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BANKRUPTCY UPDATE

Expert Analysis

Dewey Clawback Settlement Approved, GM Restructuring Questioned

By **Edward E. Neiger**

Today's column updates readers on major events that transpired in the high-profile bankruptcy proceedings of Hostess Brands, Eastman Kodak, Vertis, Solyndra, Dewey & LeBoeuf and General Motors. Among other things, the column focuses on Hostess Brands' and Solyndra's recently filed plans of reorganization, notable settlements reached in Eastman Kodak's and Dewey & LeBoeuf's bankruptcy proceedings and a lawsuit which seeks to unravel General Motor's entire restructuring. The column also discusses the recent bankruptcy filing of Vertis, which seeks to use the bankruptcy process to sell its assets to Quad/Graphics.

Hostess Brands

Hostess Brands Inc., the well-known Twinkies and Wonder Bread maker, commenced its second bankruptcy on Jan. 11, 2012, to address its burdensome debt and pension costs.

On Oct. 11, 2012, Hostess filed a Chapter 11 bankruptcy plan, which, if approved by the Bankruptcy Court, will leave unsecured creditors and major equity holders with zero recovery and cut workers' pay. The company hopes to emerge from bankruptcy in January 2013.

The plan provides that Hostess must generate enough cash through asset sales or via a lender or investor to satisfy obligations under the plan (set forth below) and maintain ongoing operations. The bankruptcy restructuring and cash infusion will reduce Hostess' secured debt obligations and de-leverage the company's balance sheet. Hostess hopes this will allow it to implement key operating initiatives and modernize its business.

Hostess stated that it reached agreements on its plan of reorganization with many key stakeholders and is continuing discussions with other major constituencies, most of whom will have to make significant sacrifices. Under the plan, the company's largest equity owners, who invested $150 million since 2009, will receive no distribution on account of their interests. Holders of general unsecured claims will likewise not receive a distribution. Holders of fourth-lien notes, with a principal balance of more than $230 million, will also not recover any money under the plan. Holders of third-lien term notes, with a principal balance of more than $190 million, are slated to receive new third-lien term notes, which are expected to be valued well below the face amount. The third-lien noteholders are also slated to receive 75 percent of the reorganized equity.

Union and non-union employees will both be subject to 8 percent wage cuts in the first year following emergence from bankruptcy under the plan. Union-represented employees will receive 25 percent of equity in the reorganized company and a $100 million new third-lien note to be paid pari passu with new third-lien notes granted to current holders of third-lien notes. The union will also receive two seats on the reorganized company's board of directors. Finally, Hostess will withdraw from its multi-employer pension plans, freeze its pension contributions for two years and reduce its contributions post-freeze. The only constituencies not materially adversely affected by the plan are the first- and second-lien noteholders, who will generally be paid in full.

Hostess Brands (Bankr. S.D.N.Y. Case No. 12-22052 (RDD))

Eastman Kodak

Film pioneer Eastman Kodak Company commenced its Chapter 11 bankruptcy proceeding on Jan. 19, 2012, to utilize the bankruptcy process to trim and streamline its business after failing to raise sufficient operating cash by selling some of its digital patents.

As discussed in a prior column, in an effort to cut its expenses, Kodak moved to terminate certain employee medical benefits. Kodak paid for medical, dental, and life insurance coverage for approximately 56,000 retired employees.

This month, Kodak reached

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a settlement in principle with a committee of retired employees that would end its retiree health care and survivor benefits liabilities. This will also put Kodak in a better position to emerge from Chapter 11.

Under the proposed agreement, on Dec. 31, 2012, Kodak will terminate medical, dental, life insurance and survivor income benefits, as well as other post-employment benefits (estimated at $1.2 billion), commonly referred to as OPEB. In exchange for the termination, Kodak will provide the official committee of retirees $7.5 million for initial administration costs, an allowed $635 million unsecured claim against the reorganized company and an allowed $15 million administrative claim (which enjoys priority of payment under the Bankruptcy Code). The settlement would result in significant savings for Kodak, which paid approximately $90 million for OPEB since its bankruptcy filing. The proposed settlement remains subject to Bankruptcy Court approval, and the hearing to approve the settlement is scheduled for today.

EKRA Ltd., an independent association of Kodak retirees, expressed its disappointment with the proposed settlement and Kodak's and the official committee of retirees' lack of disclosure of their settlement discussions.

Kodak also indicated that it is ready to commence negotiations with its other creditors on a proposed plan of reorganization and disclosed financial projections forecasting $1.2 billion in revenue for the first half of 2013 and $1.5 billion for the second half.

Eastman Kodak (Bankr. S.D.N.Y. Case No. 12-10202 (ALG))

Vertis Holdings

Vertis Holdings Inc., the Baltimore-based provider of targeted advertising and marketing solutions, filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code on Oct. 10, 2012, and sought Bankruptcy Court approval of the sale of its assets to rival Quad/Graphics Inc., who will act as a "stalking horse bidder" with a $258.5 million purchase offer. Vertis attributed the bankruptcy filing to rising materials costs, intense pricing competition, the general decline of print marketing, recent customer losses and significant secured indebtedness.

This filing marks Vertis' third time in bankruptcy, which industry professionals refer to as a "Chapter 33." Most notably, Vertis utilized the bankruptcy process in 2008 to facilitate its merger with American Color Graphics Inc. (ACG). ACG was also a Chapter 11 debtor and the two companies merged under their respective plans of reorganization. The dual-bankruptcy merger was a first of its kind. At the time, the two companies stated the reorganization process reduced the combined entities' debt obligations by an impressive $1 billion.

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The current "pre-packaged" bankruptcy filing seeks approval of a sale of nearly all of Vertis' assets, pursuant to section 363 of the Bankruptcy Code (which allows a company in bankruptcy to sell its assets free and clear of liens and liabilities) and includes a $150 million debtor-in-possession, or DIP, credit facility. Unlike an ordinary Chapter 11, in a prepackaged bankruptcy, the debtor negotiates and agrees upon a plan of reorganization with its creditors and parties in interest prior to the bankruptcy filing. In this scenario, companies still file for bankruptcy to take advantage of many of the Bankruptcy Code's provisions, including the ability to assume or reject leases and contracts. A DIP credit facility typically enjoys repayment priority over all prepetition loans and many administrative expenses.

Vertis states that it engaged in an extensive pre-bankruptcy marketing process and strategic review and the proposed sale enjoys the support of Vertis' directors, executives and lenders. Assuming Quad emerges as the winning bidder following an auction process and Bankruptcy Court approval, it will use cash on hand and its revolving credit facility to finance the deal, with an anticipated closing during the first quarter of 2013.

Vertis Holdings (Bankr. D. Del. Case No. 12-12821)

Solyndra

Infamous Solyndra LLC, manufacturer and distributor of solar panels, commenced its Chapter 11 bankruptcy proceeding on Sept. 6, 2012, in the face of significant employee litigation perpetuated by massive layoffs. This month, Solyndra sought confirmation of its Chapter 11 plan. The plan is sponsored by Solyndra's private equity investors who are slated to contribute $7.5 million in settlement payments to workers who sued over their termination. Some of the money will also go to Solyndra's other unsecured creditors. According to Solyndra, the plan benefits creditors by preserving the estate's last remaining assets—the forthcoming $92.5 million sale of Solyndra's California solar panel factory and a $1.5 billion antitrust lawsuit against Chinese competitors (earlier this month Solyndra sued Suntech Power Holdings Co. Ltd. and two other Chinese companies in California federal court, alleging they engaged in a cartel that artificially lowered solar panel prices and forced American companies to shut down).

The IRS vehemently opposed Solyndra's proposed plan of reorganization and argued that the principal purpose of the plan is to avoid taxes (a ground to deny confirmation of a plan of reorganization in certain instances). The IRS pointed to $350 million in tax breaks that are being preserved for investors Argonaut Ventures I LLC and Madrone Partners LP (who are also contributing new funds under the plan). The IRS argued that the plan improperly reorganizes Solyndra's parent as a shell corporation primarily to enable Argonaut and Madrone to utilize the tax breaks to offset future income generated by the company. The IRS further argued that the investors worked to preserve the tax breaks well in advance of Solyndra's bankruptcy filing.

Solyndra countered that the plan does not allow the private equity investors to gain any advantage that would not be available outside bankruptcy. The bankruptcy judge sided with Solyndra, finding that notwithstanding the potential tax benefits investors would glean under the plan, the primary purpose of the plan was not to avoid paying taxes. The judge stayed the order for 10 days to allow the IRS to appeal.

Solyndra (Bankr. D. Del. Case No. 11-12799)

Dewey & LeBoeuf

International law firm Dewey & LeBoeuf filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code on May 29, 2012, following reduced revenue and significant partner defections.

As discussed in the last column, soon after the bankruptcy filing, the firm and its bankruptcy advisers focused on achieving a global settlement with the firm's former partners that would release the partners from potential "clawback" claims brought by the debtor on behalf of the firm's creditors. Typical clawback claims are preference actions commenced under Bankruptcy Code section 547 and fraudulent transfer actions commenced under Bankruptcy Code sections 548 and 544.

Bankruptcy Code section 547 allows a trustee to avoid certain transfers made to creditors during the 90-day period (one year if the transferee was an insider, which may be the case with Dewey's partners) immediately before the commencement of a bankruptcy case. The theory behind such actions is that the debtor was presumptively insolvent at the time the payments were made, providing "preferential" treatment to the creditors who received them over other creditors who did not.

Bankruptcy Code §548 allows for the recovery of fraudulent transfers made within two years of a bankruptcy filing, and Bankruptcy Code §544 allows a trustee to use the look-back period of the applicable state law, which in New York is six years prior to a bankruptcy filing. A "fraudulent transfer" is any transfer or obligation made within the aforementioned look-back periods with the "actual intent" to hinder, delay, or defraud a present or future creditor.

In the absence of actual fraudulent intent, a transfer that was made within the aforementioned look-back periods may still be avoidable as "constructively fraudulent" if such transfer was made in exchange for less than reasonably equivalent value and (i) the debtor was insolvent at the time of the transfer, (ii) the debtor was rendered insolvent as a result of the transfer, or (iii) the transfer was made to an insider of the debtor.

A loss by GM at trial could result in the unwinding of the entire 2009 restructuring deal. Even if the restructuring is not undone, GM may nevertheless be forced to pay $1 billion in damages.

This month, the Bankruptcy Court approved a $71 million clawback settlement with former partners, overruling objections filed by the ad hoc committee of retirees and the official committee of former partners.

According to Dewey, the partner contribution plan will maximize the return of capital while minimizing future litigation costs, with participating partners contributing an amount calculated on a sliding scale based on their liability exposure in exchange for a general release from claims brought by the debtor's estate. Four hundred of about 670 former partners will commit the $71 million in exchange for releases.

Dewey & LeBoeuf (Bankr. S.D.N.Y. Case No. 12-12321)

General Motors

General Motors Company, which famously filed and emerged from bankruptcy in 2009, is now concerned that a lawsuit filed by a trust representing "old" GM's unsecured creditors, attacking a settlement pursuant to which GM paid hundreds of millions of dollars to a group of hedge funds in exchange for a release of claims against GM's Nova Scotia unit, may unwind its entire restructuring. The hedge funds, creditors of the Nova Scotia-based GM subsidiary, agreed in June 2009 to waive $1.3 billion in claims in exchange for a $367 million payment. The payment was made by GM Canada with money borrowed from old GM.

The unsecured creditors trust argues that the agreement was not properly disclosed to the Bankruptcy Court or GM's other creditors during the course of GM's bankruptcy proceedings.

The Bankruptcy Court already expressed its concern regarding the lack of disclosure of the settlement agreement, which was included among the executory contracts "assumed and assigned" under the previously approved sale of GM. The Bankruptcy Code allows a debtor to "assume" a contract and force the counter-party to perform thereunder if the debtor "cures" past monetary defaults.

A loss by GM at trial could result in the unwinding of the entire 2009 restructuring deal. Even if the restructuring is not undone, GM may nevertheless be forced to pay $1 billion in damages based upon the claims waived under the settlement agreement to its unsecured creditors, which is a tremendous burden at a time when GM's stock is down.

Motors Liquidation Company (Bankr. S.D.N.Y. Case No. 09-50026)