation of chapter 11 plans, supports the conclusion that § 1325(a) is not mandatory. The text of 11 U.S.C.A. § 1129 specifically states that "The court shall confirm a plan *only if* all of the following requirements are met".... (Emphasis added.) Thus, the distinction between § 1322 and § 1325(a) and the inclusion of the "only if" language in § 1129, which is absent from § 1325(a), show an unmistakable intent on the part of Congress that a plan may be confirmed even if it does not comport with the requirements of § 1325(a)(5).

886 F.2d at 1411.

(k) In contrast, the requirements of section 1129(a) are mandatory. The law in this district is that the proponent of a Chapter 11 plan ". . . bears the burden of establishing the plan's compliance with each of the thirteen elements of 11 U.S.C. §1129(a)." *In re Genesis Health Ventures*, 266 B.R. 591, 598-99 (Bankr. D. Del. 2001).

(l) Additionally, in all of the cases cited by the Debtors, the issue of failure to comply with applicable Bankruptcy Code provisions was first raised after the plans were confirmed, so that the courts were faced with requests for relief in the nature of revocation of confirmation for grounds other than the extremely limited grounds for which revocation is permitted. In each case, such relief would have upset previously confirmed – and in some cases fully performed – plans. The deciding factor in every one of those cases was that the plan had already been confirmed without anyone (including the courts) having spotted the defects before confirmation. The courts simply declined to allow collateral attacks on confirmed plans.

(m) Here, in contrast, the attack on the Plan is direct and is being made before confirmation– precisely the stage where each of the Debtors' cited authorities hold that the issue must be raised.. The UST and several administrative and tax priority claimants have raised the issue of failure to comply with applicable provisions of the Bankruptcy Code before confirmation; the Court is aware of the issues and has itself expressed reservations about the confirmability of the Plan. Thus, a critical element of Debtors' case law supporting the concept of "deemed agreement" by claimants to receive less than

is required by section 1129(a)(9) is missing: there is no question of upsetting a previously confirmed plan.

11. Aside from the issue of the Plan's failure to comply with 11 U.S.C. § 1129(a)(9) (which even in the absence of claimant objections cannot be overlooked now that the deficiency has been brought to the Court's attention), the Plan itself provides that it cannot be confirmed. Article XIV, Section A2 of the Plan imposes the following condition precedent to confirmation:

> The Holders of all Administrative and Priority Claims have consented to or have been deemed to consent to the treatment set forth in Article IV of the Plan, including without limitation their potential receipt of less that the full amount to which they would otherwise be entitled under the Bankruptcy Code.

Moreover, although Article XIV, Section C of Plan purports to reserve the Debtors' right to waive conditions precedent, the Debtors have agreed to forgo the right to waive the condition precedent set forth in Article XIV, Section A-2; they did so on the record at the January 10, 2001 Disclosure Statement hearing.

12. Because they cannot waive the condition precedent set forth in Article XIV, Section A-2 of the Plan, the Debtors have only three possible ways to resolve the objections of administrative and priority claimants.

(a) The Debtors may use their powers of persuasion to convince those claimants to withdraw their objections without additional consideration and to accept only whatever treatment is being provided to non-objecting administrative and priority claimants.

(b) The Debtors may buy off the objecting administrative and priority claimants by paying them a higher percentage of their claims, or even paying them in full, but doing so is not an appropriate solution for at least three reasons:

(i) First, the Plan does not expressly provide for or authorize full payment to such dissenting claimants; it only permits *pro-rata* payment out of funds available for distribution.[2/] In order to pay dissenting administrative and priority claimants more than their *pro rata* share of Post Confirmation Estate Assets available for distribution, the Debtors would be required to modify the Plan and Disclosure Statement and re-solicit voting, because such payments would alter the treatment to be received by all administrative and priority claimants in a manner not authorized in the Plan or explained in the Disclosure Statement. Simply put, the objecting claimants would receive more than their *pro rata* share, while all other claimants in the same category or class would have to receive less than their *pro rata* share. The non-objecting administrative and priority claimants would not receive a *pro rata* share of Post Confirmation Estate Assets available for distribution, they would receive only a *pro rata* share of what is left of those assets after buying off the dissenting claimants.

[2/]Technically, the Plan permits the Debtors to pay administrative and priority claimants their *pro rata* share of Post Confirmation Estate Assets available for distribution or to "satisfy and discharge such ... Claim in accordance with such other terms as may be agreed upon by and between the Holder thereof and the Debtors or the Plan Administrator, as the case may be." However, for reasons discussed above, this would only permit payments of less than a claimant's *pro rata* share, not more.

(ii) Second, such a remedy would merely replace an inadequate treatment with a discriminatory one, thereby violating 11 U.S.C. § 1123(a)(4). Even if non-objecting administrative and priority claimants are deemed to have agreed to accept less than they are entitled to receive under Section 1129(a)(9) (and they should not be), there is no basis for deeming them to have agreed to accept treatment unequal to that received by similarly situated claimants.

(iii) Third, buying off administrative and priority claimants who object to confirmation does nothing to address the Plan's inherent flaw, that the Debtors have an obligation under the Code to obtain claimants' agreement to non-conforming treatment; it does not authorize the debtors to foist such an agreement off on them by way of a dubious "deemer" provision. The Bankruptcy Code places the burden of obtaining claimants' agreement to non-conforming treatment on the Debtors; it does not require any action at all for administrative and priority claimants to receive conforming treatment. The Debtors cannot transmogrify their burden of obtaining agreement into the claimants' burden of objecting to non-conforming treatment.

(c) The Debtors might attempt to delay the effective date of the Plan while continuing to liquidate assets, in hopes of obtaining sufficient funds to make complying payments. This would not work for two reasons:

(i) First, the Debtors' own projections indicate that even in a "high recovery liquidation" scenario, the best they could hope for would be to pay

administrative expense claims in full and to pay priority claimants 18% of their claims. No amount of delay could make the Plan comply with Section 1129(a)(9).

(ii) Second, such a delay would distort the concept of the effective date beyond recognition. It is well settled that the effective date must be certain and reasonably close to confirmation (the expiration of the appeal period being the typical formulation), so that debtors cannot seek confirmation of a plan that speculates on creditor recoveries with creditors bearing all the risks. *In re Potomac Iron Works*, 217 B.R. 170 (Bankr. D. Md. 1997) (one year delay unreasonable); *In re Krueger*, 66 B.R. 463 (Bankr. S.D. Fla. 1986) (four month delay unreasonable because it defeats the purpose of the statutory provisions regarding payment of tax claims); *see also In re Yates Development, Inc.*, 258 B.R. 36 (Bankr. M.D. Fla. 2000) (collecting cases).

13. The Plan also discriminates unfairly among administrative claimants by giving preferential treatment to Paid Administrative Claims (defined in the Plan as administrative expense or priority claims to the extent that the holder received payment out of property of the Debtors or the estate before the effective date of the Plan) by providing in Article III-E of the Plan that all payments made on account of Paid Administrative Claims shall be final and not subject to disgorgement. Thus, any administrative or priority claimant that has already been paid more than it would be paid in the *pro rata* distribution proposed in the Plan (including payments made between now and the effective date of the Plan) would be permitted to retain such payments at the expense of other claimants in the same class or category, who will receive only a *pro rata* share of a smaller pool of funds. Those who were paid early – especially those who

were paid in full – will be treated far more favorably than those who have not yet been paid. No rationale exists for such disparate treatment, which discriminates in violation of 11 U.S.C. § 1123(a)(4). It should also be noted that such treatment provides a financial boon for those bankruptcy professionals whose fees are being paid by the estate; as of Mid-January 2002, they had already been paid nearly $25 million.

14. The Plan violates the absolute priority rule set forth in 11 U.S.C. § 1129(b)(2)(B), applicable because at least one class of interests (equity security holders) is deemed not to have accepted the Plan. As addressed in the preceding paragraph, the Plan's treatment of Paid Administrative Claims allows payment of some priority claims ahead of administrative expense claims. The Plan also provides for distribution to general unsecured creditors of 3.33% of Preference Action Recoveries, before payment in full of administrative expenses and priority claims. Because administrative claimants will not be paid in full on the effective date of the Plan as required by 11 U.S.C. § 1129(a)(9)(A), and because priority claims will not be paid the full present value of their claims as required by 11 U.S.C. § 1129(a)(9)(B) and (C), no distribution may be made to general unsecured creditors under the Plan.

WHEREFORE, the UST requests that this Honorable Court deny confirmation of the Debtors' Plan and grant such other relief as this Court deems appropriate.

Respectfully submitted,

DONALD F. WALTON
ACTING UNITED STATES TRUSTEE, REGION 3

Dated: March 1, 2002

BY: /s/ Mark S. Kenney

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CERTIFICATE OF SERVICE

I certify that, on March 1, 2002, I caused to be served a copy/copies of the United States Trustee's Objection to Confirmation of the Debtors' Third Amended Joint Liquidating Plan of Reorganization via facsimile to the following person(s):

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