UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	
	:	Chapter 11
	:	
EMERALD OIL INC., et al.[1]	:	Case No. 16-10704 (KG)
	:	
	:	Jointly administered
	:	
	:	**Hearing Date:** March 22, 2016 at 10:00 a.m.
Debtors.	:	**Objection Date:** March 16, 2106 at 4:00 p.m. Extended to March 17 at 4:00 p.m. for the U.S. Trustee
	:	**Re: Docket No. 1056**

UNITED STATES TRUSTEE'S OBJECTION TO CONFIRMATION OF THE DEBTORS' AMENDED JOINT PLAN OF LIQUIDATION PURSUANT TO CHAPTER 11 OF THE BANKRUTPCY CODE

Andrew R. Vara, the Acting United States Trustee for Region 3 ("U.S. Trustee"), by and through his undersigned counsel, hereby submits this objection to confirmation of the Debtors' Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code (the "Plan") (Docket No. 1056). In support of his objection, the U.S. Trustee respectfully states as follows:

INTRODUCTION

The Plan filed by Emerald in this case is unconfirmable, because it treats individual claimants in the same class differently, penalizing individual parties in interest that vote against the plan or fail to vote at all. Under the proposed Plan, these groups of claimants would receive nothing, yet anyone in the class voting to accept the plan would share in a distribution, a clear violation of § 1123(a)(4), rendering the plan unconfirmable under § 1129(b)(1). The Plan provides that the same claimants who are slated to receive no distribution are also forced to

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, include: Emerald Oil, Inc. (9000); Emerald DB, LLC (2933); Emerald NWB, LLC (7528); Emerald WB LLC (8929); and EOX Marketing, LLC (4887). The location of the Debtors' service address is: 200 Columbine Street, Suite 500, Denver, Colorado 80206.

extend broad releases to a set of entities and people broadly defined. These releases, are nonconsensual, and are being given in exchange for nothing in return. Unless Emerald remedies these serious defects, the Plan should not be confirmed.

JURISDICTION

1. Under (i) 28 U.S.C. § 1334, (ii) applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a), and (iii) 28 U.S.C. § 157(b)(2), this Court has jurisdiction to hear and determine this objection.

2. Pursuant to 28 U.S.C. § 586(a)(3), the U. S. Trustee is charged with administrative oversight of the bankruptcy system in this District. Such oversight is part of the U. S. Trustee's overarching responsibility to enforce the laws as written by Congress and interpreted by the courts. *See United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.),* 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that the "U. S. Trustee 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 "U. S. Trustee as a "watchdog").

3. Pursuant to 28 U.S.C. § 586(a)(3)(B), the U. S. Trustee has the duty to monitor plans and disclosure statements filed in Chapter 11 cases and to comment such plans and disclosure statements.

4. Under 11 U.S.C. § 307, the U.S. Trustee has standing to be heard on this objection.

FACTUAL BACKGROUND

5. On March 22, 2016, Emerald Oil, Inc. and five affiliated companies (collectively, "Emerald") each filed a petition with this Court under chapter 11 of the Bankruptcy Code.

Emerald's chapter 11 cases have been consolidated for procedural purposes only and are being jointly administered pursuant to Bankruptcy Rule 1015(b) [Docket No. 36]. No party has requested the appointment of a trustee or examiner in these chapter 11 cases. Emerald continues to operate its businesses and manage its properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

6. On April 6, 2016, the United States Trustee for the District of Delaware appointed an official committee of unsecured creditors (the "Committee") in these chapter 11 cases [Docket No. 125]. The members of the Committee serve as fiduciaries for all general unsecured creditors, and thus owe a fiduciary duty to unsecured creditors.

7. On July 26, 2016, the Court held a hearing to consider bidding procedures related to Emerald's proposed sale of substantially all of its assets. At that hearing, counsel for Courtland Capital Market Service, LLC ("Courtland"), explained on the record that funds managed by Fir Tree Partners and Crestline Investments, Inc. had purchased all of Emerald's pre-petition secured debt as well as the DIP loan. Courtland, as successor to Wells Fargo Bank, N.A., as agent, put the terms of a global settlement on the record. The global settlement as explained was between Courtland, as agent for the secured debt holders, the Committee, and Emerald:

> "The secured lenders will make two million dollars in cash available to general unsecured claims arising in the Chapter 11 cases. And we're calling that two million dollars the settlement amount. The settlement amount shall be paid by the secured lenders for the benefit of the debtors' general unsecured claims pool pursuant to a Chapter 11 plan of liquidation regardless of whether the winning bid at the 363 auction for substantially all the assets of the debtors pursuant to the bidding procedures motion is a cash bid or, alternatively, a credit bid by the administrative agent, provided that the purchase price must be for an amount of at least the stalking horse bid, provided further that the stalking horse bidder cannot withdraw its bid or decrease its bid to frustrate the settlement and that any

> credit bid by the administrative agent or the secured lenders will result in payment of the settlement amount.
>
> Pursuant to a liquidating plan after satisfying administrative, priority, and other secured claims, as allowed, and payment of the settlement amount, all other assets of the estate, including, without limitation, the proceeds of the sale shall be paid over to the administrative agent for the benefit of the secured lenders and the claims of the secured creditors and the administrative agent are satisfied in full, in cash.
>
> For the avoidance of doubt, the settlement amount represents a floor for the committee's recovery. And therefore, to the extent the value of estate assets exceed all secured claims and priority claims and there are funds available for distributions to unsecured creditors, the settlement amount shall be reduced dollar-for-dollar by such amounts and shall be reduced to zero at the point where amounts available for distribution to unsecured creditors hit two million dollars.
>
> The official committee of unsecured creditors will support entry of the bidding procedures order and shall support the sale motion and the relief requested at the sale hearing, as well as the debtors' efforts to resolve the treatment of the debtors' transportation contracts.
>
> The secured lenders will waive any deficiency claim as it relates to the settlement amount only.
>
> And lastly, Your Honor, the parties to this agreement shall act in good faith to memorialize and document their agreements in a mutually satisfactory manner and seek approval of the terms outlined above."

Emerald Oil, Inc., July 16, 2016, tr. 14-15.

8. The terms of the settlement as put on the record did not include a requirement that individual creditors vote in favor of the settlement in order to receive a distribution.

9. On November 1, 2016, after a hearing on October 28, 2016, the Court entered an order authorizing the sale of substantially all of Emerald's assets (Docket No. 874) to New Emerald Energy, Inc.

10. On December 30, 2016, Emerald filed the Plan and the *Disclosure Statement for the Debtors' Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code*

(Docket No. 985) (the "Disclosure Statement"). Emerald also filed its *Motion for Entry of an Order (I) Approving the Adequacy of the Disclosure Statement, (II) Approving the Solicitation and Notice Procedures with Respect to the Confirmation of the Debtors' Proposed Joint Plan of Liquidation, (III) Approving the Forms of Ballots and Notices in Connection Therewith, (IV) Scheduling Certain Dates with Respect Thereto, and (V) Granting Related Relief* (Docket No. 986) (the "Disclosure Statement Motion") on the same day.

11. The Court held a hearing to consider approval of the Disclosure Statement on February 7, 2017 and approved the Plan and Disclosure Statement for solicitation by order dated the same day (Docket No. 1048).

12. Article III(B)(4)(c) of the Plan provides that each holder of an Allowed Class 4 Claim will, if such Allowed Class 4 Claim is held by a Non-Participating GUC Holder, "not receive any distribution on account of such Allowed Class 4 Claim." A "Non-Participating GUC Holder" means "any Holder of a Class 4 Claim that votes to reject the Plan or abstains from voting." Plan, Article I(A)(82) and Article III(B)(4)(c).

13. The Plan provides for the release of claims against the "Released Parties" by the "Releasing Parties." The Released Parties are:

> (a) each Debtor; (b) the Debtors' current and former officers, directors, and managers; (c) the Lenders (solely in their respective capacities as Lenders under the Credit Documents) and the Credit Facility Agent (solely in its capacity as Credit Facility Agent under the Credit Documents); (d) the Committee; (e) the Indenture Trustee; and (f) each of the foregoing Entities' respective predecessors, successors and assigns, and current and former stockholders, members, limited partners, general partners, equity holders, Affiliates and its and their subsidiaries, principals, partners, parents, equity holders, members, employees, agents, officers, directors, managers, trustees, professionals, representatives, advisors, attorneys, financial advisors, accountants, investment bankers, and consultants, in each case solely in their capacity as such; *provided* that as a condition to receiving or enforcing any release granted pursuant to Article X.D or Article X.E hereof, each Released Party and its Affiliates shall release or

> be deemed to have released the Releasing Parties, the Estates, and the Debtors for any and all Claims or Causes of Action arising from or related to their relationship with the Debtors, but not, for the avoidance of doubt, Professional Fee Claims.

The Releasing Parties are:

> (a) the Released Parties; (b) all Holders of Claims and Interests who are deemed to accept the Plan; (c) all Holders of Claims who vote to accept the Plan; (d) all holders of Claims entitled to vote on the Plan who abstain from voting on the Plan and who do not opt out of the releases provided by the Plan; (e) all holders of Claims entitled to vote on the Plan who vote to reject the Plan and who do not opt out of the releases provided by the Plan; (f) the Committee; and (g) with respect to each of the foregoing Entities, their members, limited partners, general partners, Affiliates, principals, partners, parents, members, employees, agents, officers, directors, managers, trustees, professionals, representatives, advisors, attorneys, financial advisors, accountants, investment bankers, and consultants, in each case solely in their capacity as such.

Plan, Article I(A)(114) and (115).

14. Therefore, as a result of the above, holders of general unsecured claims that either vote to reject the plan or simply do not vote will not share in the proposed distribution to unsecured creditors, and, unless they opt out, will also be deemed to release the Released Parties.

15. Section X.D of the Plan provides for broad releases by Emerald, not only on their own behalf, but on behalf of the broad range of Released Parties set forth above for past, present, and future claims.

16. Section X.E of the Plan provides for equally broad releases to be given by creditors, not only to Emerald, but to the panoply of other parties included in Emerald's releases. The third party releases appear to be, for the most part, non-consensual.

17. Section X.F of the Plan provides for exculpation of the "Exculpated Parties", defined in Section I.A.56 as "collectively: (a) each Debtor; (b) the Debtors' current and former officers, directors, and managers; (c) each of the foregoing Entities' respective predecessors,

successors and assigns, and current and former members, limited partners, general partners, Affiliates, principals, partners, parents, members, employees, agents, officers, directors, managers, trustees, professionals, representatives, advisors, attorneys, financial advisors, accountants, investment bankers, and consultants, in each case solely in their capacity as such; and (d) the Committee and the Committee Members and each of the Committee's agents, financial advisors, attorneys, accountants, investment bankers, consultants, representatives, and other professionals, in each case solely in their capacity as such."

ARGUMENT

A. The Plan Impermissibly Discriminates Among Creditors in the Same Class

18. Section 1123(a)(4) provides that a plan must "provide the same treatment for each claim or interest of a particular class unless the holder of a particular claim or interest agrees to a less favorable treatment." Because the Plan does not comply with §§ 1123(a)(4) or 1129(b)(1), it cannot be confirmed under 11 U.S.C. §1129(a)(2).

19. The Bankruptcy Code prohibits Emerald's proposed treatment of general unsecured creditors. It is impermissible under § 1123(a)(4) to treat creditors in the same class differently. Further, it is also unfair discrimination to do so, rendering the Plan unconfirmable under § 1129(a)(2) and (b)(1).

20. The Plan treatment of unsecured creditors is discriminatory in another sense as well. This is because it acts, in essence, as a *de facto* claims objection to claims of the claimants that vote to reject the Plan or that do not vote. These creditors will not be paid on account of their claims. Indeed, the first plan contained provisions providing that if a creditor did not vote or voted against the plan, that creditor's claim would be expunged automatically with no further notice. The current Plan has essentially the same effect.

B. **The Plan's Non-Consensual Third-Party Releases <u>Are Impermissible Under Applicable Law</u>**

21. The broad third-party releases in the Plan will be given not only by those creditors eligible to vote who voted to accept the Plan, but also all creditors who voted to reject the Plan and did not "opt out", and any creditors that did not vote on the Plan at all. Therefore, as to the majority of creditors, the third party releases are non-consensual, except as to those given by parties who voted in favor of the Plan.

22. Some Courts in this District have determined that third party releases of non-debtors should be allowed only to the extent the releasing parties have given affirmative consent. *See In re Washington Mutual, Inc.*, 442 B.R. 314, (Bankr. D. Del. 2011). In *Washington Mutual* the Court held that "any third party release is effective only with respect to those who affirmatively consent to it by voting in favor of the Plan and not opting out of the third party releases." *Id.* at 355. Moreover, the Court clarified that merely having an opt out mechanism is not enough, holding that an "opt out mechanism is not sufficient to support the third party releases . . . particularly with respect to parties who do not return a ballot (or are not entitled to vote in the first place)." *Id.*[2]

23. Here, there is nothing in the record to indicate that the high threshold necessary for approval of the non-consensual third party releases has been met in these cases. The Plan proposes that the following parties will receive releases:

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[2] In *In re Spansion, Inc.*, 426 B.R. 114, 144 (Bankr. D. Del 2010), the Court reached a different conclusion with respect to non-voting classes. There, the U.S. Trustee objected to third party releases to the extent they bound parties who were deemed to have accepted the plan, and suggested that such parties should have been provided with ballots to allow them the option to opt out of the releases. *Id.* at 144. The Court overruled that objection. However, *Spansion* was not a pre-pack case, and there had already been a separate hearing to approve solicitation procedures. The Court noted that the subject of providing ballots to unimpaired parties for opt-out purposes was not raised at that hearing. *Id.* In contrast, in the present case, solicitation was made prior to the case filing, and any objection as to solicitation procedures has been preserved for the Combined Hearing.

- The Debtors;
- The Debtors' subsidiaries;
- The Debtors' Affiliates;
- The Debtors' Affiliates' subsidiaries;
- Current or former officers, directors, and managers;
- Each of the Lenders;
- The Committee;
- Each Releasing Party; and
- The predecessors, successors and assigns, current and former stockholders, members, limited partners, general partners, equity holders, Affiliates, its and their subsidiaries, principals, partners, parents, equity holders, members, employees, agents, officers, directors, managers, trustees, professionals, representatives, advisors, attorneys, financial advisors, accountants, investment bankers, and consultants of all of the above.

24. Plan, §I.A.4, I.A.25, I.A.79 and I.A.115. These broad releases run contrary to the holding of *Washington Mutual*, and are therefore inappropriate. Emerald has the burden of justifying the validity of the non-consensual third-party releases for each Released Party to be released, especially where, as here, certain parties are "deemed" to consent to the releases.

C. **<u>The Releases Provided by Emerald Under the Plan Are Impermissibly Broad</u>**

25. The Plan provides releases by Emerald and its estates of many non-debtor parties. Pursuant to this Court's decision in *Tribune,* 464 B.R. 126 (Bankr. D. Del. 2011), and *Washington Mutual,* 442 B.R. 314 (Bankr. D. Del. 2011), among others, the five factors set forth in In re *Zenith Elecs. Corp.,* 241 B.R. 92, 110 (Bankr. D. Del 1999) and *In re Master Mortgage Inv. Fund, Inc.,* 168 B.R. 930, 937-38 (Bankr. W. D. Mo. 1994) should be considered to determine whether, notwithstanding § 524(e) of the Code, a plan may provide for releases by debtors of non-debtor entities. "The factors are neither exclusive nor conjunctive requirements,

but simply provide guidance in the Court's determination of fairness." *Tribune* 464 B.R. at 186 (citations omitted). Those factors are as follows:

1. identity of interests between debtor and non-debtor releasee, so that a suit against the non-debtor will deplete the estate's resources (e.g., due to a debtor's indemnification of a non-debtor);
2. substantial contribution to the plan by non-debtor;
3. necessity of release to the reorganization;
4. overwhelming acceptance of plan and release by creditors; and
5. payment of all or substantially all of the claims of the creditors and interest holders under the plan.

Tribune 464 B.R. at 186 (citing *Washington Mutual*, 442 B.R. at 346.

26. In the present cases, neither the Plan nor the Disclosure Statement address whether any of the *Zenith* factors are met for any of the parties who will receive releases from Emerald. They also do not address why, under their voting procedures, the "consent" of creditors that do not vote or do not opt out is sufficient to indicate "overwhelming acceptance." At best, Emerald appears to be relying on the "silence is consent" theory of voting. Absent a showing, and appropriate finding by the Court, that each proposed Released Party has made a substantial contribution to the Plan,[3] and that the other elements of *Zenith* have been met, the releases given by Emerald render the Plan unconfirmable.

D. <u>The Plan's Exculpation Provision Is Impermissibly Broad Under Applicable Law</u>

27. Section X.F of the Plan provides an exculpation in favor of numerous non-estate fiduciaries, and each such parties' respective affiliates, stockholders, members, partners, officers,

[3] An example of a "substantial contribution" can be found in *Coram*, where this Court, after examining the *Zenith* factors, allowed the debtors to release noteholders who had contributed $56 million in funding to the plan, which funds allowed the debtors to repay in full all creditors other than the noteholders, as well as make a significant distribution to the debtors' shareholders. 315 B.R. at 335.

directors, employees, financial advisors, attorneys, accountants and other representatives for both pre- and post-petition activities. *See* Plan, §I.A.56 (definition of Exculpated Parties).

28. The list of parties receiving exculpation should be limited to those parties who served in the capacity of estate fiduciaries, *i.e.*, the creditors' committee, its members, estate professionals, and the Debtor's directors and officers. *See In re Indianapolis Downs, LLC,* 486 B.R. 286 (Bankr. D. Del. 2013); *In re Tribune Co.,* 464 B.R. 126, 189 (Bankr. D. Del. 2011)*; In re PTL Holdings, LLC*, 2011 WL 5509031 *12 (Bankr. D. Del. Nov. 10, 2011); *In re Washington Mutual Inc.*, 442 B.R. 314, 350 (Bankr. D. Del. 2011). As stated by the Court in *Washington Mutual, Inc.*, an "exculpation clause must be limited to the *fiduciaries* who have served during the chapter 11 proceeding: estate professionals, the Committees and their members, and the Debtors' directors and officers." *Id.* at 350-51 (emphasis added). The Court in *In re Tribune Company,* 464 B.R. 126 (Bankr. D. Del. 2011), stated agreement with the holding in *Washington Mutual* relating to exculpated parties, and held that the exculpation clause in *Tribune,* "must exclude non-fiduciaries." *Id.* at 189, quoting *Washington Mutual,* 422 B.R. at 350 -51.

29. The Plan's exculpation fails to comply with the applicable case law set forth above, as it covers many parties who are not estate fiduciaries in these cases. Even with respect to the estate fiduciaries that can be covered, the exculpation clause in the Plan is too broad, because it is not limited to actions taking place during the bankruptcy case, but also includes pre-petition activity. *See Washington Mutual,* 442 B.R. at 350 (exculpations cover "actions in the bankruptcy case"), *citing PWS*, 228 F.3d at 246. It also appears that the exculpation is prospective, seeking to exculpate actions that may be taken after the Effective Date.

30. Unless the Exculpation provision in the Plan is amended so that it covers only fiduciaries of Emerald's estates, is limited to acts and omissions during the course of the bankruptcy cases, and eliminates the "reliance upon counsel" provision, the Plan should not be confirmed.

CONCLUSION

31. The Plan should not be confirmed because it violates § 1123(a)(4), as well as § 1129(a)(2) and (b), by treating creditors in the same class differently. The Plan also should not be confirmed due to its inclusion of non-consensual third-party releases in favor of non-debtors, and other release, exculpation, and injunction provisions that are contrary to applicable law. The U.S. Trustee leaves Emerald to its burden of proof and reserves any and all rights, remedies and obligations to, *inter alia*, complement, supplement, augment, alter and/or modify this objection, file an appropriate Motion and/or conduct any and all discovery as may be deemed necessary or as may be required and to assert such other grounds as may become apparent upon further factual discovery.

WHEREFORE, the U.S. Trustee respectfully requests that this Court issue an order denying confirmation of the Plan, and/or granting such other relief as this Court deems appropriate, fair and just.

Dated: March 17, 2017
Wilmington, Delaware

Respectfully submitted,

ANDREW R. VARA
ACTING UNITED STATES TRUSTEE
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