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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	)	
	)	Case No. 19-22312 (RDD)
WINDSTREAM HOLDINGS, INC., *et al*,[1]	)	
	)	(Jointly Administered)
Debtors.	)	

OBJECTION OF UMB BANK, NATIONAL ASSOCIATION AND U.S. BANK NATIONAL ASSOCIATION, AS INDENTURE TRUSTEES, TO THE FIRST AMENDED JOINT CHAPTER 11 PLAN OF REORGANIZATION OF WINDSTREAM HOLDINGS, INC. *ET AL.*, PURSUANT TO CHAPTER 11 OF THE BANKRUPTCY CODE

[1] The last four digits of Debtor Windstream Holdings, Inc.'s tax identification number are 7717. A complete list of the debtor entities and the last four digits of their federal tax identification numbers may be obtained on the website of the Debtors' claims and noticing agent at http://www.kccllc.net/windstream. The location of the Debtors' service address for purposes of these chapter 11 cases is: 4001 North Rodney Parham Road, Little Rock, Arkansas 72212.

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MISCELLANEOUS

UMB Bank, National Association, solely in its capacity as successor indenture trustee ("UMB Bank") under that certain indenture dated as of December 13, 2017 with Windstream Services, LLC ("Services") (as successor to Windstream Corporation) and Windstream Finance Corp. as co-issuers of 8.75% Senior Notes due 2024 and U.S. Bank National Association, solely in its capacities as indenture trustee ("U.S. Bank," and together with UMB Bank, the "Trustees") under (i) that certain indenture dated as of October 6, 2010 between it and Services as issuer of 7.75% Senior Notes due 2020, (ii) that certain indenture dated as of March 28, 2011 between it and Services as issuer of 7.75% Senior Notes due 2021, (iii) that certain indenture dated as of November 22, 2011 between it and Services as issuer of 7.50% Senior Notes due 2022, (iv) that certain indenture dated as of March 16, 2011 between it and Services as issuer of 7.50% Senior Notes due 2023, and (v) that certain indenture dated as of January 23, 2013 between it and Services as issuer of 6.375% Senior Notes due 2023, hereby file this objection (the "Objection") to the *First Amended Joint Chapter 11 Plan of Reorganization of Windstream Holdings, Inc. et al., Pursuant to Chapter 11 of the Bankruptcy Code* [Dkt. No. 1812] (the "Plan"), and the accompanying Declaration of Julia M. Winters in Support of the Objection (the "Winters Declaration" or "Winters Decl.").[2] In support of the Objection, the Trustees respectfully state as follows:

PRELIMINARY STATEMENT

1. When the Debtors commenced these chapter 11 cases, they did so with the attitude that they did not belong in bankruptcy, assuring the Court that their chapter 11 stay would be short. Now sixteen months later, the Debtors seek to confirm a Plan that allocates all of the unencumbered value of their estates and all of the benefits obtained through the chapter 11

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

process to their secured creditors, leaving more than $2 billion of funded debt with no recovery at all.

2. The Plan, which was never negotiated with, or even discussed with the Official Committee of Unsecured Creditors or with the Trustees, is premised on three flawed assumptions: (1) the Obligor Debtors (*i.e.*, those Debtors who have either issued or guaranteed funded debt) have zero equity in any of their assets with which to pay any unsecured claims, (2) their postpetition settlement with Uniti – emanating from a litigation that was instigated by, prosecuted with, and seeking to remedy wrongs committed against their unsecured creditors – provides no value to those unsecured creditors, and (3) the secured creditors that facilitated the value-destructive spin-off should receive all of the value of the Debtors' estates solely on account of their secured claims as classified in the Plan. Indeed, the Plan does not contemplate any secured creditor deficiency claims and does not discuss, quantify, classify, or treat any other claims that such creditors may have, including on account of diminution in value, if any, of their prepetition collateral. In fact, the impaired, accepting class with which the Debtors are seeking to cram down every objecting class is Class 3 (First Lien Claims).

3. Given this Plan construct, the entire architecture falls apart if there is even one dollar of unencumbered value being used to satisfy secured claims. For, if a dollar of unencumbered value is distributed on account of Class 3 claims, it will result in Class 3 claimants being paid more than in full in violation of the absolute priority rule and the best interest test. To be clear, these tests are not subject to a materiality qualifier and even one dollar of misappropriated unencumbered value renders the plan unconfirmable on this basis. As set forth below, and as will be proven at trial, there is in fact substantial value in the Debtors' estates

that is not subject to the secured creditors' liens, including the $1.245 billion in proceeds from the Uniti Settlement.

4. In order to confirm their Plan, the Debtors must show that one hundred percent of these proceeds – including proceeds attributed to the Recharacterization Claim, which the Debtors say accounts for the "vast majority" of the overall settlement consideration – are subject to the secured creditors' prepetition liens or, in the alternative, that the first lien creditors' unasserted and untreated adequate protection claim would subsume any unencumbered value. As set forth herein, the Debtors' entire confirmation case is premised on two legal theories that have never been adopted by any court in any circuit. First, the Plan will rise or fall on the Debtors' assertion that the Recharacterization Claim, and indeed all of the claims that were asserted, or could have been asserted, against Uniti in the Adversary Proceeding, are subject to the secured creditors' prepetition liens. The Trustees are unaware of any case in which a court has held that a recharacterization claim asserted by a debtor constitutes a prepetition asset that could ever be subject to a prepetition grant. Indeed, such a result would be contrary to the very claim that the Debtors pleaded in both their complaint and amended complaint, which requested relief specific to the treatment of the lease arrangement under the Bankruptcy Code. It is entirely unclear at this point how a declaratory judgment with respect to the application of a Bankruptcy Code provision is a claim that any of these Debtors could have brought prepetition and thus could have pledged to their prepetition lenders.

5. Second, the Debtors' Plan will rise or fall on the Debtors' assertion that whatever unencumbered value exists within the enterprise would be subsumed by hypothetical adequate protection claims that are not being asserted or treated under the Plan. Notably, the secured creditors, on whom the Bankruptcy Code squarely places the burden of proving diminution in

value, will be offering no testimony in support of adequate protection claims. Rather, in seeking to meet the high burden of establishing such a claim, the Debtors will ask this Court to adopt an adequate protection formulation that no court has ever sanctioned for calculating the value of "collateral" within the meaning of section 361 of the Code. The only evidence that the Debtors will offer will be a comparison of (i) Windstream's total enterprise value (not the value of any collateral) prior to the bankruptcy filing, without taking into consideration the impact of the bankruptcy on such value, and (ii) the Debtors' total enterprise value (again, not the value of any collateral) at the projected end of a bankruptcy process.

6. As set forth below, an adequate protection claim is only designed to compensate secured creditors for diminution in the value of their collateral caused by specific events from, and after, the petition date. The specific adequate protection granted by this Court specifically directed that the claim would exist from and after the Petition Date. And as this Court has recently explained, the starting point calculation must account for the "post bankruptcy reality." In re Sears Holdings, Inc., Case No. 18-23538 (RDD), July 31, 2019 Hr'g Tr. at 241:20-24. The Debtors will submit no evidence reflecting what the value of collateral was on the Petition Date in light of post-bankruptcy realities.

7. In sum, both of these novel legal theories central to Plan confirmation – that all of the proceeds of a debtor's recharacterization and fraudulent conveyance claims can be encumbered by prepetition liens, and that secured creditors' diminution in collateral should be measured by enterprise value prior to any distress – should be rejected, and confirmation should be denied on the evidentiary record at confirmation.

BACKGROUND

A. The Secured Lenders' Prepetition Collateral

8. As the Court is aware, on April 24, 2015, Services and its subsidiaries transferred various telecommunications assets to Uniti and its subsidiaries, and such assets were then leased back to Holdings. In connection with the transaction, Windstream's first lien creditors agreed to enter into an amended security agreement that excluded the "Contributed Assets" (a.k.a. the Leased Property) from their collateral grant. Specifically, the amended security agreement reaffirmed the existing grant of security "but, for the avoidance of doubt, excluding any security interest granted in the Contributed Assets." (Winters Decl. Ex. A, Amended and Restated Security Agreement among Windstream Services, LLC, the Guarantors party thereto and JPMorgan Chase Bank, N.A., as Collateral Agent originally dated as of July 17, 2006 and as amended and restated as of April 24, 2015 (the "Prepetition Credit Facility Security Agreement"), § 18) The first lien creditors received approximately $1 billion in cash and the retirement of approximately $2.45 billion of existing debt for agreeing to this significant modification to their collateral package.

9. The Prepetition Credit Facility Security Agreement does not provide for an "all asset" lien. Rather, the Prepetition Credit Facility Security Agreement grants a continuing security interest in a subset of the assets owned by a subset of the Debtors, including Services and 125 of its guarantor subsidiaries (collectively, the "Obligor Debtors"). Holdings and 79 non-guarantor subsidiaries (collectively, the "Non-Obligor Debtors") have not granted any liens in favor of the first lien creditors.

10. At the same time, the Prepetition Credit Facility Security Agreement carves out substantial categories of "Excluded Assets," including certain motor vehicles, voting equity

interests in foreign subsidiaries in excess of 66% of all voting equity interests in each such foreign subsidiary, and the Contributed Assets (defined below). (Id.) In addition, the trial record will not show that any of the Debtors' scheduled real property is subject to a mortgage.

11. The security grant with respect to the first lien notes is limited in an identical manner. On November 6 and 8, 2017, Services and Windstream Finance Corp., a direct wholly-owned subsidiary of Services, issued $600 million aggregate principal amount of 8.625% Senior First Lien Notes due 2025 (the "First Lien Notes"). The grant in the security agreement for the First Lien Notes (the "First Lien Notes Security Agreement") expressly carves out "Excluded Assets," which is defined in the relevant indenture to include, among other things, "Contributed Assets." Contributed Assets, in turn, is defined as "the assets contributed or otherwise transferred on April 24, 2015 by certain of the Issuers and Guarantors to one or more subsidiaries of Communications Sales & Leasing, Inc., a Maryland corporation, pursuant to certain assignment and assumption agreements dated as of April 24, 2015." (Winters Decl. Ex. B, First Lien Notes Security Agreement, § 1(c); 2(a))

12. All parties recognized that the exclusions were meaningful. In connection with the offering of the First Lien Notes in November 2017, the Debtors stated:

> **Not all of our and the guarantors' assets secure the notes.**
>
> The notes will be effectively junior to any obligations secured by certain permitted liens and any assets that are not part of the Collateral, in each case to the extent of the value of such assets. In particular, certain categories of assets are excluded from the Collateral, as described under "Description of notes—Collateral and intercreditor arrangements," including all real property and other assets specifically excluded as "Excluded Assets." Accordingly, the value of the Collateral (or the Collateral in which the holders have a perfected security interest) may be significantly less than the value of the secured obligations. ***The value of the excluded assets is significant***. In certain circumstances, the excluded assets may also be pledged to other lenders.

(Winters Decl. Ex. C, Offering Memorandum dated November 6, 2017, p. 30) (emphasis added) Thus, as of the Petition Date, the Debtors' first lien lenders did not have liens on substantially all of the Debtors' assets or even a vast majority of the Debtors' assets.

B. The DIP Order Preserves Uniti Settlement Proceeds for Unsecured Creditors

13. On February 25, 2019, the Debtors commenced the chapter 11 cases.

14. On April 22, 2019, the Court authorized the Debtors to obtain postpetition financing on a final basis. (*Final Order (A) Authorizing the Debtors to Obtain Postpetition Financing, (B) Authorizing the Debtors to Use Cash Collateral, (C) Granting Liens and Providing Superpriority Administrative Expense Status, (D) Granting Adequate Protection to the Prepetition Secured Parties, (E) Modifying the Automatic Stay, and (F) Granting Related Relief* [Dkt. No. 376] (the "Final DIP Order"))

15. When seeking approval of interim financing, the Debtors assured the Court that they anticipated a short stay in bankruptcy, with a rapid path to a negotiated exit. (See Winters Decl. Ex. D, Feb. 26, 2019 Hr'g. Tr. at 28:7-16 ("[T]his company does not belong in Chapter 11 for an extended period of time. We did not have over the last 11 days the ability to get to an arrangement with our key stakeholders on what an exit might look like . . . . [But we] are cautiously optimistic, that we'll be back before Your Honor pretty quickly on explaining what that exit arrangement looks like.")) At the same time, the Debtors acknowledged that there were potentially significant claims against Uniti. (See id. at 27:16-25 ("[T]here are two aspects of the company's relationship with Uniti that we expect will be subject to further discussion in this case. One is the terms of the company's master – the economic terms of the company's master lease agreement that Windstream has with Uniti, and the economic terms that are entailed there. And second the underlying transaction itself that was the subject of the litigation."))

16. At the final DIP hearing, U.S. Bank, on behalf of the holders of unsecured notes, objected to ensure that the incurrence of a DIP to facilitate the purportedly rapid path to exit would not affect the rights of unsecured creditors to the value inherent in the claims against Uniti that were then under investigation. (See *Limited Objection of U.S. Bank National Association* [Dkt. No. 242], ¶ 27 ("The Prepetition Secured Parties currently have no prepetition lien rights against Holdings or the Master Lease. . . . This post-petition effort to patch a hole in the scope of prepetition collateral with Adequate Protection Liens and 507(b) Claims should not be permitted because it is prejudicial to the Noteholders. . . . The Court should avoid setting the stage for additional complications in these Bankruptcy Cases as the Debtors and others address the issues relating to the Sale-Leaseback Transaction, Holdings, and the Master Lease."))

17. Ultimately, the Court approved a broad package of adequate protection liens and claims in favor of secured creditors. (Final DIP Order, ¶ 15) At the same time, it approved the following footnote:

> The DIP Agent and Prepetition Agent are each deemed a "Permitted Leasehold Mortgagee" under that certain Master Lease dated April 24, 2015, by and among CSL National, LP, the landlords party thereto and Holdings, as tenant (the "**Master Lease**"). Notwithstanding the foregoing and any rights granted by Holdings to and accepted by the DIP Lenders under the DIP Credit Agreement or otherwise provided in this Final Order with respect to Holdings (including releases), the DIP Lenders, the Prepetition Secured Parties, the Creditors' Committee, the Debtors' creditors and equity holders, and the Debtors each reserve all rights and remedies under applicable law, if any, with respect to the execution and performance of the Master Lease and the transactions giving rise to it (the "**Uniti Spin-off**"), ***and nothing in this Final Order shall impact or prejudice the rights of any such party to benefit from any adjudication or settlement of any claims arising from, asserted or that could have been asserted on account of the Uniti Spin-Off .***

(Id. ¶ 8(a) n.9 (emphasis added))

C. The 9019 Order Does Not Confer Liens on Uniti Settlement Proceeds

18. Through May 2019, the Debtors made no effort to pursue any claims related to the Spin-Off, despite inquiries from their creditor body. Frustrated with the Debtors' unwillingness to do anything to remedy the wrongs which destroyed their capital structure, the Trustees filed a motion on June 28, 2019, seeking to strike the Master Lease from the Debtors' schedules and to stop the post-petition intercompany transfers made to facilitate the "rent" payments to Uniti. (See generally *Motion to Strike the Uniti Master Lease from the Debtors' Schedule G* [Dkt. No. 728]) On July 12, 2019, equally frustrated with the Debtors' lack of action, the Official Committee of Unsecured Creditors (the "Committee") sought standing to pursue certain claims related to the Spin-Off, arguing that the Debtors' estates held colorable and valuable claims that the Spin-Off was a fraudulent conveyance. (See generally *Motion of the Official Committee of Unsecured Creditors for (i) Leave, Standing, and Authority to Commence and Prosecute Certain Claims and Causes of Action on Behalf of Debtors' Estates and (ii) Consent Rights to Settlement* [Dkt. No. 786])

19. Only after unsecured creditors took steps to preserve and prosecute the estates' valuable claims against Uniti, did the Debtors take any action. The Debtors first sought the appointment of a mediator on July 12, 2020, in an attempt to head off any litigation. Then, on July 25, 2019, Holdings and Services filed a complaint commencing an adversary proceeding (the "Adversary Proceeding") seeking, among other things, a declaration that the arrangement between Holdings and Uniti styled as a Master Lease is a financing and not a lease of non-residential real property for purposes of applicable bankruptcy law (the "Recharacterization Claim"). The Adversary Proceeding includes fraudulent transfer and breach of contract claims arising from the relationship between the Debtors and Uniti. Each of these claims survived a

motion to dismiss, and the Recharacterization Claim was set to proceed to trial with the remaining claims held in abeyance.

20. On May 8, 2020, the Court granted the Debtors' motion to settle all of the claims in the Adversary Proceeding as well as myriad other claims that the Debtors had and could have against Uniti (the "9019 Motion"). On May 12, 2020, the Court entered an order to that effect [Dkt. No. 1807] (the "9019 Order"). On May 26, 2020, the Trustees commenced an appeal of the 9019 Order in the District Court for the Southern District of New York. The appeal was assigned to the Honorable Vincent L. Briccetti.

21. The Uniti Settlement purports to provide the Debtors' estates with $1.245 billion in aggregate consideration, though none of it is allocated to any particular estate or any particular claim. During the contested proceedings on the 9019 Motion, the Debtors repeatedly asserted that allocation of those proceeds (and the extent to which they are encumbered or unencumbered) would be addressed at confirmation. (See Winters Decl. Ex. E, May 8, 2020 Hr'g Tr. at 9:15-19 ("the issues regarding distribution and allocation of value under the plan are not before the Court today and the release that is before the Court is not intended to, nor should it, prejudice anyone's rights or arguments regarding allocation."); Winters Decl. Ex. F, May 18, 2020 Letter from Yates French to Lorenzo Marinuzzi and Christopher Shore ("The Debtors will agree to produce a presentation and underlying documents sufficient to show the Debtors' position on allocation."))

22. All of the foregoing is entirely consistent with the Debtors' representations to the Court prior to the 9019 hearing:

> And the fact that the settlement provides that the Debtors and certain of their supporting creditors may agree to direct the receipt of certain settlement proceeds to specific Debtor entities is without prejudice to any party's rights to challenge the ultimate allocation of value among the different classes of creditors at the confirmation hearing. At confirmation, the creditors' committee and indenture

> trustees (and any other objecting parties) will have every right to present arguments and evidence regarding allocation among the various classes of creditors, and if they prevail there is no impediment to distributing whatever value the Court believes is appropriate to unsecured creditors. Nothing in the term sheet, the upcoming settlement documents, or the resolution of the Debtor's settlement motion change this.

(April 2, 2020 Letter from Yates French to The Honorable Robert D. Drain [Dkt. No. 1636])

23. In approving the settlement, the Court relied upon those representations and made clear that disputes over allocation were preserved for Plan confirmation. (Winters Decl. Ex. E, May 8, 2020 Hr'g Tr. at 44:7-11 ("Nothing in this settlement allocates recoveries to any specific class. Consideration comes into the Debtor and then is subject to allocation thereafter, not pursuant to this settlement or this order.")) The 9019 Order expressly provides that "the rights of all parties are fully reserved with respect to the allocation of any proceeds of the Settlement among the Debtors and regarding any objections to confirmation of the Debtors' chapter 11 plan, subject in any event to each party's rights as such rights would otherwise exist under applicable law." (9019 Order, ¶ 40)

D. The Plan Does Not, and In Any Event Could Not, Provide Distributions Based on Purported Adequate Protection Claims

24. To date, the Debtors have not allocated the settlement consideration either to any particular estate or to any particular settled claim. (Winters Decl. Ex. G, Thomas Dep. Tr. at 139:11-140:12 [redacted]) Instead, the Debtors have vaguely suggested how settlement consideration ***could*** hypothetically be allocated among the Recharacterization Claim and all other released claims. (<u>See</u> May 22, 2020 Letter from Yates M. French to The Honorable Robert D. Drain [Dkt. No. 1915] (the "<u>May 22 Letter</u>") ("at least the vast majority" of proceeds are attributable to the Recharacterization Claim); Winters Decl. Ex.

G, Thomas Dep. Tr. at 82:19-83:2 [redacted] As it stands then, the Court has no record from which it can determine which Debtors have what assets to satisfy their prepetition creditors, or determine what portion of the consideration that is indisputably not subject to a prepetition lien (i.e., the pleaded fraudulent conveyance claims) are unencumbered.

25. Were there any doubt about allocation, for their part, representatives of the first lien creditors have confirmed that they and the Debtors will not be allocating the settlement consideration in advance of confirmation. (See Winters Decl. Ex. H, Weber Dep. Tr. at 154:9-18 ([redacted])

26. Notwithstanding prior assurances that allocation would be resolved in connection with the Plan, the Debtors now contend that allocation to any particular estate or any particular claim is unnecessary. According to the Debtors, the first lien creditors are entitled to assert adequate protection claims that would subsume any unencumbered value, regardless of where it resides. (See May 22 Letter ("[F]or the sake of argument only, ***even if*** 100% of the settlement proceeds were to be hypothetically treated as assets not subject to the secured lenders' prepetition liens (and in reality these proceeds are all a combination of cash, general intangibles, and other prepetition collateral), the combination of the DIP financing, adequate protection liens, and administrative claims far exceed their value."))

27. To be clear, the Plan does not provide for the allowance of any such adequate protection claims. Instead, as noted above, the Plan awards all distributable value to the secured creditors solely on account of their Class 3 First Lien Claims. (Plan, Art. III.B.3) The

Disclosure Statement is consistent – there are no disclosures of what holders of adequate protection claims will be recovering on account of any such claims. (Disclosure Statement [Dkt. No. 1813], Art. VII.G ("General Unsecured Claims at the Obligor Debtors are also junior to up to $1 billion in superpriority financing arising under the DIP Facility and $25 million to $75 million of administrative and priority claims on a consolidated basis as of the Effective Date."))

28. At the same time, the Plan awards no guaranteed recovery to holders of general unsecured claims against Obligor Debtors. Specifically, if Class 6A (Obligor General Unsecured Claims) votes to accept the Plan, each holder of a claim in such class shall receive cash in an amount equal to one-eighth of one penny per dollar of claims – i.e., approximately $1.2 million on account of more than $1.132 billion of unsecured notes claims. (Plan, Art. III.B.6) If the class votes to reject the Plan, then each holder of a claim in such class shall receive treatment consistent with the "best interests of creditors test" under section 1129(a)(7) of the Bankruptcy Code. The Liquidation Analysis in the Disclosure Statement concludes that the hypothetical liquidation value is zero. (Id.; Disclosure Statement, Art. III.D) The proposed treatment for holders of Second Lien Claims is identical. (Plan, Art. III.B.5). While the Plan would hypothetically permit this Court to determine that unsecured creditors are entitled to a distribution, the Debtors have made clear their position that unsecured creditors will receive nothing.

29. In support of awarding all value to the Class 3 First Lien Claims but no value to Class 6A Obligor General Unsecured Claims, the Debtors will offer the testimony of two experts.[3] First, Nicholas Leone of PJT Partners LP is expected to testify that, if one compares the total enterprise value of Holdings and all of its subsidiaries, prior to the Aurelius decision,

[3] (See Winters Decl. Ex. K (Expert Report of Nicholas Grossi), Ex. O (Expert Report of Nicholas Leone))

with the total enterprise value on the Effective Date, the estimated adequate protection claim is between approximately $654 million and $1.9 billion. Notably, Mr. Leone will not testify to the valuation as to any particular item of collateral within the grant of the First Lien Notes. Instead, relying on the advice of counsel, he will testify that the total enterprise value of the entire Windstream enterprise was a "good proxy" for the value of the collateral held by certain of the Debtors within that enterprise. To the extent that this Court finds that total enterprise value is even relevant in an adequate protection determination, Mr. Leone will provide no testimony as to the total enterprise value of the Debtors given the reality of their having filed for chapter 11 protection. Again, Mr. Leone's entire analysis is premised off of a valuation of the entire enterprise prior to any distress.

30. Second, the Debtors will offer testimony from Nicholas Grossi of Alvarez & Marsal North America, LLC. Mr. Grossi's entire analysis, however, is premised on the fact that all of the assets of every Debtor are encumbered, contrary to the grants described above, and assumes that there is no value to any claims against Uniti in a liquidation scenario even though Uniti has already agreed to provide $1.2 billion in value to settle those claims. The First Lien Creditors will be offering no expert testimony to satisfy their burden of proving up an adequate protection claim.

OBJECTION

31. To be confirmed, the Plan must comply with section 1129(a) of the Bankruptcy Code. See 11 U.S.C. § 1129(a). As Plan proponents, the Debtors bear the burden of establishing that the Plan complies with each confirmation requirement by a preponderance of the evidence. In re Fur Creations by Varriale, 188 B.R. 754, 760 (Bankr. S.D.N.Y. 1995) (citation omitted); In re Kent Terminal Corp., 166 B.R. 555, 561 (Bankr. S.D.N.Y. 1994). Absent substantive

consolidation, each Debtor must meet that burden with respect to its estate. In re Tribune Co., 464 B.R. 126, 183 (Bankr. D. Del. 2011).

32. The Debtors cannot sustain their burden with respect to the Plan. First, the Plan fails to satisfy the good faith requirement under section 1129(a)(3) of the Bankruptcy Code. Second, the Plan fails to satisfy the requirements for cramdown under section 1129(b) of the Bankruptcy Code because it provides holders of First Lien Claims with recoveries in excess of their allowed secured claims in violation of the absolute priority rule. Third, the Plan fails to satisfy the best interests of creditors test under section 1129(a)(7) of the Bankruptcy Code because it provides holders of Obligor General Unsecured Claims with less value than they would recover in a hypothetical liquidation under chapter 7 of the Bankruptcy Code.

I. THE DEBTORS CAN OFFER NO EVIDENCE AT THE CONFIRMATION HEARING THAT THE PLAN WAS PROPOSED IN GOOD FAITH

33. The Bankruptcy Code requires that a plan of reorganization be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). The "good faith" requirement in section 1129(a)(3) requires a court to examine the process used to propose a plan settlement and to review the plan itself to determine whether "'such plan will fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code.'" See In re Quigley Co., 437 B.R. 102, 125 (Bankr. S.D.N.Y. 2010) (quoting In re Madison Hotel Assocs., 749 F.2d 410 (7th Cir. 1984)). Section 1129(a)(3) "speaks more to the process of plan development than to the content of the plan." In re Bush Indus., Inc., 315 B.R. 292, 304 (Bankr. W.D.N.Y. 2004).

34. A bankruptcy court has an independent duty to determine if a plan is filed in good faith. In re Bodine, 113 B.R. 134, 136 (Bankr. W.D.N.Y. 1990). To do so, it must be presented with a record that demonstrates that the plan was negotiated in good faith and not proposed for

some nefarious reason. See, e.g., In re Quigley Co., 437 B.R. 102, 129 (Bankr. S.D.N.Y. 2010) (denying confirmation where corporate governance was disregarded in order to obtain settlements); In re Bush Indus., 315 B.R. at 306 (denying confirmation where board engaged in self-dealing, violating its fiduciary obligation to advance equally the interests of all creditors). Here, given among other things, the Debtors' choices in responding to discovery, the record at confirmation will show three material flaws with the Debtors' assertion that their proposal to provide no recovery to funded debt unsecured creditors was done in good faith.

35. First, the Debtors can offer no evidence regarding the negotiations of that central aspect of the Plan. In seeking discovery on that section 1129(a)(3) factor, the Trustees served a Rule 30(b)(6) notice on each of the Debtors seeking testimony as to the "negotiation, drafting and approval of the Plan." In response, the Debtors offered, after the fact discovery cut-off, two witnesses, Mr. Leone and Mr. Grossi.[4] Mr. Grossi testified that he had no personal knowledge of Plan negotiations, and offered no testimony regarding the Debtors' negotiation of any Plan provision, other than to say he had discussed such matters with counsel. (Winters Decl. Ex. I,[5] Grossi Rough Dep. Tr. at 82:24-83:2, 84:24-85:19, 87:5-8) Mr. Leone, who was personally involved in plan negotiations, was repeatedly instructed not to answer on the basis of mediation privilege. (Winters Decl. Ex. J, Leone Dep. Tr. at 146:22-151:18) Similarly, Mr. Thomas testified that all of his knowledge with respect to plan negotiations were shielded by mediation privilege. (Winters Decl. Ex. G, Thomas Dep. Tr. at 137:9-138:14; see id. at 19:17-20:3, 35:15-36:12, 168:2-12) As an initial matter, the mediation was limited to the "issues or claims arising

[4] The trustees will address at the confirmation hearing, after seeing the proposed direct testimony, whether the debtors should have been permitted to offer fact testimony after the fact discovery cut off.

[5] The final transcript of Mr. Grossi's deposition was not available in sufficient time to be cited herein.

out of or related to the Uniti Arrangement" and the scope of mediation with respect to plan issues was limited to the "allocation of distributable value under a chapter 11 plan following any resolution" of the Uniti Arrangement. (*Order Appointing a Mediator* ¶ 4 [Dkt. No. 874]) The treatment of unsecured claims was not a topic of the mediation. In any event, the Debtors did not engage in Plan negotiations with the Trustees at any point in time – either before the filing of the Plan or thereafter.

36. Given the Debtors' refusal to provide testimony, the only evidence of any negotiations is a plan term sheet attached to the Plan Support Agreement, which provides no recovery to unsecured creditors. There will be no record as to <u>how</u> it was decided that Class 6A creditors should receive no recovery, who proposed the death trap feature, whether the Debtors ever insisted that the first lien creditors should permit a distribution to unsecured creditors, or why, after reserving issues relating to allocation the Debtors decided not to allocate the Settlement proceeds at all. Without such evidence, the Court cannot find that the central provision of the Plan – the allocation of all distributable value to the first lien creditors – was proposed in good faith. <u>In re Prudential Energy Co.</u>, 59 B.R. 765, 768 (Bankr. S.D.N.Y. 1986) (denying confirmation because there was insufficient information to find that the plan was proposed in good faith including because debtors failed to disclose material evidence in support of the plan); <u>see</u> <u>also</u> <u>In re Eng</u>, No. 13-02195-8-SWH, 2014 Bankr. LEXIS 1890, at *10 (Bankr. E.D.N.C. Apr. 25, 2014) (denying confirmation where plan was not proposed in good faith as debtor "offered no reason as to" when it would pay certain unsecured creditors or why the class was impaired).

37. <u>Second</u>, with respect to all but two Debtors, the Court cannot find that the Plan was proposed in good faith, as there is no evidence that the fiduciaries of any of the subsidiary

Debtors exercised their duty to maximize value for the benefit of their creditors. In re Bush Indus., 315 B.R. at 306 ("In bankruptcy, officers and directors owe a primary duty to maximize the return to creditors."); Unofficial Comm. of Equity Holders of Penick Pharm., Inc. v. McManigle (In re Penick Pharm., Inc.), 227 B.R. 229, 232-33 (Bankr. S.D.N.Y. 1998) (fiduciary duties include the "duty to maximize the value of the estate" and "ensur[ing] that the resources that flow through the debtor in possession's hands are used to benefit the unsecured creditors and other parties in interest.").

38. Indeed, the boards of the subsidiary Debtors still have not held a single post-petition meeting or executed a single consent or taken any other corporate action in these cases which would establish that they ever even exercised a duty of care or duty of loyalty with respect to the Plan. (Winters Decl. Ex. G, Thomas Dep. Tr. at 138:15-139:10) Moreover, the holistic outlook of the Holdings/Services board and the Debtors' advisors does not relieve the officers and directors of the subsidiary Debtors from their fiduciary duty to maximize the value of their individual estates. See Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.), 860 F.2d 515, 520 (2d Cir. 1988) (stating that, where substantive consolidation is improper, "a creditor cannot be made to sacrifice the priority of its claims against *its* debtor by fiat based on the bankruptcy court's speculation that it knows the creditor's interests better than does the creditor itself" (emphasis in original)); see also Flora Mir Candy Corp. v. R.S. Dickson & Co. (In re Flora Mir Candy Corp.), 432 F.2d 1060, 1063 (2d Cir. 1970) (quoted by Augie/Restivo, 860 F.2d at 521) (denying consolidation even at the expense of an otherwise desirable arrangement because it "may indeed be desirable *but not at the cost of sacrificing the rights of [a subsidiary's] debenture holders*" (emphasis in original)).

39. Third, even if the Court were willing to overlook the lack of any record regarding negotiations or approval of the Plan, it should not overlook the inescapable conclusion that the Debtors proposed the Plan without even understanding whether the treatment of Class 6A was justified at the time it was filed. While the Debtors attempted to finesse the issue in the Disclosure Statement by stating they believed there were no unencumbered assets, the record is clear that they had conducted no analysis as to whether they have any unencumbered assets, made no calculation of the value of their secured lenders' collateral, made no determination as to the allowability of intercompany claims, or determined how the Settlement proceeds would be allocated, either by settled claim or by Debtor. (Winters Decl. Ex. J, Leone Dep. Tr. at 125:11-126:5, 151:24-152:21, 159:11-160:13, 161:7-162:18; Winters Decl. Ex. G, Thomas Dep. Tr. at 149:15-150:4; Winters Decl. Ex. I, Grossi Rough Dep. Tr. at 80:10-82:23, 119:4-16, 139:2-10)

40. The only record evidence is that the First Lien Creditors proposed that unsecured creditors should receive no recovery, the Debtors agreed to that treatment and filed a Plan that so proposed, and then the Debtors advisors went to work building, and re-building, a justification for that treatment. As set forth below, that process of reverse engineering a claim treatment, particularly on a radically compressed timeframe, has forced the Debtors to take untenable legal, factual and expert positions in the expectation that this Court will overlook the myriad flaws in their case in an attempt to provide closure to these cases.

41. While the Trustees recognize that bankruptcy courts are generally willing to give the benefit of the doubt to debtors when evaluating section 1129(a)(3), this case stands for the remarkable proposition that a debtor in possession may propose a plan of reorganization that provides no recovery to more than $2 billion in unsecured claims without having a single substantive communication with its official committee of unsecured creditors or the

representatives of its over $1 billion in prepetition funded debt, and may turn over the business to secured lenders without voicing any protest or making any effort to realize any equity value in their assets.

II. THE PLAN VIOLATES THE ABSOLUTE PRIORITY RULE

42. The Trustees understand that Class 6A (Obligor General Unsecured Claims) will vote to reject the Plan, meaning that the Debtors will be unable to satisfy section 1129(a)(8) of the Bankruptcy Code. The Debtors must therefore demonstrate, by a preponderance of the evidence, that the Plan is fair and equitable with respect to each class of claims that is impaired and voted not to accept the Plan. See 11 U.S.C. § 1129(b).

43. Section 1129(b)(2) of the Bankruptcy Code sets forth a non-exhaustive list of requirements for a plan to be fair and equitable. 11 U.S.C. § 1129(b)(2)(B) ("For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class ***includes*** the following requirements . . . .") (emphasis added). These minimum requirements include that (i) the plan provides each holder of a claim in such class with payment in full on account of its claim, and that (ii) the plan comports with the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B).

44. The absolute priority rule mandates that, to satisfy the "fair and equitable" requirement, the holder of any claim junior to the claim of the objecting class "will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii). "[A] corollary of the absolute priority rule is that a senior class cannot receive more than full compensation for its claims." In re Exide Techs., 303 B.R. 48, 61 (Bankr. D. Del. 2003) (internal quotations and citations omitted); In re MCorp Fin., Inc., 137 B.R. 219, 235 (Bankr. S.D. Tex. 1992) ("[A] dissenting class should be assured that no senior class receives more than 100 percent of the amount of its claims . . . [this] safeguards that no claim or

interest receive more than 100 percent of the allowed amount . . . ."); see also 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][a] (16th ed. 2020) (the "fair and equitable" standard "can be seen to have at least two key components: the absolute priority rule; and the rule that no creditor be paid more than it is owed."). The Supreme Court has reinforced this principle, holding that the Bankruptcy Code does not authorize nonconsensual departures from the absolute priority rule with respect to a final distribution of estate value. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 985 (2017).

45. As set forth in detail below, however, this dispute is not over a mere dollar of overpayment. Rather, hundreds of millions of dollars of distributable value was not encumbered as of the Petition Date, is not subject to postpetition liens, and remains available for distribution to general unsecured creditors. Because all of that value is being distributed on account of Class 3 (First Lien Claims), the Plan contemplates providing first lien creditors with more than the value of their collateral, and thus their allowed secured claim, thereby violating the absolute priority rule. See 11 U.S.C. § 506(a)(1) (a creditor's claim "is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.").[6]

46. In recognition of the fact that the Plan cannot provide for recoveries in excess of allowed claim amounts and therefore cannot provide secured creditors with unencumbered value, the Debtors have made multiple arguments as to why, contrary to the general recognition that

[6] To the extent that the first lien creditors argue that they are receiving some portion of the Plan distributions on account of unsecured claims, the Plan would fail for the separate reason that it discriminates against other unsecured creditors who will not share in such distribution, Because the Plan does not classify or treat deficiency claims, the Trustees do not describe this objection in further detail herein, but reserve the right to amend the Objection to the extent the Debtors modify the Plan.

there is unencumbered value at Obligor Debtor estates, there is no value available for distribution to those estates' unsecured creditors. These arguments include that (1) any unencumbered value is subject to an unclassified, untreated adequate protection claim for the diminution in value of the secured creditors' collateral, (2) any unencumbered value will be used to satisfy administrative claims including DIP Facility Claims, and (3) all of the proceeds that the Debtors will realize from their settlement with Uniti are encumbered by the secured parties' prepetition liens. Each of these arguments is addressed below.

A. The Secured Creditors Cannot Recover on Adequate Protection Claims

47. Under the Final DIP Order, the first lien creditors may only recover on adequate protection claims to the extent of the aggregate diminution in value of their interests in the prepetition collateral from and after the Petition Date resulting from the imposition of the automatic stay, the use of collateral during the chapter 11 case, or the priming of prepetition liens. (Final DIP Order, ¶ 15) As an initial matter, the Plan does not allow adequate protection claims in any amount, and the hypothetical rights of the first lien creditors are therefore irrelevant to the Court's determination as to whether the Plan violates the absolute priority rule.

48. In any event, neither the first lien creditors nor the Debtors can meet the high burden of establishing a diminution in value of the first lien creditors' interest in collateral that is compensable through an adequate protection claim. Official Committee of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Capital, LLC), 501 B.R. 549, 591 (Bankr. S.D.N.Y. 2013) ("That the [secured creditors] now seek to assert this adequate protection claim based on diminution in value does not shift the initial burden of proving the extent and validity of the

claim under section 506(a) to the Debtors. Rather, this burden remains squarely with the secured creditor . . . .").[7]

49. Instead, the Debtors will rely entirely on the testimony of Nicholas Leone who, as noted, compared the total enterprise value of the Debtors on the Petition Date to the total enterprise value of the Debtors at the assumed exit date and makes certain adjustments to conclude that the adequate claim is somewhere between $[redacted] million to $[redacted] million, assuming all of the Uniti Settlement consideration is encumbered, and $[redacted] million to $[redacted] million, assuming none of the Uniti Settlement consideration is encumbered. That analysis hinges on two fundamental errors. First, Mr. Leone does not value any of the "Collateral" as defined in either of the first lien security documents. Instead, he attempts to conflate the total enterprise value of the Debtors (including Holdings and other non-obligors) to the value of assets held by certain of the obligor subsidiaries of Holdings. This valuation theory assumes that the total enterprise value of a debtor is a "good proxy" for the value of the asset collateral where substantially all of a debtor's assets are, in fact, collateral. Notably, Mr. Leone will candidly admit that that this theory is not based upon any text, treatise, or authoritative source for valuation of an asset. In any event, the first lien creditors do not have a lien on the Debtors' enterprise. Nor could they – state law security regimes provide for asset-specific rights and do not permit the creation of liens on enterprise value. See, e.g., Edward J. Janger, The Logic and Limits of Liens, 2015 U. ILL. L. REV. 589, 592-93 (2015) ("A secured loan does not confer a distributional priority ahead of all

[7] The premise of the Debtors' adequate protection case is that the total enterprise value of the Debtors has declined from before the filing to the assumed emergence date. To date, however, neither the Debtors nor the first lien creditors have made any effort to explain the reason for such decline in enterprise value or how it relates to the circumstances giving rise to an adequate protection claim as granted pursuant to the Final DIP Order.

other claimants against the debtor—it establishes a property right in specific property with distinct attributes defined by nonbankruptcy law.").

50. Rather, under state law, the first lien creditors' collateral package is limited to the assets enumerated in their security grant, and the secured creditors must value each of those assets to prove an aggregate diminution in value. The appropriate methodology differs from entity to entity. For example, the collateral package includes "General Intangibles," as well as the Obligor Debtors' equity interests in their subsidiaries. (See Winters Decl. Ex. A, Prepetition Credit Facility Security Agreement § 18(a)(vi); Winters Decl. Ex. B, First Lien Notes Security Agreement § 2(a)(vi)) The value of the collateral attributable to solvent Non-Obligor Debtors would equal the value of the pledged equity, subject to an adjustment for the costs that such entity would incur to procure services currently provided by affiliates if it were spun off.

51. The pledged equity interests in insolvent Obligor Debtors, on the other hand, are worthless. Instead, the value of the collateral attributable to these entities must be measured by the value of each pledged asset. This exercise is necessarily complicated by the fact that the assets pledged by certain entities may be inextricably intertwined with, and derive value from, unencumbered assets, including, for example, the lease arrangement with Uniti and the property subject to such arrangement. Given that the bulk of the value in the enterprise relates to the Uniti arrangement, the discount on collateral value is significant.

52. To be clear, the Debtors could have conducted a proper valuation of the actual collateral in this case. They knew how to value the Non-Obligor Subsidiaries on a standalone basis. (Winters Decl. Ex. J, Leone Dep. Tr. at 204:8-205:13 [redacted]

[redacted] Indeed, PJT did just that as part of the liquidation analysis, [redacted]. (Winters Decl. Ex. K, Grossi Report ¶ 25; Winters Decl. Ex. I, Grossi Rough Dep. Tr. at 144:25-146:21) The Debtors could also have valued the tangible and intangible collateral at the Obligor Debtors. They, and their advisors were certainly familiar with the cost approach of valuing such assets after examining Ernst & Young's valuation in the Adversary Proceeding.

53. In sum, neither the first lien creditors nor the Debtors will meet their burden to provide evidence with respect to the value of any "Collateral" as of the Petition Date or the assumed Effective Date.

54. Second, to the extent that this Court is even willing to consider a total enterprise valuation as a proxy for the valuation of collateral, this Court would also have to adopt an entirely new theory of adequate protection in order to credit any of Mr. Leone's testimony. In calculating total enterprise value as of the Petition Date, Mr. Leone relied upon the Debtors' February 2019 projections in his discounted cash flow and comparable companies analyses. There will be no dispute at trial that those projections, contained in board materials from a February 2019 board meeting, were prepared before the outcome of the Aurelius litigation was known and do not contain any projected expenses associated with the chapter 11 cases or the impact of bankruptcy on the Debtors' business.

55. Mr. Leone will explain that he looked at these pre-distress projections based upon advice from counsel. But the legal theory that a court should look to pre-distressed collateral

values in the calculation of an adequate protection claim is incorrect as a matter of law. As this Court recognized in In re Sears Holdings Corp., the Supreme Court's decision in Associates Commercial Corp. v. Rash, 520 U.S. 954 (1997) requires courts to consider the proposed use of collateral in the hands of the debtor. Case No. 18-23538 (RDD), July 31, 2019 Hr'g Tr. at 225:8-14 (Bankr. S.D.N.Y.). Thus, when valuing inventory and accounts for purposes of calculating a diminution in value claim, this Court held that the starting value must account for the "post-bankruptcy reality." Id. at 241:20-24. The Court gave no weight to expert testimony that simply relied on the book value of the collateral as of the petition date without applying a reasonable discount to reflect the "reality that faced [the creditors] at the start of this case with respect to their interest in the Debtors' interest in their collateral." Id. at 233:18-21. Likewise, in In re Residential Capital, LLC, the court held that secured creditors failed to carry their burden of proving a diminution in value because their petition date valuation did not account for the distress of the Debtor at the time. 501 B.R. at 596. Both cases recognize that the realizable value of the collateral at the start of the case is affected by context – that the collateral is being operated by a debtor in bankruptcy.[8] For this Court to adopt any of Mr. Leone's testimony and

[8] The use of pre-bankruptcy projections raises another fundamental issue – if management projections for revenue from the outset of a chapter 11 case prove to be inaccurate, but are nevertheless relevant to establish the value of collateral as of the petition date, secured creditors will be able to assert massive adequate protection claims based only on overly optimistic projections that never come to fruition. Courts routinely consider the accuracy of management projections in valuation exercises. See, e.g., In re Nellson Nutraceutical, Inc., No. 06-10072 (CSS), 2007 Bankr. LEXIS 99, at *123-24 (Bankr. D. Del. Jan. 18, 2007) (finding experts' enterprise value calculations needed to be downwardly adjusted where they were based on the company's "unrealistic" long range plan, which provided rosy projections to bolster the perceived value of the business and were later confirmed to be wrong by debtors' subsequent poor performance). Adequate protection is not insurance against unrealized management expectations, and the Petition Date value should not be based on the Debtors' unrealistic and unrealized expectations for the business – particularly where those expectations ignore the fact that the Debtors filed chapter 11 cases.

opinions, the Court will have to revolutionize the law of adequate protection. It should not do so.[9]

B. The DIP Order Prohibits Application of Certain Unencumbered Assets to Satisfy DIP Claims or Adequate Protection Claims

56. As an initial matter, the Plan contemplates that the DIP Facilities Claims will be repaid in cash in full on the Effective Date and that first lien creditors will recover solely on account of secured claims, not adequate protection claims. (Plan, Art. II.B; III.B.3) As such, the Plan does not contemplate any monetization by the DIP lenders on their DIP Liens, or the first lien creditors on their Adequate Protection Liens in these chapter 11 cases. Accordingly, the hypothetical rights of DIP lenders or first lien creditors with respect to unencumbered assets are irrelevant for purposes of assessing the Plan.

57. In any event, the DIP lenders and first lien creditors would be unable to recover on their postpetition claims in the manner suggested by the Debtors. First, the final clause in Footnote 9 of the Final DIP Order protects the rights of unsecured creditors to value attributable to the Uniti Settlement notwithstanding the existence of postpetition liens thereon. As set forth in the Final DIP Order:

> The DIP Agent and Prepetition Agent are each deemed a "Permitted Leasehold Mortgagee" under that certain Master Lease dated April 24, 2015, by and among CSL National, LP, the landlords party thereto and Holdings, as tenant (the "**Master Lease**"). Notwithstanding the foregoing and any rights granted by Holdings to and accepted by the DIP Lenders under the DIP Credit Agreement or otherwise provided in this Final Order with respect to Holdings (including releases), the DIP Lenders, the Prepetition Secured Parties, the Creditors' Committee, the Debtors' creditors and equity holders, and the Debtors each

[9] While courts may refer to total enterprise value for purposes of valuing collateral, they have done so where there is no dispute that the relevant security interest encumbers all assets. Here, there is no dispute that the secured creditors' liens are far narrower in scope, and there is no dispute that lenders have no claims or liens at Holdings, nor any liens on the Master Lease of the property thereunder, which are the central assets of the Debtors' operations.

> reserve all rights and remedies under applicable law, if any, with respect to the execution and performance of the Master Lease and the transactions giving rise to it (the "**Uniti Spin-off**"), ***and nothing in this Final Order shall impact or prejudice the rights of any such party to benefit from any adjudication or settlement of any claims arising from, asserted or that could have been asserted on account of the Uniti Spin-Off***.

(Final DIP Order ¶ 8(a) n.9 (emphasis added))

58. Close inspection of the plain language of Footnote 9 reveals that it is composed of two separate parts – only the first is a mere "reservation of rights" as argued by the Debtors and the first lien creditors. Specifically, the first part of Footnote 9 purports to "reserve all rights and remedies under applicable law" with respect to the Uniti transactions. (Id.) That is not surprising, in that the parties at the time sought to maintain a level playing field with respect to potential claims challenging the Uniti Arrangement. (See Winters Decl. Ex. L, Apr. 16, 2019 Hr'g Tr. at 36:14-16 [Dkt. No. 1457] ("[A]t this point all parties reserve rights on how the Unity [sic] situation may evolve."))

59. But with respect to the fruits of the preserved claims, Footnote 9 does not simply reserve rights. Instead the final clause in Footnote 9 uses the mandatory phrasing "shall" to ensure that constituents would retain their ability to benefit from preserved claims against Uniti. That language was purposeful, as it reflects the sensitivity of the parties at the time to the need to ensure that value generated during the cases would not be diverted exclusively to the secured parties. (See id. at 57:9-14 (counsel to indenture trustee) ("[T]he Unity [sic] lease is in the operating room of this bankruptcy case and we are concerned that granting unclear diminution, adequate protection liens to secured creditors would potentially interfere with the ability of the Committee and the Debtors to figure out how to approach that legally . . . ."))

60. Second, the DIP Order includes a reverse-marshaling provision that, in an enforcement scenario, would require DIP lenders to use commercially reasonable efforts to recover first from all DIP Collateral other than proceeds of avoidance actions, commercial tort claims, claims against directors and officers of the Debtors, and claims against the prepetition secured creditors. (Final DIP Order, ¶ 10(d)). That provision likewise limits efforts to recover on DIP Liens and/or Adequate Protection Liens on such collateral unless other DIP Collateral is insufficient. (Id.) The Debtors have introduced no evidence indicating that, in a hypothetical enforcement scenario – which is not contemplated by the Plan – the DIP lenders and first lien creditors would be unable to recover in full from other DIP Collateral first before resorting to proceeds of avoidance actions and other unencumbered assets. To the contrary, the evidence to be submitted by the Debtors at trial will establish that, even in a hypothetical liquidation, sufficient cash exists to repay the DIP Facilities Claims without recourse to unencumbered assets. (Winters Decl. Ex. I, Grossi Rough Dep. Tr. at 174:4-177:12).

C. The Debtors Have Not Proven That All of their Assets Are Encumbered

61. Under section 1129 of the Bankruptcy Code, the Debtors have the burden of demonstrating that the proposed cram down treatment is fair and equitable. Accordingly, the Debtors must prove that there is no absolute priority violation and thus must prove that no unencumbered value is being used to satisfy Class 3 secured claims. (See supra) In an effort to meet that burden, the Debtors make various arguments as to why particular assets are either encumbered by prepetition lien or are of no value. Each of these arguments fails.

1) Settlement Proceeds Allocable to the Recharacterization Claim Are Unencumbered

62. Obviously, the biggest issue to be addressed by the Court at confirmation is whether or not all of the proceeds of the Uniti Settlement are encumbered by prepetition liens. They are not, for five independent reasons.

63. First, the value attributable to the settlement of the Recharacterization Claim must be awarded to unsecured creditors because they would have benefited from the claim had it been litigated to conclusion. See, e.g., In re Miami Metals I, Inc., 603 B.R. 531, 537 (Bankr. S.D.N.Y. 2019) (rejecting settlement and explaining that "the Second Circuit has explicitly instructed that when the rights of nonsettling parties are implicated by the terms of a settlement, the court cannot approve it without considering the interests of those non-settling parties." (internal quotations and citations omitted)); In re Exide Techs., 303 B.R. at 69-70 (rejecting settlement where value allocated to unsecured creditors was a small fraction of the potential value to them of the claim being settled).

64. Specifically, had the Court entered a ruling in favor of the Recharacterization Claim, then it would have determined that the purportedly transferred assets remained owned by the applicable Debtor subsidiaries. This result has been recognized by several courts. See, e.g., In re 4W Holdings, Inc., 593 B.R. 448, 456 (Bankr. N.D. Tex. 2018) ("Once the Court entered the Recharacterization Judgment, it was determined that the Facilities in the Transfer Portfolio were never leased property under the Master Leases but were in fact owned by the Debtors all along . . . ."); In re Nite Lite Inns., 13 B.R. 900, 909-10 (Bankr. S.D. Cal. 1981) (finding as a result of recharacterization that beneficial ownership of the transferred property never left the debtor-lessee). Indeed, the Debtors sought this precise relief. (See *Joint Initial Opp'n to Uniti's*

Motion for Summary Judgment [Adv. Proc. Dkt. No. 51], ¶ 39 n.4; *Plaintiff's Opp'n to Uniti's Motion to Dismiss* [Adv. Proc. Dkt. No. 36], ¶ 10). The purportedly transferred assets ceased to be encumbered upon the closing of the spin transaction in 2015. (See Winters Decl. Ex. A, Prepetition Credit Facility Security Agreement, § 18 (reaffirming the prior security agreement but, for the avoidance of doubt, excluding "Contributed Assets," and expressly carving out the "Contributed Assets"); Winters Decl. Ex. B, First Lien Notes Security Agreement, § 2 (carving out "Excluded Assets")) Therefore to the extent still owned by the Debtor subsidiaries, such assets are unencumbered. See In re K-V Discovery Solutions, No. 12-13346 (ALG), 2013 Bankr. LEXIS 565, at *12 (Bankr. S.D.N.Y. Feb. 11, 2013) ("Unless the grant of a security interest is contained in a security agreement, there is no security interest.") (internal quotations and citations omitted).

65. That result would be consistent with the history of commercial dealing among the parties here. The exclusion of the purportedly transferred assets from the collateral of the first lien creditors was essential to the consummation of the 2015 transactions. Prior to the spin, the first lien creditors had liens on the Contributed Assets. In exchange for a consent fee in the form of approximately $1 billion in cash and the early repayment by the company of approximately $2.45 billion in then-existing first lien exposure, the first lien creditors consented to the spin transaction and the related revisions to the existing security agreement to terminate their interest in the leased property. As it stands, the Debtors' refusal to concede that the Recharacterization Claim proceeds should be made available to the unsecured creditors underscores their remarkable position that the only party who should benefit from the settlement arising from the spin transaction are the parties who facilitated the transaction and received billions of dollars for

doing so, while those parties whose indentures were violated by the transaction, as found by Judge Furman, get nothing.

66. Second, the Recharacterization Claim is a postpetition asset incapable of being subject to a prepetition lien. The Debtors themselves made this clear when they requested relief that could only be granted by a bankruptcy court. (See Am. Compl. [Adv. Dkt. No. 71] ¶ 221 ("Holdings and Services request a declaration that the Uniti Arrangement, including the Master Lease, does not constitute a 'lease' ***under the Bankruptcy Code*** but instead should be recharacterized as a financing arrangement.") (emphasis added); id. ¶ 225 ("Holdings and Services request a declaration that the Master Lease is not a lease of 'real property' ***under the Bankruptcy Code***, including 11 U.S.C. § 365.") (emphasis added). Indeed, the relief requested by the Debtors would have been unavailable outside of bankruptcy. See In re Homeplace Stores, 228 B.R. 88, 95-96 (Bankr. D. Del. 1998) (doctrine of equitable estoppel, which would bind parties in privity to a contract, does not apply against debtors in bankruptcy when the defense would operate at the expense of the debtor's creditors).[10] Given that the Recharacterization Claim did not exist before bankruptcy, no security interest could attach to it. See N.Y. U.C.C. § 9-203(b); United States v. Chowaiki, 369 F. Supp. 3d 565, 573 (S.D.N.Y. 2019) ("[A] security interest cannot be enforced against the debtor or against third parties unless 'the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party.'").

67. Third, the Recharacterization Claim cannot be subject to a prepetition lien because it does not constitute an asset owned by the Debtors. As the Court recognized, the Recharacterization Claim does not belong to the Debtors:

[10] In addition to the fact that the debtors would be estopped from raising the claim outside of bankruptcy, no court would have Constitutional jurisdiction to determine a case or controversy regarding how a Bankruptcy Code provision should be interpreted outside of bankruptcy.

> It is suggested in the motion that the recharacterization remedy is one in which only a debtor would have standing in that it is an estate cause of action such as a preference claim, a fraudulent transfer claim, or a veil-piercing claim where no particular creditor is uniquely injured. I believe, to the contrary, that recharacterization is essentially an objection to a claim and, therefore, can be pursued, subject to a caveat that I'll state in a minute, by other parties in interest and a debtor. That caveat is that the Court, recognizing the costs and delays of litigation in a bankruptcy case affect multiple parties, should have the ability to control who brings that litigation in the interests of the estate generally.
>
> So I believe that Services does have standing simply as a creditor, especially here where the litigation is already being brought by Holdings and being brought by the same counsel that is also representing Services. In other words, there's no undue adverse effect on the estate and creditors generally to have both entities be a plaintiff on the recharacterization claim.

(Winters Decl. Ex. M, Dec. 12, 2019 Hr'g Tr. at 68:20-69:15) As such, the Recharacterization Claim clearly could not have been subject to the grant by the prepetition obligors. N.Y. U.C.C. § 9-203(b).

68. Fourth, the Recharacterization Claim cannot be subject to the prepetition grant in favor of the secured creditors because it derives from the lease arrangement with Uniti, which was an asset of Holdings. (See Winters Decl. Ex. N, Master Lease, Preamble (naming Holdings as "Tenant"); id., § 1.3 (giving Holdings the exclusive right to use the network assets for fifteen years, with Tenant-only option to extend the term up to a total of thirty-five years)) Holdings is not an obligor on any of the Debtors' prepetition funded debt. As such neither Services not any Obligor Debtor owned any interest in the lease arrangement, rendering them incapable of granting any security therein.

69. Fifth, even if the Recharacterization Claim was subject to a lien on the Petition Date, the value attributed to the settlement thereof does not constitute the proceeds of collateral. Section 552 of the Bankruptcy Code provides, generally, that prepetition liens do not attach to property of the debtor that is acquired after the petition date, unless such after-acquired property

is "proceeds, products, offspring or profit"' of the prepetition collateral and the relevant security agreement provides that the lien attaches to such after-acquired property. 11 U.S.C. § 552(b). The carve-out for proceeds, products, offspring and profits is "intended to cover after-acquired property that is directly attributable to prepetition collateral, without addition of estate resources." In re Residential Capital, LLC, 501 B.R. at 612 (internal quotations and citations omitted). Here, it is undisputed that the claims against Uniti were prosecuted by the Debtors with significant estate resources. Proceeds from the settlement of such claims therefore would not constitute proceeds of collateral.

70. Ignoring these facts, the Debtors suggest instead that the value inherent in the Recharacterization Claim constitutes collateral for two separate reasons. First, the Debtors argue that the Recharacterization Claim constitutes a "General Intangible" subject to the prepetition grant by the Obligor Debtors. (See Winters Decl. Ex. A, Prepetition Credit Facility Security Agreement § 18(a) (granting lien on, among other things, "General Intangibles"); First Lien Notes Security Agreement § 2(a) (same)); see also N.Y. U.C.C. § 9-102(a)(42) (defining a general intangible as "any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights letters of credit, money, and oil, gas, or other minerals).

71. No court has ever held that a recharacterization claim constitutes a general intangible. To the contrary, courts have interpreted general intangibles in the context of litigation claims to refer to rights arising under breach of contract claims. See, e.g., Merchants Nat'l Bank v. Ching, 681 F.2d 1383, 1388 (11th Cir. 1982). The Recharacterization Claim, however, is not analogous to a breach of contract claim, given that the underlying lease was not

with any Obligor Debtor, the cause of action calls into question the existence and validity of the contract itself as opposed to constituting an act of enforcement thereunder, and the cause of action was not even personal to the grantors or in existence prior to the bankruptcy. Accordingly, the Recharacterization Claim is not a General Intangible, and there is no prepetition lien on the settlement value ascribed to it. Smith v. C&S Wholesale Grocers, Inc. (In re Delano Retail Partners, LLC), No. 11-37711-B-7, 2017 Bankr. LEXIS 2397, at *15 (Bankr. E.D. Cal. Aug. 14, 2017) (finding that where the claims settled "are not (and when bought were not) encumbered," that "can only mean those claims are not (and when bought were not) subject to any security interest").

72. Second, the Debtors argue that gaps in the first lien creditors' collateral are beside the point, because they have valid liens on equity interests in the Non-Obligor subsidiaries that absorb the value of any settlement proceeds allocated to such Non-Obligors. That argument fails for a multitude of reasons. As noted repeatedly, the Debtors have not allocated proceeds of the Uniti Settlement, either by claim or by estate. However, the only plaintiffs in the Recharacterization Claim were Holdings and Services. None of the other Debtor subsidiaries joined the claim (despite the Trustees' urging of the Debtors to amend the complaint to add them). Thus, there is no record that any of the Non-Obligor Debtors has a recharacterization claim. In fact, because the Plan treats each of the Non-Obligor Debtors as paying all of its creditors in full and thus solvent, it appears that there is no harm to creditors at such estates to be remedied through a recharacterization claim. The only court that the Trustees are aware of to rule on the issue found that solvent debtors lack standing to assert recharacterization claims. See Mirant Mid-Atl. LLC v. Morgantown OL1 LLC (In re Mirant Corp.), 327 B.R. 262, 207 (Bankr.

N.D. Tex. 2005) (denying motion for recharacterization of lease where debtor was solvent and could perform its lease obligations and pay other claims).

2) The Settlement Proceeds Allocable to Other Settled Claims are Likewise Unencumbered

73. All of the foregoing, of course, assumes that the entire quantum of settlement consideration is on account of the Recharacterization Claim. The Debtors have admitted that the settlement compromised not just the Recharacterization Claim asserted by Holdings and Services, but also all avoidance claims that any Debtor may have had against Uniti, including those asserted in the Adversary Proceeding and in the Committee's standing motion. See 9019 Order [Dkt. No. 1807, Ex. 1 § 11] ("[T]he Windstream Released Claims shall include all claims, interests, obligations, rights, suits, damages, causes of action, remedies, and liabilities whatsoever that were or could have been asserted in the Adversary Proceeding."). Specifically, the cause of action asserted by the Debtors in Count 3 of the complaint was to avoid transfers made to Uniti since 2017 under section 544 of the Bankruptcy Code. (See Am. Compl. ¶¶ 227-41 (alleging that Debtors were insolvent as of Q3 2017 and that Windstream received no consideration, let alone reasonably equivalent value, for hundreds of millions of dollars in Tenant Capital Improvements and above-market "rent" made after such time)) And the cause of action which the Committee sought standing to assert was the more substantial claim that the Debtors were insolvent at the time of the spin-off transaction and did not receive any value, let alone reasonably equivalent value, for, among other things, the assets subject to the spin-off transaction. (See *Motion of the Official Committee of Unsecured Creditors for (I) Leave, Standing, and Authority to Commence and Prosecute Certain Claims and Causes of Action on Behalf of Debtors' Estates and (II) Consent Rights to Settlement* [Dkt. No. 786], ¶¶ 76-88)

74. As with all avoidance claims, these avoidance claims – and settlement proceeds thereof – are textbook unencumbered assets unavailable for recovery by the first lien creditors on account of their secured claims. In re Residential Capital, LLC, 497 B.R. 403, 414-15 (Bankr. S.D.N.Y. 2013) (avoidance actions "arise post-petition and must be considered after-acquired property belonging to the estate," thus their proceeds "belong to the estate and are not [secured] collateral"); see also In re Tek-Aids Indus., Inc., 145 B.R. 253, 256 (Bankr. N.D. Ill. 1992) (to "give every secured creditor with a properly perfected security interest in all of the Debtor's personal property a lien on recoveries by the Trustee in [a] preference action[] . . . would not only defy logic, but would undermine the policy behind the avoidance powers as well"). The Uniti Settlement Agreement specifies that the exact releases provided by the Debtors are material and cannot be severed. As such, a portion of the value of the settlement with Uniti must be allocated to avoidance claims and applied to satisfy claims of general unsecured creditors.

3) Other Excluded Assets Comprise Additional Unencumbered Value

75. Aside from the proceeds of the Uniti Settlement, additional material assets were indisputably excluded from the prepetition definition of "Collateral" and are therefore unencumbered:

a. The Debtors' real property. As noted above, there are no mortgages on any of the Debtors' real property that will be offered into evidence. Of the $587 million in real property disclosed by the Debtors in their schedules, approximately $154 million is held by Obligor Debtors. The Debtors did not pledge their real property to secure prepetition debt, the relevant debt documents exclude the obligation to deliver mortgages or other real property security documents with respect to the Debtors' real property, and there are no mortgages or other real property security documents in connection with the prepetition secured debt that would otherwise evidence a security interest in the Debtors' real property assets. Mr. Grossi will testify that there the book value of real property owned by the Obligor Debtors is approximately $154 million, and the Debtors will offer no other valuation.

b. Cash held as of the Petition Date in certain accounts. Certain accounts held by the Debtors with cash as of the Petition Date totaling not less than $8,423,991 are not subject to valid liens. The Debtors will not introduce evidence of control agreements with respect to such accounts.

c. Tax attributes. The Debtors' rights to carry forward net operating losses, tax credits, and other tax attributes are not "personal property" in which a security interest can be granted. In addition, certain of the Debtors' tax attributes are owned by Holdings, which is not an Obligor Debtor. The evidence at trial will show that the Debtors will be using these tax attributes at emergence to offset cancellation of debt income – i.e. these asset will be used for the benefit of first lien creditors as owners of the reorganized equity.

d. Commercial tort claims. Commercial tort claims, including certain of the claims asserted by the Debtors in their adversary proceeding against Charter, are not subject to prepetition liens because no such claims were described with requisite specificity in the relevant security documents.

e. Avoidance actions against defendants other than Uniti. The Debtors completed several purchase and sale transactions with third parties in 2017 and 2018 (the Court may recall that the Debtors' position in the Adversary Proceeding is that they were insolvent no later than Q3 2017). Potential avoidance actions with respect to such transactions have not been settled or released in connection with the Uniti settlement. Such claims would not be encumbered by the prepetition secured creditors' liens. The Debtors can offer no evidence at trial that any of those claims were diligenced much less determined to be of no value.

f. Postpetition intercompany payments. Unencumbered assets of Holdings must be used to fund repayment of more than $800 million in postpetition advances made by Services on a superpriority basis to Holdings to fund rent payments to Uniti. The proceeds of such claims, when paid, would not be encumbered by the secured creditors' prepetition liens at Services.

g. The easements, permits, franchises, and pole agreements. The Debtors transferred beneficial ownership interests in easements, permits, franchises, and pole agreements in connection with the spin-off transaction, but have always retained legal title to such assets. As noted above, the collateral grant in the first lien security documents specifically carves out any liens on any of the leased property, including and does not include any of the real property assets retained by the Debtors. The Debtors will offer no evidence at trial regarding the value of these assts.

h. Expressly excluded assets. The secured creditors do not hold liens on certain assets that are carved out from the security grant, including various motor vehicles and 34% of the voting equity interests in non-debtor foreign subsidiaries. The Debtor concede that the motor vehicles have a value of approximately $7.5 million, but will offer no evidence regarding the equity in the foreign subsidiaries.

76. The Debtors have indicated that the value of these assets in their view is *de minimis*, begging the question as to how anything can be *de minimis* relative to the zero recovery the unsecured creditors are slated to receive under the Plan. But the evidence will show that the Debtors have done very little meaningful valuation work to support this conclusion, instead relying on their fundamentally flawed assertion of adequate protection claims. In other words, to the extent the Court determines there are no adequate protection claims, the Court cannot come to the conclusion that the Obligor Debtors have no assets of any value that are unencumbered.

III. THE PLAN VIOLATES THE BEST INTERESTS OF CREDITORS TEST UNDER SECTION 1129(A)(7) OF THE BANKRUPTCY CODE

77. The Court must deny confirmation because the Plan fails to provide holders of Obligor General Unsecured Claims with the value they would receive in a hypothetical chapter 7 liquidation. Section 1129(a)(7)(A) requires that each holder of a claim or interest in an impaired class:

> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date . . . .

11 U.S.C. § 1129(a)(7)(A).

78. This section, referred to as the "best interests of creditors test," was "designed to protect individual creditors even in the face of majority support for a plan." ACC Bondholder Grp. v. Adelphia Commc'ns Corp. (In re Adelphia Commc'ns Corp.), 361 B.R. 337, 367 (S.D.N.Y. 2007). It "is perhaps the strongest protection creditors have in Chapter 11." In re Ditech Holding Corp., 606 B.R. 544, 607 (Bankr. S.D.N.Y. 2019) (internal quotation and citation omitted). To satisfy the best interests test, the Debtors must show by a preponderance of the

evidence that every creditor or interest holder who votes to reject the Plan will receive at least as much under the Plan as such creditor or interest holder would receive if the Debtors were liquidated under chapter 7 of the Bankruptcy Code. See 11 U.S.C. § 1129(a)(7); In re Adelphia Commc'ns Corp., 361 B.R. at 364.

79. The Debtors have failed to carry their burden. First, the Liquidation Analysis and Mr. Grossi's opinions with respect thereto are based on the false premise that [redacted] (Winters Decl. Ex. K, Grossi Report ¶¶ 14, 20, 38) As described above, there is substantial unencumbered value in the Obligor Debtors' estates including the proceeds of the Uniti Settlement as well as other categories of unencumbered assets with meaningful value. To the extent even a single dollar should be allocated to holders of claims in Class 6A, the Liquidation Analysis is wrong.

80. Second, the conclusion that all assets are encumbered by liens is buttressed by the incorrect assumption in the Liquidation Analysis that the Uniti Settlement is not consummated prior to the hypothetical liquidation. As such, the Liquidation Analysis omits the value of the contingent litigation claims that the Debtors would still hold (and potentially could liquidate) if the Settlement releases are not effectuated. (Winters Decl. Ex. I, Grossi Rough Dep. Tr. at 142:9-15 [redacted] This, coupled with Mr. Grossi's assumption that the Debtors would be compelled to reject the Master Lease (Winters Decl. Ex. K, Grossi Report ¶ 18) presents the worst of all hypothetical worlds – no settlement with Uniti, no litigation against Uniti and no contract with Uniti.

81. Third, to the extent that the Liquidation Analysis can be applied if the Court concludes that there is unencumbered value, the Liquidation Analysis fails to map the flow of unencumbered assets through particular estates. At trial, Mr. Grossi will admit that to the extent there is unencumbered value, such as the Uniti Settlement proceeds, the estate to which such value is allocated would matter. (Winters Decl. Ex. I, Grossi Rough Dep. Tr. at 207:24-208:15) Yet the Liquidation Analysis treats the Obligor Debtors as a monolithic block. Accordingly, while Mr. Grossi's testimony can be relied on for estimating the liquidation value of certain unencumbered assets, it cannot provide an answer as to what unsecured creditors of any particular estate would receive in a liquidation.[11] Thus, should the Court determine that there is some unencumbered value in these estates, the Liquidation Analysis fails.

JOINDER

82. The Trustees join in, and hereby incorporate by reference, the arguments made by the Official Committee of Unsecured Creditors in the *Objection of the Official Committee of Unsecured Creditors to Confirmation of the First Amended Joint Chapter 11 Plan of Reorganization of Windstream Holdings, Inc. et al., Pursuant to Chapter 11 of the Bankruptcy Code.*

[11] The tables in Appendix C and D of Mr. Grossi's report do not paint this picture as they, among other things, ignore distributions to secured creditors from Non-Obligor Debtors that would reduce the secured creditors' deficiency claims, and apply joint and several claims (such as pension termination claims) at each Debtor without capping the claim at a full recovery.

CONCLUSION

WHEREFORE, the Trustees respectfully requests that the Court (i) sustain the Objection, (ii) deny confirmation of the Plan (iii) grant such other and further relief as the Court deems just and proper.

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