UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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In re:

AVIANCA HOLDINGS S.A., et al.,

Debtors.

Chapter 11
Case No. 20-11133(MG)
(Jointly Administered)

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UDI BARUCH GUINDI, DAVID BARUCH, SOSHANA BARUCH, HABIB MANN, GOLAN LP AND ISAAK BARUCH,

Appellants,

-against-

AVIANCA HOLDINGS S.A., et al.,

Appellees.

CIVIL ACTION NO.
1:21-CV-10118-AJN

Oral Argument Requested

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REPLY BRIEF FOR APPELLANTS IN FURTHER SUPPORT OF THEIR APPEAL OF THE BANKRUPTCY COURT'S ORDER CONFIRMING DEBTORS AVIANCA HOLDINGS S.A., ET AL.'S CHAPTER 11 PLAN

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Appellants respectfully submit this reply brief in further support of their appeal from the Bankruptcy Court's order confirming Debtors' reorganization Plan.[1]

PRELIMINARY STATEMENT

In the Appeal Brief, Appellants demonstrated that the Court should reverse the confirmation order because: (1) it improperly put the burden to prove the value of the Shared Collateral on Appellants, and Appellees entirely failed to demonstrate the Shared Collateral's value; (2) as such, the Plan violates the absolute priority rule; and, separately, (3) the Plan is premised on an improper substantive consolidation of the Avianca Debtors but not the Unconsolidated Debtors. In opposition, Debtors try to sanitize the Bankruptcy Court's errors and their own omissions by misstating the law and standing the facts on their head. Their arguments all fail.

Debtors maintain that their failure to solicit new equity investors somehow proves that the Shared Collateral has insufficient value. This, however, is contrary to well-settled law holding that property retained by a debtor is valued by its cost to replace such property. Even if it were not, Debtors' purported "marketing process" to obtain equity investments is not an accurate reflection of the Shared Collateral's value. Indeed, Debtors' CEO expressly admitted that potential equity investors look to factors like future cash flow, projections for internal rates of return, quality of

[1] Unless indicated otherwise, capitalized terms used herein have the same meaning set forth in Appellants' opening brief dated January 19, 2022, Dkt. 17 (the "Appeal Brief" or "App. Br.").

management, and others that have nothing to do with the price it would cost to replace the Shared Collateral.

Equally meritless are Debtors' attempts to explain why the absolute priority rule does not apply to the Plan, or pretend that the Plan would somehow satisfy that rule. Ultimately, Debtors' unsupported arguments cannot explain how paying Appellants a literal penny on the dollar while issuing accrued dividend payments to the Unconsolidated Debtors' wholly unimpaired equityholders satisfies the rule.

Finally, Debtors cannot justify substantive consolidation by simply asserting that they sufficiently established "creditor reliance" or "hopeless entanglement." Debtors' testimony on cross-examination refutes any such assertion, and in any event, Debtors fail to adequately explain why the Unconsolidated Debtors should be excluded from a consolidation.

ARGUMENT

I. THE BANKRUPTCY COURT MISAPPLIED THE STANDARD TO PROVE THE VALUE OF THE SHARED COLLATERAL

Appellants demonstrated that the Bankruptcy Court misapplied *In re Heritage* by holding that Appellants had the burden to disprove the claimed value of the Shared Collateral. Appellants also demonstrated that Debtors utterly failed to demonstrate the Shared Collateral's value by offering evidence that, at best, showed they could not convince investors to sink more capital into their failing businesses that have repeatedly defaulted on their debts. App. Br. pp. 16-24.

In opposition, Debtors do not dispute that *In re Heritage* governs or that Debtors bore the initial burden to demonstrate the value of the Shared Collateral. Opp. Br. pp. 17-18.[2] Nor do Debtors dispute that their evidence was limited to Debtors' inability to obtain additional equity investments (while successfully raising an additional $160 million in debt financing) and did not concern the separate value of the Shared Collateral. *Id.* p. 25. Instead, Debtors argue that (A) they met their burden by showing that their marketing efforts yielded no new investors, and (B) the value of the Shared Collateral is a factual issue that the Court cannot reverse because the Bankruptcy Court's findings are not clearly erroneous. These arguments fail.

A. <u>Debtors Failed to Demonstrate the Value of the Shared Collateral</u>

Debtors' argument that the best way to prove the value of the Shared Collateral was to demonstrate that they could not solicit new investors for their businesses fails because (1) it is not the applicable standard and (2) in any event, Debtors' failures are not an accurate reflection of the Shared Collateral's value.

It is well settled that the value of collateral retained by a debtor, such as the Shared Collateral, is the amount it would take for the debtor to replace the property. *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 964-65 (1997) (value of retained

[2] While Debtors imply in a footnote that courts in this district are beginning to place the initial burden on creditors, they admit that any argument to that effect "is academic" given that the Bankruptcy Court proceeded under the *In re Heritage* standard. Opp. Br. p. 18 n.18. Moreover, this ignores the numerous cases cited by Appellants demonstrating that courts are trending towards *In re Heritage*'s holding. App. Br. pp. 17-18.

property "is the cost the debtor would incur to obtain a like asset"); *In re Residential Capital LLC*, 501 B.R. 549, 591-92 (Bankr. S.D.N.Y. 2013) (collateral must be valued "based on the fair market value of the collateral in the hands of the Debtors"); *In re Heritage Highgate, Inc.*, 679 F.3d 132, 141 (3d Cir. 2012) (same). As such, in order to meet their burden under *In re Heritage*, Debtors were required to show the price they would have to pay to replace the Shared Collateral. Debtors did not even try to do this, despite conceding that a property's value is based on what "a willing buyer in the debtor's trade" would pay to replace it. Opp. Br. p. 23 (citing *In re Am. Land Acquisition Corp.*, 2013 Bankr. LEXIS 2353, at *24-25 (Bankr. E.D.N.Y. June 10, 2013)). Notably, however, Debtors did not claim, much less submit evidence to support, that any of the "125 potentially interested parties" was in the same business as Debtors such that their lack of interest became relevant. Thus, by their own admission, Debtors failed to demonstrate the Shared Collateral's value by the metric they concede governs.

Indeed, it is self-evident that Debtors failed to demonstrate the value of the Shared Collateral because Debtors' CEO, Neuhauser, expressly testified that Debtors (i) did not know the value of the Shared Collateral; (ii) could not offer an approximate amount of the value; and (iii) did not even know how many airplanes constituted the Shared Collateral. A-320:20-23.

Further demonstrating that Debtors' purported valuation method is fatally flawed, Neuhauser also admitted numerous facts that demonstrate that Debtors' failure to obtain new equity investments does not accurately reflect the value of the Shared Collateral, including that:

- Equity investors make investments to achieve an internal rate of return, and an investment in Debtors' businesses may not reach such rate even if selling the Shared Collateral would generate a positive return (A-324:20-325:2);
- Investors look primarily to a business's future potential earnings in determining whether to make an investment, and not the market value of the assets used to operate the business (A-322:20-323:25); and
- The COVID-19 pandemic had, at the time, decimated demand for Debtors' air travel services and potential investors may have relied on their perception of such demand destruction in declining to invest (*id.*).

These admissions are compounded by the fact that this is Debtors' second bankruptcy since 2004 and third restructuring since that time, while keeping the same management and outside advisors. *See* A-327:16-25, A-337:1-9; *In re New York, N.H. & H.R. Co.*, 4 B.R. 758, 792 (D. Conn. 1980) ("[t]he stigma of bankruptcy alone is a factor that will seriously depress the market value of a company's securities"). While Debtors' businesses and management may not have been sound investments, that does not mean that the Shared Collateral had insufficient value. Indeed, Neuhauser admitted that Debtors ***successfully obtained an additional $160 million in debt financing secured by the Shared Collateral***. A-321:8-21; A332:13-21. As such, even under Debtors' logic, lenders saw enough value to make a massive nine-figure loan secured by a portion of the surplus value of the Shared Collateral.

Next, Debtors admit that the "market price" for shares in their businesses is not a reliable estimate of value where there is "some reason to distrust it." *See* Opp. Br. p. 29 (*quoting VFB LLC v. Campbell Soup Co.*, 482 F.3d 624, 633 (3d Cir. 2007)). Here, there is ample reason to distrust the market's Spring 2021 purported valuation of Debtors' businesses given the nature of the COVID-19 pandemic, the uncertainty of its resolution, the then-ongoing border closures and other travel restrictions, and decrease in airline travel. *See In re New York, N.H. & H.R. Co.*, 4 B.R. at 792 (market value of securities was improper where "the market has underrated" their value due to being "somewhat unsettled" from "social, political, and economic stresses current on the domestic and international scenes"); *In re Penn Central Transportation Co.*, 596 F.2d 1102, 1115-16 (3d Cir. 1979) (market approach was improper where "the market value of the security will depend upon the investing public's perception of the future prospects of the enterprise," which "may well be unduly distorted by the recently concluded reorganization and the prospect of lean years for the enterprise in the immediate future").

Tellingly, Debtors fail to cite a single case holding that a debtor successfully proved the value of property serving as collateral by demonstrating that it could not attract equity investments in its business. This is because a lack of investment demand does not demonstrate the value of collateral. Rather, it only demonstrates that investors, seeking to match or exceed an internal rate of return, did not view an investment in Debtors' businesses as likely to achieve that rate, which could be due to concerns about current management and other apprehensions about the businesses that have nothing to do with the value of certain property. Notably, most of the cases Debtors try to rely upon involved determining the value of assets based on the market value of ***the assets themselves***, not the corporate owners.[3] The remainder of the cases they cite did not involve determining the value of a company's assets, but rather the companies themselves, which has no bearing here.[4]

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[3] *See Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 456-57 (1999) (market exposure of property at issue determined the property's value); *In re Am. Land Acquisition Corp.*, 2013 Bankr. LEXIS 2353, at *24-25 (offer to buy the property likely reflects its true value); *In re Boston Generating, LLC*, 440 B.R. 302, 323-24 (Bankr. S.D.N.Y. 2010) (same); *Keener v. Exxon Co., USA*, 32 F.3d 127, 132 (4th Cir. 1994) (same); *In re Residential Capital, LLC*, 501 B.R. at 595-97, 603 (same); *In re Claar Cellars LLC*, 623 B.R. 578, 587 n.7 (Bankr. E.D. Wash. 2021) (same); *In re Flour City Bagels, LLC*, 557 B.R. 53, 78-79 (Bankr. W.D.N.Y. 2016) (same); *In re Buerge*, 2014 Bankr. LEXIS 1264, at *6, 46 n.87 (B.A.P. 10th Cir. Apr. 2, 2014) (auctioning the assets would determine their value); *In re HomeBanc Mortg. Corp.*, 573 B.R. 495, 516-18 (Bankr. D. Del. 2017) (same); *In re Motors Liquidation Co.*, 576 B.R. 325, 341-42 (Bankr. S.D.N.Y. 2017) (value of over 200,000 assets in dispute was determined by analyzing a sample of such assets).

[4] *See In re Granite Broad. Corp.*, 369 B.R. 120 (Bankr. S.D.N.Y. 2007) (valuating debtors' ***company*** to determine whether the plan deprived ***equity holders*** of appropriate recovery) (emphasis added); *In re Genco Shipping & Trading Ltd.*, 513 B.R. 233, 242-43 (Bankr. S.D.N.Y. 2014) (same); *In re Chemtura Corp.*, 439 B.R. 561 (Bankr. S.D.N.Y. 2010) (determining the "total

B. <u>The Propriety of a Valuation Method Is a Question of Law</u>

Debtors' argument that the Court cannot reverse the Bankruptcy Court's order because the value of the Shared Collateral is a factual issue is completely misguided. It is black letter law that whether a lower court applied the correct legal standard is a legal question to be analyzed *de novo*, even in Bankruptcy Court. *U.S. Bank N.A. ex rel. CWCapital Asset Mgmt. LLC v. Vill. at Lakeridge, LLC*, 138 S. Ct. 960 (2018) (appellate courts "should apply *de novo* review" to tests applied by the bankruptcy court, and "must correct any legal error"); *see also In re Maddox*, 200 B.R. 546, 549 (D.N.J. 1996) (whether collateral was properly valued under 11 U.S.C. § 506(a) is reviewed *de novo*). That is the exact question at issue on this appeal.

Moreover, even if the clearly erroneous standard applied – which it does not – it is well settled that an appellate court can reverse or remand a bankruptcy court's order as clearly erroneous where the findings are not supported by the record. *See In re Union Bank*, 127 B.R. 514, 518, 522 (E.D.N.Y. 1991) (findings are clearly erroneous because "the record as a whole does not support the findings made by the Bankruptcy Court"); *In re 9281 Shore Rd. Owners Corp.*, 187 B.R. 837, 847, 850 (E.D.N.Y. 1995) (bankruptcy court's "finding…is clearly erroneous" when unsupported by the record); *Tekkno Labs., Inc. v. Perales*, 933 F.2d 1093, 1097 (2d

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enterprise value" of a group of debtors – not specific assets); *VFB LLC*, 482 F.3d at 633 (publicly-traded securities showed the value of a subsidiary).

Cir. 1991) (vacating order is proper "if the findings and the record are not sufficient to enable us to be sure of the basis of the decision"). As set forth above, the Bankruptcy Court ignored Neuhauser's testimony admitting that (i) Debtors did not know the value of the Shared Collateral; (ii) investors looked to myriad complex and unrelated factors well outside of the value of the Shared Collateral when deciding whether to invest; and (iii) Debtors successfully obtained an additional $160 million in debt financing secured by a portion of the surplus value of the Shared Collateral. Accordingly, the Bankruptcy Court committed reversible error by rubber-stamping Debtors' unsupported contentions in the face of this evidence.

II. THE BANKRUPTCY COURT FAILED TO PROPERLY APPLY THE ABSOLUTE PRIORITY RULE

In the Appeal Brief, Appellants demonstrated that the Bankruptcy Court's improper valuation of the Shared Collateral also resulted in a violation of the absolute priority rule by allowing the Unconsolidated Debtors' creditors and equityholders to receive full, unimpaired recoveries while Appellants would only receive a penny on the dollar, despite less than one-third of the 2023 Noteholders voting to approve the Plan. App. Br. pp. 27-30. Debtors, tellingly, do not dispute this disparate treatment. Instead, Debtors scramble to come up with a reason why the absolute priority rule does not apply here. Their efforts fail.

Debtors first claim that the absolute priority rule does not apply because the value of the Shared Collateral was insufficient, and as such, Appellants' claims were properly classified as part of the "general unsecured" class that voted to approve the Plan. Opp. Br. pp. 38-39, 42-43. This circular argument fails because, as set forth above, Debtors did not prove that the Shared Collateral had insufficient value. *See* Point I, above.

Debtors' second argument is that the absolute priority rule does not apply because a sufficient amount of the 2023 Noteholders voted to approve the Plan, such that it would not matter if there was a separate class for the 2023 Note Claims. In so doing, Debtors simply wish away the facts. It is undisputed that fewer than one-third of the 2023 Noteholders voted to approve the Plan, which votes were induced by Debtors' deceptive and unsupported representation that the Shared Collateral had insufficient value to satisfy the 2023 Notes. This does not meet the threshold needed to approve a plan. App. Br. pp. 15, 27-28. Debtors try to avoid this by claiming in a footnote, with no support, that the Court should look to the number of *actual* votes, not *eligible* voters. Opp. Br. p. 44 n.15. Once again, Debtors are wrong. *See In re Hertz*, 38 B.R. 215, 216-17 (Bankr. S.D.N.Y. 1984) (debtors met voting threshold by obtaining approval from a sufficient number of the creditors "who were ***eligible to vote*** for or against the Plan") (emphasis added).

Finally, Debtors argue that Appellants are not creditors of the Unconsolidated Debtors, and as such the Plan would not violate the absolute priority rule. Here, too, Debtors ignore reality and do not cite a single case to support their position. Debtors do not dispute that the vast majority of even the Avianca Debtors are not guarantors of the 2023 Notes, nor that the same pool of funds is being used to satisfy all claims asserted in this matter. A-353:20-355:6 ("Q: The mere fact that the unconsolidated debtors are not guarantors of the 2023 notes doesn't really put them in a different position than the vast majority of the Avianca debtors; is that correct? A: That fact, specifically, you are correct."). As such, the Plan violates the absolute priority rule by leaving the Unconsolidated Debtors' creditors and equityholders unimpaired while forcing Appellants to take a literal penny on the dollar. *In re Lehman Bros. Holdings Inc.*, 855 F.3d 459, 470 (2d Cir. 2017) (all "creditors are entitled to be paid ahead of shareholders in the distribution of corporate assets"); *In re DBSD N. Am., Inc.*, 634 F.3d 79, 94 (2d Cir. 2010) (same); *In re LATAM Airlines Grp. S.A.*, 620 B.R. 722, 797 (Bankr. S.D.N.Y. 2020) (same).

III. THE BANKRUPTCY COURT ERRED BY MISAPPLYING THE STANDARD FOR SUBSTANTIVE CONSOLIDATION

The Bankruptcy Court also erred by finding that Debtors met their heavy burden to warrant substantive consolidation because most of the *Augie/Restivo* factors do not apply here. Further, to the extent consolidation was appropriate, the Unconsolidated Debtors should have been included because there is no material difference between them and the Avianca Debtors. App. Br. pp. 24-27. In opposition, Debtors essentially ignore Appellants' arguments and, instead, double down on their purported evidentiary showing to claim that they sufficiently showed "creditor reliance" or "hopeless entanglement" under *Augie/Restivo*. Opp. Br. pp. 32-38. They did not.

A. <u>Appellants Did Not Rely on the Avianca Debtors as a Single Unit</u>

Debtors argue that the public and creditors relied on the Avianca Debtors, but not the Unconsolidated Debtors, operating as a single unit, and thus substantive consolidation is proper. Opp. Br. pp. 35-38. This argument fails because substantive consolidation under the "creditor reliance" standard cannot apply where the ***creditor challenging the consolidation*** did not treat the debtors as a single entity. *See Augie/Restivo Baking Co.*, 860 F.2d 515, 518-19 (2d Cir. 1988) (no creditor reliance where the creditors challenging substantive consolidation believed "that they were dealing with a separate entity" and did not anticipate "having the creditors of a less sound debtor compete for the borrower's assets"); *In re Republic Airways Holdings Inc.*, 565 B.R. 710, 719-22 (Bankr. S.D.N.Y. 2017) (Opp. Br. p. 32) (creditor reliance is analyzed "from the creditors' perspective," "not the managers of the debtors themselves, or consumers"). During cross-examination, Debtors admitted that Appellants never treated the Avianca Debtors as a single entity, as not all the Avianca Debtors were guarantors of the 2023 Notes. A-354:11-21 (admitting that 28 of the Avianca Debtors are not guarantors of the 2023 Notes). Accordingly, Debtors' argument fails.

B. Debtors Did Not Prove Hopeless Entanglement

Equally meritless is Debtors' insistence that the Avianca Debtors' common operations and consolidated financial statements were sufficient to prove that their affairs are hopelessly entangled, while the Unconsolidated Debtors were excluded because they maintain separate books and records. Opp. Br. pp. 33-35. Debtors' own testimony proves that this argument fails. Debtors admitted that the Avianca Debtors maintain separate books and records via separate subledgers and a central cash management system that tracked the various intercompany transactions. A-351:18-352:5; A-347:3-12; *see also* A-956 ¶18; *In re Owens Corning*, 419 F.3d 195, 215 (3d Cir. 2005) (no hopeless entanglement where "all the relevant accounting data…still exists" and "only a reasonable review to make any necessary adjustments [was] required."); *In re Augie/Restivo*, 860 F.2d at 518-19 (same). Debtors cannot simultaneously insist that the Unconsolidated Debtors' separate books and records make it "easy" to disentangle their affairs, but that the Avianca Debtors' separately-tracked subledgers are somehow a hopelessly entangled mess. Opp. Br. p. 36; A-364:1-5. Tellingly, Debtors did not testify that they even *tried* to disentangle the Avianca Debtors' affairs – they simply threw up their hands in preemptive, and convenient, defeat in order to "goal seek" their preferred outcome. A-367:18-25 ("I can't even fathom how long it would take [to untangle the records]").

The cases cited by Debtors to support their "hopeless entanglement" argument are all inapposite, because, unlike here, the debtors all shared books and records, rendering their untangling prohibitively expensive and unrealistic. *See In re Extended Stay, Inc.*, 2020 Bankr. LEXIS 2128, *168-69, 172 (Bankr. S.D.N.Y. Aug. 8, 2020) (Opp. Br. p. 31) (debtors proved the "rare case" of hopeless entanglement where none of the debtors had "their own books and records, and adequate records of complete accounting activity related to each legal entity were not maintained"); *accord In re Republic Airways Holdings Inc.*, 565 B.R. at 719-22 (Opp. Br. p. 32); *In re Seatrade Corp.*, 369 F.2d 845, 846-48 (2d Cir. 1966) (Opp. Br. pp. 34-35) (finding "a rare case" of hopeless entanglement due to debtors' disregard of corporate formalities, including pooling together their funds).

Even if the Court found that substantive consolidation was proper, there is no material difference between any of the Debtors to justify excluding the Unconsolidated Debtors. To the contrary, as demonstrated in the Appeal Brief, Debtors do not dispute that (i) all of the Debtors have common direct or indirect ownership, with the Avianca Debtors owning between 90-92% of the Unconsolidated Debtors; (ii) the assets and liabilities of the Unconsolidated Debtors are part of Debtors' consolidated financial statements; (iii) Debtors' financial projections are made "on a consolidated basis" for all Debtors, including the Unconsolidated Debtors. App. Br. pp. 14-15, 26-27. Moreover, Debtors admitted that, like many Avianca Debtors, "Avifreight was established solely to comply with local regulations." A-958 ¶26; A-955 ¶18. As such, excluding the Unconsolidated Debtors is simply an improper tactical attempt to use substantive consolidation as a sword to protect Debtors' three most financially sound entities. *Augie/Restivo Baking Co.*, 860 F.2d at 521 (substantive consolidation improper where some debtors' assets would be used to pay other debtors' debts and enrich particular creditors); *In re Owens Corning*, 419 F.3d at 216 (prohibiting the use of substantive consolidation "as a sword" because "the benefit to creditors [from consolidation] should be from cost savings that make assets available rather than from the shifting of assets to benefit one group of creditors at the expense of another").

CONCLUSION

For the foregoing reasons, Appellants respectfully request that the Court reverse the Bankruptcy Court's confirmation order in full.

Dated: New York, New York
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