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Same Class, Different Recoveries-No Bar To Plan Confirmation

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Equal treatment of claims in the same class within a plan of reorganization is an important creditor protection in Chapter 11. However, is it possible to provide certain benefits to some creditors within a single class and not others without running afoul of the Bankruptcy Code? In a recent ruling on an issue of first impression, the U.S. Court of Appeals for the Eighth Circuit certainly made clear it thought so in *Ad Hoc Committee of Non-Consenting Creditors v. Peabody Energy, (In re Peabody Energy),* No. 18-1302, 2019 U.S. App. LEXIS 23824 (8th Cir. Aug. 9, 2019). In *Peabody*, the Eighth Circuit held that a debtors' Chapter 11 plan complied with Bankruptcy Code Section 1123(a)(4) (which mandates that a plan provide the same treatment to all members of a particular class), despite providing more favorable treatment to creditors that agreed to backstop a rights offering by paying the participating creditors significant premiums and allowing them to purchase preferred stock at a deep discount.

Peabody Energy Corp., a coal company, and certain of its affiliates filed voluntary Chapter 11 bankruptcy petitions during a time of falling demand and prices in the industry that resulted in a steep decline in the debtors' revenues. At the time of the bankruptcy filings, there was an ongoing dispute between several of the debtors' secured and senior-unsecured creditors over the extent to which the debtors' assets served as collateral for the secured creditors' debts. After filing for bankruptcy protection, the debtors commenced an adversary proceeding seeking a declaratory judgment regarding that dispute. The mediation that followed expanded beyond resolution of the security-interest fight and ultimately culminated in a global settlement that included a proposed plan of reorganization as its centerpiece.

The proposed plan sought to deleverage the debtors' balance sheet and included, among other things, a $1.5 billion equity raise through a $750 million backstopped rights offering of common stock and $750 million backstopped private placement that involved an exclusive sale of discounted preferred stock to qualifying creditors. Under the $750 million backstopped private placement, creditors could qualify to buy the preferred stock by executing certain agreements that obligated them to: buy a set amount of preferred stock; agree to backstop the rights offering and private placement (i.e., purchase the unsold shares of common and preferred stock); and support the plan in the confirmation process. The amount of preferred stock qualifying creditors could and were required to buy depended on the portion of the pre-bankruptcy debt they held and on how swiftly they took action to qualify. In addition to purchasing the preferred shares at a discount, qualifying creditors also received several

payment premiums for executing the agreements. In short, the creditors received preferred stock at a discount and significant premiums in exchange for their prompt agreement to backstop the arrangement and support the bankruptcy plan. Regardless of whether a creditor participated in the private placement, it would receive the same distributions as other creditors in its class under the plan.

The bankruptcy plan was supported by an overwhelming majority of the debtors' creditors and all 20 classes of creditors voted in favor of the plan. Nevertheless, a group of creditors that had proposed an alternative reorganization plan opposed the backstopped private placement of preferred stock and objected to confirmation of the debtors' plan. The objecting creditors argued that the right of qualifying creditors to participate in the private placement constituted unequal treatment for their claims in contravention of Bankruptcy Code section 1123(a)(4). The bankruptcy court overruled the objection and confirmed the plan. The objecting creditors appealed.

While the appeal was pending, the debtors began consummating the confirmed plan by, among other things, taking in the $1.5 billion equity raise and distributing millions of shares of preferred and common stock to compensate those investors, receiving $1.5 billion in exit financing, and making $3.5 billion in claim distributions pursuant to the plan. Against that backdrop, the district court found that the objecting creditors' appeal was equitably moot. Alternatively, the district court affirmed the ruling of the bankruptcy court, finding that the plan satisfied the equal-treatment requirement of Bankruptcy Code Section 1123(a)(4) and had been proposed in good faith.

The objecting creditors appealed to the circuit court. Rather than taking the perhaps easier route of reviewing the district court's finding that the appeal was equitably moot, the Eight Circuit opined on the merits and affirmed the ruling of the district court that the plan satisfied the equal-treatment requirement and had been proposed in good faith.

In reviewing the propriety of the private rights offering, the circuit court noted, among other things, that: all creditors, including the objecting creditors, had the opportunity to participate in the private placement; the participating creditors provided consideration in promising to support the plan and backstopping the stock offerings; the debtors analyzed other alternatives before pursuing the plan that was ultimately confirmed; and the official committee of unsecured creditors independently reviewed and rejected the competing plan proposals of the objecting creditors.

Under the facts and circumstances before it, the Eighth Circuit found that the right to participate in the private placement was not treatment for the creditors' claim, but rather was consideration for valuable new commitments to support the plan and backstop the offering of both preferred and common stock. The court held therefore, that even under a de novo standard of review the plan did not violate the equal treatment requirement of Bankruptcy Code Section 1123(a)(4).

The Eighth Circuit also found that the bankruptcy court did not commit clear error in finding that the debtors proposed their plan in good faith where the plan embodied the global settlement resolving the significant security-interest dispute that paved the way to reorganization; enjoyed the overwhelming support of creditors; and was compared by the debtors and official committee against alternative plans. Although it was feasible the debtors may have made more money selling the stock at full price, the debtors efforts at reorganization would have faced tremendous cost and uncertainty as the testimony showed that any delay in confirmation would likely cost the

debtors approximately $30 million per month, plus the litigation expenses related to resolving the security-interest dispute that had been resolved on a consensual basis through the confirmed plan. Accordingly, the court left the good faith factual finding undisturbed.

The Eighth Circuit's decision in *Peabody* joins decisions from the Second, Fifth and Ninth circuits in ruling that a plan may treat one set of claim holders within a single class more favorably than another so long as the treatment is not for the claim but for distinct, legitimate rights or contributions from the favored group separate from the claim. As bankruptcy cases continue to grow in size and complexity, creative approaches such as that employed in *Peabody* are certain to be utilized in efforts to salvage businesses in troubled industries.

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