UNITED STATES BANKRTUPCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
	:	
KIOR, INC.,	:	Case No. 14-12514 (CSS)
	:	
Debtor.	:	**Related to Docket No. 470**

LEIDOS ENGINEERING, LLC'S OBJECTION TO CONFIRMATION OF KIOR, INC.'S SECOND AMENDED CHAPTER 11 PLAN OF REORGANIZATION

General unsecured trade creditor Leidos Engineering, LLC, c/o Leidos, Inc. ("Leidos") hereby objects to the confirmation of debtor KiOR Inc.'s (the "Debtor") proposed Second Amended Chapter 11 Plan of Reorganization as Revised Dated April 7, 2015 [Docket No. 470] (the "Plan").[1] The Plan violates the Bankruptcy Code and should not be confirmed because: (i) the Plan impermissibly affords better treatment to certain hand-picked trade creditors without offering any rational basis for treating other, similarly-situated creditors differently and less favorably, (ii) the Plan is not feasible because the Liquidating Trust, which comprises the only asset available for payment of Class 9 general unsecured claims, is grossly underfunded, and (iii) the Plan improperly denies creditors the ability to select the Liquidating Trustee, who is granted broad authority to manage, prosecute and settle the Liquidating Trust Assets for the benefit of Class 9 general unsecured creditors. Leidos requests that the Court deny confirmation of the Plan unless and until these flaws are corrected.

FACTUAL BACKGROUND

A. General Background

1. On November 9, 2014, (the "Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtor continues to operate its business as a debtor-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

[1] Capitalized terms not defined herein shall have the meanings ascribed to them in the Plan.

2. As of the Petition Date, the Debtor identified Leidos as a top 10 unsecured creditor. *See* [D.I. 1], at p. 11. Although Leidos applied to sit on the statutory committee of unsecured creditors, no official committee was appointed in the case.

B. Leidos' Provision of Services to the Debtor

3. Prior to the Petition Date, in April 2014, the Debtor's Board of Directors and its counsel retained Leidos to provide critical independent engineering consulting services to KiOR with respect to certain research and operational data derived from KiOR's production facilities. Leidos provided these services in a thorough, timely and competent manner; however, the Debtor failed to make any payment to Leidos for its services. As such, as of the Petition Date, the Debtor owed Leidos over $167,895 for Leidos' services. *See* Proof of Claim No. 73.

C. Pertinent Plan Provisions

4. The Plan identifies three classes of general unsecured claims: (i) Class 7 Continuing Trade Claims, (ii) Class 8 Convenience Class Claims, and (iii) Class 9 General Unsecured Claims. The Continuing Trade Claims included in Class 7 consist of "Trade Creditors, as identified by the Debtor in the Plan Supplement" that elect to provide trade credit to the Reorganized Debtor "in the greatest amount and on the most favorable terms and conditions that such Trade Creditor was providing to the Debtor during the ninety (90) days before the Petition Date, for at least twelve (12) months after the Effective Date." *See* Plan, at art. III, § B(7)(a).

5. The Plan Supplement specifies the creditors to be included in Class 7 and indicates that the Continuing Trade Claims held by such creditors total $1,740,181. *See* [D.I. 404], Ex. B. Notably, the creditors included on the list of Continuing Trade Claims appear to consist largely of professional service firms. In fact, the largest Class 7 claim listed by far,

comprising over 65% of the total claims, is the claim of the Debtor's special counsel, Wilmer Cutler Pickering Hale and Dorr LLP ("Wilmer Hale"), in the amount of $1,184,696. *See id.*

6. Under the Plan, Class 7 creditors are to receive "(i) a Cash payment equal to fifty percent (50%) of the Allowed amount of such Claim plus (ii) the same treatment accorded to General Unsecured Creditors in Class 9[.]" *See* Plan, at art. III, § B(7)(b). Class 7 creditors shall also receive a "full and complete release from any potential Avoidance Action by the Debtor, the Reorganized Debtor, the Estate or the Liquidating Trust." *Id.*

7. With the exception of Allowed Convenience Claims (which are classified into Class 8), the Plan classifies any remaining general unsecured claims in Class 9. The Plan provides that Class 9 creditors shall receive "ratable rights to the Liquidating Trust Assets" as determined by the Liquidating Trustee, who is in turn identified as "Mr. Kurt Gwynne, or such other Person or Entity ... acceptable to the Debtor and approved by the Bankruptcy Court." *See* Plan, at art. I, § B(70), art. III, § B(9)(b). Furthermore, the Plan provides that the Liquidating Trust is to be vested with "(i) the funding designated for Class 8 (Convenience Claims), (ii) cash in the amount of $100,000 and (iii) the Vested Causes of Action and proceeds thereof, on the Effective Date." *See id.* at art. V, § C(2).

ARGUMENT

A. The Plan Contains an Improper Classification Scheme

8. The Plan suffers a fatal flaw because it (i) improperly places so-called "continuing trade creditors" in a separate class from other similarly situated creditors without justification and (ii) unfairly discriminates among similarly situated creditors by providing meaningfully greater recoveries to continuing trade creditors than other general unsecured creditors, such as Leidos.

(i) There is No Justification for the Disparate Treatment between Class 7 and Class 9 Creditors.

9. A plan must satisfy each of the requirements of Bankruptcy Code section 1129(a) in order to be confirmed. *See* 11 U.S.C. § 1129(a). Bankruptcy Code section 1129(a) in turn requires that a plan comply with the applicable provisions of chapter 11, particularly Bankruptcy Code sections 1122 and 1123. *See, e.g.*, *In re Multiut Corp.*, 449 B.R. 323, 333 (Bankr. N.D. Ill. 2011) (explaining that the legislative history for section 1129(a)(1) requires that a plan comply with the applicable provisions of chapter 11, such as section 1122 and 1123, governing the classification and contents of a plan).

10. A plan's classification of claims is subject to strict scrutiny. *In re S & W Enter.*, 37 B.R. 153, 157 (Bankr. N.D. Ill. 1984). Bankruptcy Code section 1122(a) provides that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." 11 U.S.C. § 1122(a). "Separate classifications for unsecured creditors are only justified where the legal character of their claims is such as to accord them a status different from the other unsecured creditors[.]" *Lisanti v. Lubetkin (In re Lisanti Foods, Inc.)*, 329 B.R. 491, 510 (Bankr. D.N.J. 2005) (citing *Grenada Wines, Inc. v. New England Teamsters & Trucking Industry Pension Fund*, 748 F.2d 42, 46 (1st Cir. 1984)).

11. In the present case, the Plan violates Bankruptcy Code section 1122(a) because it places certain hand-picked "continuing trade claims" in Class 7 when such claims are substantially similar to the trade claims of Class 9, and fails to demonstrate that the legal character of such "continuing trade claims" warrants disparate treatment. First of all, nowhere in the Plan or the Plan Supplement does the Debtor demonstrate that each claim identified as a Continuing Trade Claim has satisfied the stringent trade credit requirements under the Plan of "in

the greatest amount and on the most favorable terms and conditions" in order to qualify for classification into Class 7. Moreover, even if they did, such claims still do not possess a "legal character" warranting the separate classification and more favorable treatment prescribed under the Plan. This is not surprising, as Leidos cannot discern any distinction in the legal character of its own trade claim, which is classified in Class 9, and the trade claims in Class 7, so as to justify the disparate treatment. *See id.* As such, because there is no justification for the separate classification of Class 7 and Class 9 trade creditors, the Plan is not confirmable under Bankruptcy Code section 1122(a).

(b) The Plan Unfairly Discriminates Among Similarly Situated Creditors

12. Next, when an impaired class does not accept a plan, the plan proponents must demonstrate that the plan "does not discriminate unfairly" and is "fair and equitable" to the non-accepting impaired class. *See* 11 U.S.C. § 1129(b). Although the "unfair discrimination" standard technically applies only under section 1129(b) when a class has not accepted a plan, courts should consider a confirmation objection raised by a dissenting creditor that is based on alleged improper classification if (i) the combination of separate classification and materially different treatment results in substantially different economic effects between the two classes and (ii) the purpose and effect is other than the debtor's good faith effort to protect its future business operations. 7 Collier on Bankruptcy ¶ 1122.03[3][a] (Alan N. Resnick & Henry R. Somer eds. 16th ed.) (citing *In re Jersey City Med. Ctr.*, 817 F.2d 1055 (3d Cir. 1987)).

13. Various tests are used to determine whether a proposed plan unfairly discriminates with respect to each class of claims or interests. *In re TCI 2 Holdings, LLC*, 428 B.R. 117, 157 (Bankr. D.N.J. 2010). "Regardless of the standard used to determine unfair discrimination, courts agree that if the treatment of substantially similar claims is 'grossly disparate,' – i.e., a difference in recovery of 50% or more – 'it is very difficult for the plan

proponent to show 'fair' discrimination." *See In re Deming Hospitality, LLC*, 2013 Bankr. LEXIS 1428, at *14-15 (Bankr. D.N.M. 2013); *see also In re Tribune Co.*, 472 B.R. 223, 243 (Bankr. D. Del. 2012) (defining "grossly disparate" as a difference of 50% or more in recovery [e.g. 10% versus 60% recovery], and noting that courts have "roundly rejected plans" proposing such treatment).

14. In the present case, there is no question that the treatment of Class 7 and Class 9 trade claims is "grossly disparate" and results in materially different economic treatment. The Plan proposes to pay cash equal to 50% of the claims of the so-called continuing trade creditors, *in addition* providing such creditors the same treatment to be afforded to creditors in Class 9. At the same time, Class 9 general unsecured creditors are relegated to distributions based on unidentified, underfunded and unvalued "vested causes of action." Given the current Plan structure, it is completely speculative whether general secured creditors will receive *any* recovery under the Plan. As such, the economic differences in treatment between Class 7 and Class 9 creditors under the Plan are significant.

15. Furthermore, the Debtor cannot satisfy its heavy burden in justifying the grossly disparate treatment between Class 7 and Class 9 claims. Relying simply on a definition of "continuing trade creditors" as those continuing to provide goods and services on ordinary and customary trade terms is insufficient. Indeed, similar rationales have been rejected by courts where, as here, no evidence exists that the trade creditors being provided preferential treatment are critical to the debtor's ability to reorganize or would otherwise refuse to transact business with the debtor. *See e.g., In re CW-Capital Asset Management, LLC*, 2014 U.S. Dist. LEXIS 87900, at *20-21 (Bankr. E.D.N.C. 2014); *In re Snyders Drug Stores, Inc.*, 307 B.R. 889, 895

(Bankr. S.D. Ohio 2004); *In re Sentry Operating Co. of Tex., Inc.*, 264 B.R. 850, 864 (Bankr. S.D. Tex. 2001).

16. Moreover, in the present case, the claimants included in Class 7 cannot be regarded as critical to the Debtor's ability to reorganize. The Court has found that the Debtor has "no immediate prospects of revenue and no immediate prospects of profitability," "the Debtor's technology is not commercially viable as it exists, and further research, development and money will be required to get that technology to a place where even more money needs to be spent to take it to the next step." *See* Disclosure Statement [D.I. 471], at § I(B)(1). Certainly, in light of these findings, the Continuing Trade Claims, which are largely held by professional services firms, cannot be considered "critical" to the Debtor's ability to reorganize since the Debtor has no business operations or even revenue at this time or in the foreseeable future. In addition, there is no evidence that Class 7 creditors would refuse to deal with the reorganized Debtor on acceptable terms going forward absent preferential payment under the Plan. To the contrary, the largest continuing trade creditor, Wilmer Hale, a law firm that also represents the Khosla parties, continues to represent the Debtor as special counsel post-petition and filed four unopposed monthly fee applications to date totaling over $1.3 million in legal fees and expenses. *See* Fourth Monthly Fee Application of Wilmer Hale, at [D.I. 571].

17. Based on these facts, the Debtor cannot establish that the separate classification and dramatically preferential treatment of its hand-selected, so-called "continuing trade creditors" is permissible under the Bankruptcy Code. Until these fatal flaws in classification are rectified by either including all similarly situated trade creditors in Class 7 or refraining from affording such favorable treatment to *any* trade creditors, confirmation of the Plan should be denied.

B. The Liquidating Trust is Inadequately Funded

18. Next, the Plan fails to satisfy the feasibility requirement imposed by Bankruptcy Code section 1129(a)(11) because the Liquidating Trust lacks sufficient funds to administer the trust assets, which include derivative claims for alleged breaches of fiduciary duty and/or violations of federal securities laws against, among others, the Debtor's directors and officers. *See* Plan, at art. I, §§ B(15), (67), (104). Given the nature of the claims to be pursued by the Liquidating Trust, the Liquidating Trust will require significant resources to litigate the claims. In fact, the Debtor has estimated that defense costs alone for such litigation would amount to several million dollars in legal fees. *See* Disclosure Statement, at [D.I. 471], Ex. D.

19. In light of the nature and likely substantial cost of prosecuting the claims and causes of action held by the Liquidating Trust, the Debtor's contribution of a mere $100,000 to fund the trust is *per se* insufficient and unreasonable. Thus, because the Liquidating Trust is undercapitalized, the Plan lacks feasibility and should not be confirmed.

C. The Liquidating Trustee Should Be Selected By Creditors

20. Finally, the Liquidating Trustee is charged with broad authority in valuing, investing, pursuing, liquidating, and distributing the assets in the Liquidating Trust, among other things. *See* Plan, at art. V, §§ C(6), (7). The Liquidating Trustee has the sole discretion to "litigate, settle, transfer, release or abandon and/or compromise" any Vested Causes of Action. *See id.* at § C(7). Given the Liquidating Trustee's broad power, discretion and authority to recover assets on behalf of creditors, including litigation claims against the Debtor's current and former officers, directors, shareholders and insiders, the selection of the Liquidating Trustee should be made by the creditors whose interests the Trustee serves, not the Debtor. In addition, the Liquidating Trust should include better accountability and reporting obligations of the

Liquidating Trustee to the creditors he or she serves. Leidos respectfully submits that the Plan should not be confirmed without these changes.

CONCLUSION

WHEREFORE, for the foregoing reasons, Leidos respectfully requests that the Court deny confirmation of the Debtor's proposed Plan.

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