

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:)	Chapter 11
)	
EMERGE ENERGY SERVICES LP, <i>et al.</i> ,)	Case No. 19-11563
)	
Debtors. ¹)	(Jointly Administered)
_____)	

OPINION²

Before the Court is confirmation of the *Second Amended Joint Plan of Reorganization for Emerge Energy Services LP and Its Affiliated Debtors Under Chapter 11 of the Bankruptcy Code* filed on November 1, 2019³ (the “Plan”). Various objections to the Plan were filed. At the conclusion of the confirmation hearing, which was held over the course of five days at the end of October and the beginning of November 2019, the outstanding objections were those of the Official Committee of Unsecured Creditors (the “Committee”),⁴ the Office of the United States Trustee (the “U.S. Trustee”),⁵ the Securities and Exchange Commission (the “SEC”),⁶ and Chippewa County Department of Land Conversation & Forest Management (“Chippewa”).⁷ For the reasons that follow, the Court concludes that the Plan may be confirmed but only if the third-party release provision is modified.

¹ The Debtors in these cases, along with the last four digits of each Debtor’s federal tax identification number, are: Emerge Energy Services LP (2937), Emerge Energy Services GP LLC (4683), Emerge Energy Services Operating LLC (2511), Superior Silica Sands LLC (9889), and Emerge Energy Services Finance Corporation (9875). The Debtors’ address is 5600 Clearfork Main Street, Suite 400, Fort Worth, Texas 76109.

² This Opinion constitutes the Court’s findings of fact and conclusions of law as required by Rule 7052 of the Federal Rules of Bankruptcy Procedure. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334 and 157(a). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(1) and (b)(2)(L).

³ D.I. 596.

⁴ *Objection of the Official Committee of Unsecured Creditors to Confirmation of the First Amended Joint Plan of Reorganization of Emerge Energy Services LP and Its Affiliated Debtors Under Chapter 11 of the Bankruptcy Code* [D.I. 495].

⁵ *Objection of the United States Trustee to Confirmation of Debtors’ First Amended Joint Plan of Reorganization for Emerge Energy Services LPS and Its Affiliated Debtors Under Chapter 11 of the Bankruptcy Code* [D.I. 514].

⁶ *Objection of the Securities and Exchange Commission to the Approval of the Disclosure and Confirmation of the Debtors’ Joint Chapter 11 Plan* [D.I. 255]; *Supplemental Objection of the SEC to Confirmation of the Debtors’ Joint Chapter 11 Plan* [D.I.424].

⁷ *Chippewa County’s Objection to the First Amended Joint Plan of Reorganization and Joinder to Atlantic Specialty Insurance Company’s Limited Objection* [D.I. 526].



I. RELEVANT BACKGROUND

A. Summary of the Debtors' Business

The above-captioned debtors and debtors-in-possession (collectively, the “Debtors”) are primarily engaged in the business of mining, processing, and distributing silica sand proppant, a key component in the hydraulic fracturing – or fracing – of oil and gas wells. They do so through Emerge Energy Services LP (the “Partnership”), a publicly traded partnership, and various subsidiaries. Emerge Energy Services GP (the “General Partner”) is the general partner of the Partnership and is ultimately controlled by Insight Equity Management Company, LLC (“Insight”) through Emerge Energy Services Holdings LLC. Insight also owns approximately 27% of the Partnership’s publicly traded common units.

The production of sand consists of three basic processes – mining, wet plant operations, and dry plant operations. Most of the Debtors’ mining activities take place in an open pit environment. After sand is removed, it is moved to the Debtors’ wet processing facilities, where it is separated from unusable materials. Then, it is dried in dry plants, readied into a final product, and stored until shipment to customers.

The Debtors mine and own or lease functional plants in Wisconsin and Texas. The Wisconsin sand, called northern white sand, is transported by rail to transload facilities closer to customers and then shipped by truck to its final destination. The Texas sand is called in-basin sand. It is closer to customers and thus need only be shipped by truck.

The Debtors also own a partially developed in-basin facility (“Kingfisher”) located in Kingfisher, Oklahoma, a part of the Scoop/Stack region. Kingfisher is comprised of about 40 acres of owned real property, about 600 additional leased acres, improvements, and equipment. While original plans estimated the total cost of completion to be \$15 million to \$20 million, the Debtors have spent approximately \$15 million, and another \$18 million is projected to be required.

B. Events Leading to and Necessitating These Bankruptcy Cases

Several notable events occurred in the frac sand industry generally and with the Debtors’ operations specifically that led the Debtors to this Court. To start, beginning in 2017, due to high cost of transport, industry demand shifted away from northern white sand to in-basin sand. This led the Debtors to reduce their Wisconsin operations and ultimately required the rightsizing of their over-abundant leased railcars and transload facilities.

Additionally, the Debtors acquired and developed a facility in San Antonio, Texas (“San Antonio”), which became the focal point of the Debtors’ go forward business plan. However, despite multiple target dates to do so, San Antonio has never produced more than 50% of its nameplate capacity, which is about 285,000 tons of sand per month. Indeed, the Debtors have had great difficulty in achieving forecasted production levels and have historically consistently and significantly fallen short.

On June 21, 2019, San Antonio experienced a catastrophic levee breach (the “Berm Breach”) that damaged and halted its mining and wet plant operations. Construction of a new berm was completed at the start of the confirmation hearing, but mining operations have begun only on a limited test basis. To fulfill their obligations to critical customers, the Debtors have been purchasing inferior and more expensive wet feedstock from external sources and processing it to a final product in San Antonio’s drying facilities.⁸ Prior to the Berm Breach, the Debtors projected San Antonio to steadily ramp to nameplate capacity by July 2021. Now, the ramp has been pushed to September 2021, assuming the facility fully restarts. The Debtors have submitted an insurance claim of approximately \$35 million on account of revenue losses sustained as a result of the Berm Breach (the “Business Interruption Insurance Claim”) as well as one for property damage.

Unrelated to the challenges of the Debtors’ Wisconsin and San Antonio operations, in January 2019, Kingfisher’s construction was stopped. At present, the Debtors have no intention of completing it. They have no committed capital to do so, and it is unclear whether further development is economically prudent given the current Oklahoma proppant market, which is crowded with frac sand suppliers and faced with challenging mining conditions. Moreover, further engineering may be necessary given the Berm Breach. The Debtors do not intend to sell Kingfisher but rather intend to long-term idle the facility to maintain the option to resume development if and when it is deemed appropriate and financing obtained.

In addition to these unfortunate events, the market as a whole is distressed. The frac sand industry is volatile, having experienced both downturns and upturns since the period of its initial rapid growth ended in 2014. After a stabilized and improved market from late 2016 to mid-2018, the market has again become stressed, leading to increased supply and price erosion for in-basin and northern white sand. Accordingly, business is currently on the decline.

C. Restructuring Efforts

Beginning on December 31, 2018, the Debtors entered into a series of forbearance agreements following defaults under their two long-term secured facilities – a revolving loan facility and a notes purchase facility. As of the commencement of these cases, approximately \$66.7 million was outstanding under the revolving loan facility and approximately \$215.7 million was outstanding under the notes purchase facility. These obligations are secured by senior, first and second priority interests in, and liens upon, substantially all of the Debtors’ assets. HPS Investment Partners, LLC (“HPS”) serves as agent under both lending facilities.

Pursuant to the forbearance agreements, the Debtors also installed turnaround professionals, including Bryan Gaston from Ankura Consulting Group, LLC (“Ankura”) as restructuring officer, and hired restructuring advisors, including Houlihan Lokey Capital, Inc. (“Houlihan”) as financial advisor and investment banker. Those professionals focused on, among other things, operational turnaround initiatives (such as renegotiating railcar leases) as well as a financial restructuring.

⁸ During these bankruptcy proceedings, a dryer stack at San Antonio was damaged in a windstorm, which further exacerbated issues by causing a shutdown of one of the dryer facilities.

A restructuring support agreement (the “RSA”) was entered into on April 18, 2019 among the Debtors, Insight, the Debtors’ lenders under their revolving loan and notes purchase facilities, and HPS. Concurrently therewith, power and control over the restructuring contemplated by the RSA was delegated by the General Partner and Insight (by way of Emerge Energy Services Holdings LLC) to a special restructuring committee of the General Partner’s board (the “Special Restructuring Committee”).

The RSA contemplated an out-of-court restructuring whereby the noteholders would receive new second lien secured notes and 95% of the Partnership’s ownership interests subject to dilution based on a management incentive plan (“MIP”) and contingent warrants. The outstanding obligations under the revolving loan facility would either be paid in full from proceeds of a new facility or consensually refinanced. Existing equity holders would receive 5% of the new Partnership equity plus contingent warrants representing 15% of new equity. Mutual releases and exculpation of the stakeholders would be exchanged.

Ultimately, due to, among other things, the inability to adequately renegotiate the railcar leases, the persistent market downturn, and the Berm Breach, the out-of-court restructuring was not consummated, and these cases were commenced on July 16, 2019 to effectuate the RSA’s alternative in-court restructuring, which is substantially reflected in the Plan.

D. Summary of Relevant Claim Treatments Under the Plan

The Debtors’ Plan seeks to consummate the debt-for-equity swap contemplated by the RSA’s out-of-court restructuring. It contemplates that on emergence the reorganized Debtors will enter into a \$100 million exit facility and draw approximately \$50 million to repay obligations on account of their borrowings under the postpetition debtor-in-possession financing facility (the “DIP”) and the prepetition revolving loan facility. On account of their outstanding prepetition note obligations, the Debtors propose to distribute to the noteholders, among other things, 100% of the reorganized Partnership’s ownership interests subject to dilution by a MIP.

Although under the Debtors’ valuation, holders of general unsecured claims, who have been placed in Class 6, are entitled to receive nothing under the Plan, they were given the opportunity at the direction of the Special Restructuring Committee, pursuant a provision commonly known as a “deathtrap”, to receive 5% of the reorganized Partnership’s ownership interests otherwise being issued to the noteholders and new warrants representing 10% of the reorganized Partnership’s ownership interests.⁹ To obtain these benefits, the class was required to vote in favor of the Plan. If it did, then existing Partnership equity would also receive a distribution of new warrants representing 5% of the reorganized Partnership’s ownership interests. According to the Debtors, this offer was given to the general unsecured creditors to incentivize them to vote

⁹ Given the post-emergence valuation and the total general unsecured claims pool, this offer presented the general unsecured creditors with the opportunity to receive a de minimis distribution.

in favor of the Plan. However, Class 6 rejected it¹⁰ and thus, the general unsecured creditors therein stand to receive no distribution under the Plan.

II. OUTSTANDING PLAN OBJECTIONS

There are four parties objecting to the Debtors' Plan – the Committee, the U.S. Trustee, the SEC, and Chippewa.

The Committee objects to the Plan on two primary grounds. It contends that the Plan is not fair and equitable under section 1129(b)(1) of the Bankruptcy Code¹¹ because the noteholders are receiving more than to which they are entitled and that the Plan violates the best interests test of section 1129(a)(7) because there exist unencumbered assets with value that should flow to unsecured creditors under a hypothetical chapter 7 liquidation. In addition, the Committee asserts that the Plan has not been proposed in good faith under section 1129(a)(3) and that, for the reasons asserted by the U.S. Trustee and SEC, the Plan's proposed third-party releases violate applicable bankruptcy law.

The Plan objections of the U.S. Trustee and SEC focus on the Debtors' third-party releases proposed to be granted by those holders of general unsecured claims and the Partnership's equity interests who failed to properly opt-out. Both parties argue that for various reasons such releases are non-consensual and therefore cannot be approved as the Debtors did not satisfy the appropriate legal standard set forth in *Gillman v. Continental Airlines (In re Continental Airlines)*.¹²

The final remaining objection to the Debtors' Plan has been asserted by Chippewa. Chippewa issued and administers the operational permit of the debtor Superior Silica Sands LLC ("Superior Sands") for the northern white sand mine and facilities located in Auburn, Wisconsin ("Auburn"). There is no dispute that Superior Sands is out of compliance with the terms of its permit. Of particular issue for Chippewa is Superior Sands' failure to install adequate groundwater monitoring as well as its failure to post a bond adequate to provide financial assurance for the performance of legally required reclamation. Currently the bond posted is approximately \$3 million. Chippewa has requested \$4.65 million. Chippewa has argued that the Plan is not feasible under section 1129(a)(11) and lacks adequate means for implementation under section 1123(a)(5) due to its failure to sufficiently detail how the Debtors intend to comply with their reclamation and monitoring obligations. For similar reasons, Chippewa asserts that the Plan has not been proposed in good faith.

¹⁰ See Declaration of Michael Paque of Kurtzman Carson Consultants LLC Regarding the Solicitation of Votes and Tabulation of Ballots Cast on First Amended Joint Plan of Reorganization for Emerge Energy Services LP and Its Affiliated Debtors [D.I. 542].

¹¹ Unless otherwise noted, all statutory references used herein are to the Bankruptcy Code.

¹² 203 F.3d 203, 212-14 (3d Cir. 2000).

III. DISCUSSION

A. The Fair and Equitable Test Under Section 1129(b)(1)

As noted, Class 6 holders of general unsecured claims are impaired under the Plan, have voted as a class to reject the Plan and thus will be receiving no distribution on account their claims. Accordingly, pursuant to section 1129(b)(1), the Court may only confirm the Plan over the dissenting vote of the Class 6 creditors if the Debtors established by a preponderance of the evidence¹³ that, among other things, the Plan is fair and equitable with respect to Class 6.¹⁴ This is referred to as a “cramdown” and requires that the noteholders, placed in the senior Class 5, not receive under the Plan more than full compensation on account of their claims.¹⁵ Here, it is undisputed that for unsecured creditors to be entitled to a distribution in these cases, the total enterprise value (or “TEV”) of the reorganized Debtors must exceed the debt hurdle of approximately \$317 million, which is the aggregate outstanding obligations on account of the DIP, the revolving loan facility, and the notes purchase facility. If the TEV exceeds this hurdle, then the Plan cannot be crammed down on Class 6 as currently proposed.

It is the Committee’s position that upon emergence, the reorganized Debtors’ TEV will range between \$335 million and \$445 million, with a midpoint of \$390 million. Given the debt hurdle, under this analysis, the unsecured creditors are in the money by approximately \$73 million. Needless to say, however, the Debtors dispute the Committee’s valuation conclusions and argue that their TEV ranges between \$180 million to \$220 million, with a midpoint of \$200 million. If true, the Plan’s proposed distribution to the noteholders only will provide an approximate 38-55% distribution on account of their claims.

Although Insight informally tested the market for a sale of the Debtors before the petition date, no actionable proposals were received. Moreover, there has been no formal or informal marketing process for the Debtors during these proceedings, and no unsolicited offers. Much was made of these facts during the confirmation hearing, but the reality is that the Court is simply left with no market evidence as to value and, as result, the Court’s decision must rest on the battle of the parties’ valuation experts. Perhaps a marketing process would have made confirmation simpler, but it is not required.

To support their burden under section 1129(b)(1), the Debtors proffered expert valuation testimony and analysis of Adam Dunayer from Houlihan. The Committee relied upon expert

¹³ *In re Wash. Mut., Inc.*, 442 B.R. 314, 328 (Bankr. D. Del. 2011).

¹⁴ Section 1129(b)(1) provides that:

Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

¹⁵ Section 1129(b)(2)(B)(ii); *see also In re Exide Techs.*, 303 B.R. 48, 61 (Bankr. D. Del. 2003) (quoting *Matter of Genesis Health Ventures, Inc.*, 266 B.R. 591, 612 (Bankr. D. Del. 2001)).

testimony and analysis of Matthew Rodrigue of Miller Buckfire & Co., LLC (“Miller Buckfire”), the Committee’s investment banker. To estimate the Debtors’ post-emergence TEV, both experts utilized the Debtors’ Business Plan (as discussed and defined below) and the financial projections therein. They also relied on the same valuation methodologies – the discounted cash flow (“DCF”) and comparable company analyses, two commonly used and widely accepted methods to measure future earning capacity. Both experts weighted the results of their DCF and comparable company analyses similarly, and then separately valued and added the same three individual asset components not otherwise included in the Debtors’ projections – namely, Kingfisher, the Business Interruption Insurance Claim, and an escrow related to a prior sale transaction (collectively, the “Other Assets”). Both Houlihan and Miller Buckfire were qualified as experts during the confirmation hearing, had a firm grasp on the Debtors’ affairs and industry, prepared detailed valuation analyses, and testified credibly. Yet despite these similarities, the experts reached vastly different value conclusions.

Part of that difference originates from the experts’ valuations of the Other Assets. Houlihan assigned a value range to these assets of \$21.4 million to \$26.9 million whereas Miller Buckfire valued them between \$42 million to \$101 million, resulting in a midpoint difference of \$44 million. The remaining value differences stem primarily from the experts’ selection of a variety of key inputs for their DCF and comparable company models, leading to a midpoint difference of \$140 million. Both experts have criticized each other’s decisions with respect to the inputs and noted that the selections were results driven. In other words, the selection of the disputed inputs by Houlihan resulted in a material decrease in value, and in the case of Miller Buckfire’s selections, resulted in a material increase in value.

A DCF analysis “measures value by forecasting a firm’s ability to generate cash.”¹⁶ It is “calculated by adding together (i) the present value of the company’s projected distributable cash flows (i.e., cash flows from investors) during the forecast period, and (ii) the present value of the company’s terminal value (i.e., the value of the firm at the end of the forecast period).”¹⁷ A comparable company analysis:

estimates the value of a company by using the value of comparable companies as an indicator of the subject company. ‘Values are standardized using one or more common variables such a revenue, earnings, or cash flow, with the expert then applying a multiple of the financial metric or metrics that yields the market’s valuation of these comparable companies.’¹⁸

While the Court will avoid a lengthy explanation of the mathematical formulas and required data points necessary to value an operating business by utilizing the DCF and comparable company analyses, it will note that “when it comes to valuation issues, reasonable minds can and

¹⁶ *Exide*, 303 B.R. at 63 (internal quotations omitted).

¹⁷ *Id.*

¹⁸ *In re Genco Shipping & Trading Ltd.*, 513 B.R. 233, 243 (Bankr. S.D.N.Y. 2014) (quoting *In re Chemtura Corp.*, 439 B.R. 561, 575-76 (Bankr. S.D.N.Y. 2010)).

often do disagree. This is because the output of financial valuation models are driven by their inputs, many of which are subjective in nature.”¹⁹ As a result, “valuation of a business remains an art based on the use of informed, careful judgment . . . , and it cannot be expected to yield mathematically precise results.”²⁰ It has been described as a “guess compounded by an estimate” and it will result rarely in conclusions “without doubt or variations.”²¹ Accordingly, the Court must consider the reliability of managements’ projections and the credible testimony proffered by each expert in support of its respective input selections and determine whether or not the Debtors met their burden to demonstrate by a preponderance of the evidence that their valuation supports a plan predicated on a TEV of less than the debt hurdle. Here, the Court has done so and, for the following reasons, concludes that the Debtors have met their burden.

1. The Projections

As a threshold matter, the financial projections that serve as the basis for the parties’ valuation conclusions are found in the Debtors’ three-year business plan (the “Business Plan”) for the period January 1, 2019 to December 31, 2021. The Business Plan was prepared by the Debtors at the request and oversight of the Special Restructuring Committee and went through multiple iterations.

It was first created in May 2019. In August 2019, it was revised to reflect the positive economics of renegotiated railcar leases as well as negative consequences of the San Antonio Berm Breach and diluted business operations due to distressed market conditions. As a result of the revisions, total three-year EBITDA declined \$44.2 million.

The Court finds the Business Plan and the projections therein reliable and an appropriate balance of optimism and realism in light of the conditions of the market and the Debtors. The evidence indicates that they are the Debtors’ best hope, and that there is no guarantee of success. Reliable testimony of the Debtors characterized the assumptions as aggressive and the projections very difficult to meet. Among other things, the Business Plan assumes that San Antonio will fully ramp despite its previous failed attempts. Moreover, it assumes that every grain of sand produced is sold, and that the assumed selling price does not fall. However, the industry is on the decline. Indeed, there was testimony that spot pricing for sand has fallen \$5 per ton from assumptions in the Business Plan and that price erosion occurring due to sand oversupply will only worsened if San Antonio achieves full ramp unless there is an unexpected, dramatic demand increase. To make matters worse, the Debtors lost their top customer at their Kosse, Texas facility, leaving them with only one primary customer there and no ability to make a profit. Moreover, even if the railcar leases are right-sized, the Debtors’ northern white sand business will be “at best, break-even[.]”²²

¹⁹ *In re Coram Healthcare Corp.*, 315 B.R. 321, 339 (Bankr. D. Del. 2004) (quoting *Peltz v. Hatten*, 279 B.R. 710, 736-37 (D. Del. 2002)).

²⁰ *Muskegon Motor Stockholders Protective Committee v. Davis (In re Muskegon Motor Specialties)*, 366 F.2d 522, 530 (6th Cir.1966).

²¹ *In re PTL Holdings LLC*, No. 11-12676, 2011 WL 5509031, at *6 (Bankr. D. Del. Nov. 10, 2011).

²² Oct. 30, 2019 Hr’g Tr. 106:3-4; *see also* Nov. 4, 2019 Hr’g Tr. 20:1-3 (“We’re struggling to not lose money in that business . . .”).

2. The Valuation Analyses

The Court will first address disputes regarding the experts' DCF and comparable company analyses as they significantly affect the TEV conclusions. In particular, the key value drivers relate to the (1) selection of the set of comparable companies and (2) use of market value of debt as opposed to face (or book) value of debt to calculate the range of EBITDA multiples of the comparable companies. According to the Committee, its decision on these inputs increase the Debtors' midpoint TEV by \$122 million.

a. The Set of Comparable Companies

“The key to [a comparable company] analysis is the choice of appropriate comparable companies relative to the company in question.”²³ That is because the comparable companies within the set and their financial data serve as a proxy for the subject company's market and industry volatility and related future cash flow generating ability.

For the Debtors, Houlihan considered five companies as possible comparables to the Debtors – Hi-Crush Inc. (“Hi-Crush”), Smart Sand, Inc. (“Smart Sand”), Covia Holdings Corporation (“Covia”), U.S. Silica Holdings, Inc. (“U.S. Silica”), and Source Energy Services Ltd. (“Source Energy”). It then examined, among other things, their relative size, composition of assets, and market served, and ultimately selected Hi-Crush and Smart Sand as comparables. For the Committee, Miller Buckfire considered the same five companies and similar factors, but ultimately excluded only Source Energy. Accordingly, the disputed potential comparable companies are Covia and U.S. Silica.

In rendering its decision, Houlihan excluded Covia and U.S. Silica primarily due to their diversification of business lines and size. In particular, it opined that both companies are significantly diversified into industrial sand sales unlike the Debtors who concentrate substantially all of their sales in the frac sand market. Both also have greater sales and scope of operations. Moreover, Houlihan noted that U.S. Silica is also diversified into logistic and storage operations similar to Hi-Crush and Source Energy but unlike the Debtors.

In Miller Buckfire's opinion, Covia and U.S. Silica should be included in the comparable set because they share similar product categories, markets and customers served, and other operating and financial characteristics of the Debtors. Despite their size differences, Miller Buckfire concluded that they have sufficient overlapping business lines and similar volatile profitability for their energy business lines. In support of the reliability of its comparable set, Miller Buckfire noted that all four companies are considered competitors of the Debtors and that third-party analysts consider them comparables.

The Court finds Houlihan's exclusion of Covia and U.S. Silica to be appropriate. As a preliminary matter, the Court agrees with Houlihan's opinion that “Competitors and comparables are two completely different animals. . . . Just because a company is a competitor[, that] doesn't

²³ *Genco*, 513 B.R. at 244 (citing *Chemtura*, 439 B.R. at 575-76).

make it a good comparable.”²⁴ Additionally, with respect to analyst opinion that Covia and U.S. Silica are comparables, the Court has no guidance as to the purpose or credibility of those conclusions. The Court must rely on the parties’ experts and evidence adduced.

To that end, the materials assembled by and testimony of Houlihan indicate that Covia and U.S. Silica have considerably more processing facilities, mines, and capacities than the Debtors, Hi-Crush, and Smart Sand. Moreover, Covia has fifteen times more transload facilities than the Debtors spread across North America, and U.S. Silica has eight times more throughout the United States. Hi-Crush, Smart Sand, and the Debtors have only six to eleven transload facilities, and they are located only in certain geographical areas. These factors mean that Covia and U.S. Silica’s ability to produce, sell, and affordably move product to customers is notably greater. Indeed, their reported revenues are significantly higher than the Debtors. Moreover, their diversification into industrial sand sales is not insignificant and is unique among the comparable set, making their revenue generating abilities greater and profitability less dependent on the oil and gas and fracking markets than the others. The Court finds these differing characteristics of Covia and U.S. Silica critical contributors to their risk profiles and is convinced that they would cause misleading results if included in the set of comparables.

Both experts testified that there is no perfect comparable set, but the Committee has argued that Houlihan’s two company set of Hi-Crush and Smart Sand puts greater emphasis on Smart Sand, which is less comparable to the Debtors. However, both experts concluded Smart Sand is a comparable company after analyzing its characteristics. Moreover, while having a larger set of comparable companies might work to diminish the effects of anomalies between the subject company and its comparables, the Court does not think it would be appropriate to include Covia and U.S. Silica just for the sake of having more companies in the set to offset Smart Sand as their inclusion would skew the value conclusion. Indeed, according to the Committee, their larger set of comparable companies increased the Debtors’ TEV by \$78 million. If anything, anomalies in the set could have been addressed by the discounted weight given to the comparable company analysis by the experts.

b. Market Value Versus Face Value of Debt

The next dispute of the experts is the Debtors’ use of Hi-Crush’s market value of debt versus the Committee’s use of its face value as an input for calculating a range of valuation multiples for the set of comparable companies. More specifically, once the set of comparable companies was assembled by the experts, they extracted certain financial data from the companies – namely, their debt obligations, equity value, and excess cash – and calculated the comparable companies’ TEV. The TEVs were then applied to the comparable companies’ projected EBITDA to derive a range of valuation multiples. The resulting range was applied against the Debtors’ projected EBITDA to arrive at the experts’ comparable company TEV conclusions. The Committee’s decision to use the face value of debt during this analysis increased the Debtors’ TEV by \$82 million.

²⁴ Nov. 4, 2019 Hr’g Tr. 46:9-14.

To support its use of market debt, Houlihan testified that the debt of Hi-Crush trades at a significant discount to par value and consequently, the debt's value is more appropriately represented by such market pricing. On the other hand, Miller Buckfire selected to use face value, which is consistent with the firm's default policy. Miller Buckfire testified that the circumstances here did not warrant deviating from such policy because Hi-Crush's equity is trading with material value. While Miller Buckfire acknowledged that debt trading below par can be an indicator of distress and that distress may warrant the use of market value, it is of the opinion that when the equity is trading with material value, the face value of debt must be used as the equity trades on the assumption that debt will be repaid at face value.

The deployment of market or face value of debt is a decision based on an expert's discretion and the particular facts and circumstances of the case at hand. As Miller Buckfire acknowledged, there is conflicting literature regarding their use. And both experts admitted to having used each other's selections in past valuations but assert that their determinations in these cases are appropriate. Based on the record, the Court cannot conclude that Houlihan's decision was unreasonable. Indeed, while Miller Buckfire testified that the trading of equity at material value is an indicator that the market believes debt will be repaid at full face value, both experts agreed that equity could trade for other reasons, including solely because of the option value to be realized from a potential future improvement.

In sum, the Court finds no reason to disturb Houlihan's selection of comparable companies or its use of market value of debt for the calculation of the range of valuation multiples. Multiple other decisions of the experts have been disputed related not only to their DCF and comparable company analyses²⁵ but also their valuation of the Other Assets. However, even if the Court found in favor of the Committee on these disputes, the Debtors' TEV could never surpass the debt hurdle to put Class 6 in the money and, therefore, the Plan is fair and equitable with respect to such class.

c. Other Considerations

Despite the foregoing valuation conclusion, the Court will address two additional TEV issues of the parties.

²⁵ The experts disagreed whether to adjust for the Berm Breach in the comparable company analysis by (a) modifying the Debtors' projected 2020 EBITDA before applying the derived EBITDA multiples and (b) applying different weights to the Debtors' estimated 2020 and 2021 enterprise value ranges. With respect to the DCF analysis, the experts disagreed on the appropriate size premium and whether to use the Debtors' pro forma capital structure or a hypothetical industry capital structure when calculating the weighted cost of capital. The weighted cost of capital "is based upon a combined rate of the cost of debt capital and the cost of equity capital" and is used to derive the discount rate used to calculate present value of projected future cash flows. *Exide*, 303 B.R. at 64. With respect to the DCF analysis, the experts also differed on whether to apply their terminal multiple to the Debtors' full terminal year projected 2021 EBITDA or to only the last two quarters in order to estimate the Debtors' terminal value (*i.e.* the Debtors' unlevered free cash flows beyond the forecasts of the Business Plan).

i. Normalization

After deriving the comparable companies' range of valuation multiples, Miller Buckfire applied them to, among other things, the Debtors' "normalized" projected 2020 EBITDA to account for the effects of the San Antonio Berm Breach. While certainly normalization is appropriate when extraordinary and nonrecurring events occur so that the subject and comparable companies can be more accurately compared, the literature relied upon by the parties suggests that doing so requires an expert to normalize based on managements' expectation of operations, primarily using historical data.²⁶

Here, Mr. Kim from Province, Inc. ("Province"), the Committee's financial advisor, normalized the Debtors' 2020 EBITDA for Miller Buckfire. To do so, Province assumed that San Antonio would produce and sell on a monthly basis 200,000 to 285,000 tons of sand during every month of 2020. It based this assumption on existing contracts and production projections made by the Debtors prior to the Berm Breach. All other management assumptions remained the same.

The end result of Province's normalization is a \$45 million projected 2020 EBITDA, an increase of \$8.1 million from the Debtors' projection. However, the Court questions the reasonableness of this revision as a proper normalization adjustment given, among other things, that the actual monthly performance of San Antonio has never met even Province's low estimate of 200,000 tons, that pre-Berm Breach, the Debtors only hoped to reach full capacity at San Antonio in mid-July 2020 at the earliest, the reasonable uncertainty surrounding the achievement of the ramp in light of the Debtors' historical inability to do so, and the current state of the industry and related demand.

ii. Kingfisher

Additionally, the Court rejects Miller Buckfire's Kingfisher valuation range of \$15 million to \$55 million, representing, at the low end, the book value amount of the Debtors' investment at Kingfisher – or, the costs incurred – and, at the high end, its operational value.

First, it is not appropriate to value Kingfisher as an operating facility. An operational Kingfisher is not in the Debtors' go forward Business Plan, and the record evinces managements' credible and reasoned decision to maintain an idled state. There is nothing in the record to suggest that this decision was made in bad faith to lower TEV or otherwise to avoid giving unsecured creditors a Plan distribution. Decisions with respect to Kingfisher began before the bankruptcy cases and have only strengthened since. The Court will not disturb managements' judgment in the matter.²⁷

²⁶ See Benjamin H. Groya, *Implementing Normalization Adjustments*, Valuation Practices and Procedures Highlights 78-79.

²⁷ See, e.g., *PTL Holdings*, No. 11-12676, 2011 WL 5509031, at **3-5 (finding, based on the record, that the debtors' projections were neither fatally flawed or otherwise materially unreliable); *In re Nellson Nutraceutical, Inc.*, No. 06-10072, 2007 WL 201134, *75-76 (Bankr. D. Del. Jan. 18, 2007) (looking to the accuracy of management's historic projections, the court rejected projections "where the evidence clearly indicates that management created an unrealistic business plan").

Moreover, Miller Buckfire's valuation of Kingfisher as a completed and operational facility is not based on sound projections. Although Kingfisher projections were included in the Business Plan, they were assembled at the request of HPS with certain assumptions to give a picture of potential value to weigh an additional capital investment. The Debtors disavow the reliability of these figures, noting that they were done at high level and not as a real forecast. Among other things, the Debtors point to their static assumptions in rendering the projections, such as the amount of finished product the Debtors may sell and the related costs. The Court finds the Debtors' testimony credible, notes that the Committee did not provide any independent evidence that would support the Kingfisher projections, and accordingly does not find them to be a reliable indicator of EBITDA should Kingfisher become operational.

Second, with respect to the Committee's low-end value conclusion of \$15 million, such figure represents Miller Buckfire's opinion of value if Kingfisher was sold as a going concern to a willing buyer in the Debtors' business (*i.e.* a like-user scenario).²⁸ While Houlihan utilized the same methodology and there is no disagreement that the Debtors' actual costs incurred equal \$15 million, there is credible and reasoned testimony from Houlihan that the price to be obtained in a like-user sale would likely be much lower due to depreciation and other factors leading to value destruction.²⁹ Moreover, the ability to find such a buyer was reasonably called into question given, among other things, the current state of the Scoop/Stack market.³⁰

B. The Best Interests Test Under Section 1129(a)(7)

Because the Class 6 general unsecured claimholders rejected the Plan and will not receive a distribution, pursuant to section 1129(a)(7), the Court may only confirm the Plan if the Debtors have established by a preponderance of the evidence that, as of the effective date of the Plan, those claimholders would not be entitled to receive anything if the Debtors were liquidated under chapter 7 (the "Best Interests Test").

²⁸ See *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 960 (1997) ("the value of the property . . . is the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller.").

²⁹ The Court is cognizant that there is an extant dispute with Kingfisher's alleged mechanics' lienholders regarding the value of their asserted secured claims. To ease the burden on the Court and parties during the confirmation hearing, the Debtors agreed that they would not take the position during the TEV disputes that the value of Kingfisher is worth less than \$11,207,973.59. See *infra* n.30. Because it is not necessary to the Court's confirmation decision to determine with certainty Kingfisher's value, the Court will go no further on the issue with respect to its section 1129(b)(1) fair and equitable analysis.

³⁰ On October 9, 2019, the Debtors received a letter from Yansa Silica, LLC ("Yansa"), which summarized the principal terms of a possible transaction whereby Yansa would buy Kingfisher for \$11,207,973.59. The reliability of this expression of interest as a basis for Kingfisher's value is questionable given that Yansa is related to at least one mechanics' lienholder, there was a dispute as to the value of such lienholder's alleged secured claim as of the date of the letter, and the possible transaction appears not to have been pursued by Yansa following the Debtors' request that it execute a non-disclosure agreement prior to the parties moving forward with due diligence.

The Debtors contend that the Plan satisfies the Best Interests Test and in support thereof have submitted a liquidation analysis of the estates' assets as of October 31, 2019, the presumed effective date of the Plan (as revised, the "Liquidation Analysis"). The Liquidation Analysis was completed by Mr. Gaston, with the assistance of the Debtors, Houlihan, and others at Ankura, and estimates the proceeds that would be generated if the Debtors' assets were liquidated in an "orderly but fairly expedited" fashion by a chapter 7 trustee in accordance with the Bankruptcy Code.³¹

The Liquidation Analysis indicates that there will be no proceeds available to distribute to unsecured creditors in a chapter 7 liquidation. In particular, it provides the following relevant analysis and assumptions:

- The gross recovery from a liquidation sale of all the Debtors' assets is estimated to range from \$78.2 million to \$105.6 million.
- The recovery on account of encumbered assets is estimated to range from \$64.2 million to \$81.8 million, which will be insufficient to satisfy the secured claims.
- Of the gross recovery amount, only \$2.22 million to \$4.04 million will be generated from the liquidation of the estates' alleged unencumbered assets, which, according to the Debtors, are only avoidance actions unrelated to the Committee's Business Interruption Insurance Claim lien challenge for which they have sought standing to pursue on behalf of the estates.³²
- The liquidation value of Kingfisher is estimated to range from \$400,000 million to \$4 million as a result of scrap sales, and the Business Interruption Insurance Claim is estimated to range \$11.8 million to \$19.8 million. The Debtors assert that these assets are encumbered.
- The total chapter 7 liquidation costs are estimated to range from \$15.7 million to \$16.3 million (the "Chapter 7 Liquidation Costs").
- The total chapter 11 costs, which include certain professional and U.S. Trustee fees, are estimated to be \$12 million (the "Chapter 11 Costs").
- The asserted adequate protection claims of the prepetition lenders for diminution in value during the chapter 11 proceedings range from \$22.3 million to \$39.1 million on account of the Debtors' new money DIP draws and cash collateral usage. During the chapter 7 proceedings, their adequate protection claims range from \$110.1 million to \$147 million on account of the difference in amount recoverable by the lenders under

³¹ Oct. 30, 2019 Hr'g Tr. 168:5-16.

³² See *Motion of the Official Committee of Unsecured Creditors for an Order Granting the Committee: (A) Derivative Standing to Assert, Prosecute, and Settle Claims Relating to (1) Certain Unencumbered Property and (2) Lien Avoidance; and (B) Authorization to Hold, Assert, and If Necessary, Waive Privileges on Behalf of the Estates* [D.I. 520].

the proposed Plan and that which they are estimated to recover in chapter 7 (together, the “Adequate Protection Claims”).

- The Debtors’ Liquidation Analysis assumes that the Chapter 7 Liquidation Costs, the Chapter 11 Costs, and the Adequate Protection Claims will have distribution priority over unsecured claims and be payable first from the proceeds of unencumbered property.

The Committee has criticized several value estimates and assumptions made by the Debtors in their Liquidation Analysis that if accepted would lead to the conclusions that unsecured creditors are entitled to a distribution and that accordingly, the Plan violates the Best Interests Test. Namely, according to the Committee, Kingfisher and the Business Interruption Insurance Claim are unencumbered property that will provide value to unsecured creditors in a chapter 7 liquidation scenario. For these two assets, the Committee offers a total liquidation value of \$32.8 million to \$45 million, which amounts to \$17.9 million to \$30 million for the Business Interruption Insurance Claim and \$15 million for Kingfisher. Moreover, the Committee argues that only the Chapter 7 Liquidation Costs will be satisfied by the unencumbered assets in a liquidation scenario. It contends that the Chapter 11 Costs will be borne by the secured lenders via the carve-out (the “Carve-Out”) provided for in the Final DIP Order entered in these cases,³³ and with respect to the Adequate Protection Claims, the Committee disputes their calculation and argues that the prepetition lenders agreed in the Final DIP Order to seek a recovery for such claims only from encumbered property. No other assumptions or values in the Debtors’ Liquidation Analysis have been specifically challenged by the Committee.

To decide whether the Debtors’ unsecured creditors are entitled to a distribution in a chapter 7 scenario, the Court first determined the aggregate liquidation value of all potential unencumbered property as proffered by the Committee. That property is Kingfisher, the Business Interruption Insurance Claim, and the avoidance actions. Then, it examined whether the Chapter 11 Costs and the Adequate Protection Claims are entitled to satisfaction from the proceeds of such property and, if so, whether proceeds would remain for unsecured creditors. Following such analysis, the Court concludes that unsecured creditors would receive no distribution in a hypothetical chapter 7 proceeding and thus, the Plan satisfies the Best Interests Test.

1. Hypothetical Chapter 7 Liquidation Values

As set forth in *In re Lason, Inc.*, which was relied upon by the Committee, a “hypothetical liquidation entails a considerable degree of speculation about a situation that will not occur unless the case is actually converted to a chapter 7.”³⁴ The court continued that “[a] liquidation ‘contemplates valuation according to the depressed prices that one typically receives in distressed

³³ *Final Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing and (B) Use Cash Collateral, (II) Granting Certain Protections to Prepetition Secured Parties, (III) Scheduling a Final Hearing, and (IV) Granting Related Relief* (Aug. 4, 2019) [D.I. 209] ¶ 11 (the “Final DIP Order”).

³⁴ 300 B.R. 227, 233 (Bankr. D. Del. 2003) (quoting *In re Sierra-Cal*, 210 B.R. 168, 171-72 (Bankr. E.D. Cal. 1997)).

sales” and that such liquidation can be done either through “‘forced sale’ conditions or as a going concern.”³⁵

With the exception of Kingfisher and the Business Interruption Insurance Claim, the Committee did not specifically challenge the valuation methodologies, assumptions, and conclusions in the Debtors’ Liquidation Analysis, and the Court finds them to be persuasive and credible. Generally, however, Miller Buckfire disagreed that a chapter 7 trustee would obtain forced sale prices of the Debtors’ assets as reflected in the Liquidation Analysis. It testified that a chapter 7 trustee would sell the Debtors’ assets as a going concern (either as a whole or in parts) to a like-user and possibly achieve hundreds of millions of dollars depending upon the process and the facts and circumstances present at the time.

The Court does not agree on the record presented that a going concern sale of the Debtors’ property is a reasonable assumption in a chapter 7. While certainly the Court could imagine a chapter 7 trustee pursuing something other than a forced sale, Miller Buckfire did not provide persuasive testimony as to why and how these events were likely to occur if the Debtors’ cases were converted to ones under chapter 7 given, among other things, the lenders’ blanket liens.³⁶ And based on the Court’s experience, the answers to these questions are not readily apparent. Moreover, no specific estimate of recoveries under this alternative scenario were provided to assist the Court in comparing such a circumstance with the one provided by the Debtors in their Liquidation Analysis.

Additionally, with respect to Kingfisher, the Court disagrees with the Committee’s asserted \$15 million chapter 7 liquidation value based upon a like-user sale. For reasons already discussed, it is too high; and, as the case law reveals, it is reasonable to assume that a chapter 7 sale will yield lower values due to the conditions presented. Accordingly, the Court sees no reason to disrupt the Debtors’ proffered range of \$400,000 to \$4 million for Kingfisher.

With respect to the liquidation value of the Business Interruption Insurance Claim, after considering the testimony and evidence adduced, the Court concludes that the Debtors have satisfied their burden. As noted, the Debtors have submitted a \$35 million Business Interruption Insurance Claim to its insurer. In the Debtors’ Liquidation Analysis, Mr. Gaston assigned a liquidation value range to this claim of \$11.8 million to \$19.8 million. The high-end value reflects discounts for recovery risk and the Debtors’ inability to substantiate a claim for loss after conversion due to a presumed cessation of operations. The low-end value is simply 60% of the high-end value.

Province testified for the Committee regarding the liquidation value of the Business Interruption Insurance Claim. In its opinion, the value ranges from \$17.9 million to \$30 million,

³⁵ *Id.*

³⁶ *Menorah Congregation & Religious Ctr. v. Feldman (In re Menorah Congregation & Religious Ctr.)*, 554 B.R. 675, 692 (Bankr. S.D.N.Y. 2016) (noting that “the Court should consider the experience, accuracy, and general credibility of the expert witnesses, and the logic and persuasiveness of their analyses in light of the facts.”); *see also Genesis Health Ventures*, 266 B.R. at 599 (discussing the shifting burdens of proof once debtors have met their burden under section 1129(a)(7)).

subject to a negative adjustment of up to \$400,000 to account for San Antonio's actual September production levels, which were an estimated input for the analysis. To reach its value conclusion, Province added additional recovery components to the Debtors' claim (namely, certain restructuring costs and a quality of revenue claim (together, the "Added Claim Components")), and lowered the recovery risk.³⁷

Similar to the Debtors' TEV, the dispute over the liquidation value of the Business Interruption Insurance Claim has come down to a difference in opinion as to what is recoverable under the insurance policy and the chances of doing so. The Court will neither augment the value of the Business Interruption Insurance Claim with the Added Claim Components nor adjust the risk of recovery as the Committee requests.

The record suggests that the Debtors are fully motivated to recover as much as they can from the insurer on account of the Berm Breach. If there were viable additions to the claim that could be made based on the Committee's independent analysis, the Debtors would be obligated to pursue them and, indeed, they did so for certain Committee recommendations. However, with respect to the Added Claim Components, the evidence does not support them. For instance, Province's assertion that the chapter 11 proceedings were commenced as a direct result of the Berm Breach contradicts the record and calls into question the reasonableness of adding restructuring costs to the claim. Moreover, the record does not support the viability of the Committee's quality of revenue claim in the numbers suggested, and it is unclear to the Court whether such a claim can even be made under the policy. Finally, Houlihan's testimony shed light on the recovery risks associated with a business interruption claim based on projected production levels for a facility such as San Antonio that has had difficulty achieving such levels. Accordingly, it is reasonable for the Debtors to take a conservative approach to the risk of recovery.

As a result of the foregoing conclusions, the Court finds the aggregate range of liquidation value for the totality of potentially unencumbered property to be \$14.42 million to \$27.838 million. Following the deduction of the estimated Chapter 7 Liquidation Costs, which the Committee agrees will be satisfied from such property, \$11.578 million may be available for unsecured creditors if the Committee is correct that the \$12 million of Chapter 11 Costs and the over \$100 million of asserted Adequate Protection Claims are not payable from unencumbered property:

Kingfisher	\$400,000 - \$4,000,000
Business Interruption Insurance Claim	\$11,800,000 - \$19,800,000
Avoidance Action Proceeds	\$2,220,000 - \$4,038,000
Subtotal	\$14,420,000 - \$27,838,000
Less Chapter 7 Liquidation Costs	\$15,745,000 - \$16,260,000
TOTAL POTENTIAL RECOVERY	(\$1,325,000) - \$11,578,000

³⁷ Due to the ongoing claim negotiations with the insurer, the parties were careful during the confirmation hearing not to reveal confidential information related to the claim's calculations. The Court remains similarly diligent.

2. Chapter 11 Costs

The Committee contends that in a hypothetical liquidation of the Debtors, outstanding Chapter 11 Costs must be applied to the Final DIP Order's Carve-Out and not to the proceeds of unencumbered property. However, while the lenders in the Final DIP Order did agree that a portion of their collateral may be used for the payment of certain chapter 11 fee claims if conversion occurs,³⁸ the Final DIP Order does not address *when* such funds are to be used to satisfy such claims. The Court agrees with the Debtors as well as the cases on which they rely, including *Official Committee of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Capital, LLC)* and *In re Molycorp, Inc.*,³⁹ that the Carve-Out funds are only available as a backstop if and to the extent that proceeds from unencumbered assets are insufficient to satisfy the Chapter 11 Costs. Accordingly, after applying the uncontested \$12 million estimate of the Chapter 11 Costs to the available \$11.578 million of potentially unencumbered proceeds, there would be no funds available to distribute to unsecured creditors in a hypothetical chapter 7 of the Debtors and therefore, the Best Interests Test is satisfied.

3. Adequate Protection Claims

Even if the Court's analysis regarding the application of the Carve-Out is incorrect, the \$11.578 million of potentially unencumbered proceeds would not be available to unsecured creditors in a hypothetical chapter 7 because, at a minimum, the lenders' chapter 11 adequate protection claims on account of the new money DIP draws would absorb them.

Under the Bankruptcy Code, a secured creditor is entitled to adequate protection to protect its interest in debtor property from a decrease in value during the pendency of a bankruptcy case.⁴⁰ Here, as adequate protection, the prepetition secured parties were granted under the Final DIP Order, among other things, allowed superpriority administrative expense claims in an amount equal to the aggregate diminution in the value of their interests in their prepetition collateral (including cash collateral) from and after the petition date, if any, for any reason, including collateral use and priming.⁴¹ The claims have recourse to and are payable from all of the Debtors' assets except the avoidance actions and their proceeds,⁴² which would be used in any event during a chapter 7 liquidation to satisfy either the aforementioned Chapter 7 Liquidation Costs or the Chapter 11 Costs.

In determining the appropriateness and amount of chapter 11 adequate protection claims for diminution, the Court must measure the difference in value of a secured creditor's interest in collateral at two different relevant points in time. Here, those times would be the petition date and the Plan's effective date. Pursuant to section 506(a) and applicable case law, including the

³⁸ See Final DIP Order ¶ 11.

³⁹ *Official Committee of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Cap., LLC)*, 501 B.R. 549, 622 (Bankr. S.D.N.Y. 2013); *In re Molycorp, Inc.*, 562 B.R. 67, 76-77 (Bankr. D. Del. 2017).

⁴⁰ See, e.g., 11 U.S.C. §§ 361, 362, 363, 364.

⁴¹ See Final DIP Order ¶ 18(b).

⁴² See *id.*

Supreme Court’s decision in *Associates Commercial Corp. v. Rash* and the Third Circuit’s decision in *In re Heritage Highgate, Inc.*,⁴³ the appropriate valuation methodology is dependent on what is to be done with the subject collateral on the effective date – whether it is to be liquidated, surrendered, or retained. If, pursuant to a plan, a debtor intends to retain the collateral at issue – as the Debtors have done with respect to their assets – then “the value of the property (and thus the amount of the secured claim under § 506(a)) is the price a willing buyer in the debtor’s trade, business, or situation would pay to obtain like property from a willing seller.”⁴⁴ It is not measured by foreclosure value as suggested by the Committee.

Here the Court has not received a specific valuation of the going concern value of the Debtors’ assets on the petition date. However, the record is clear that the value of the assets, substantially all of which are the lenders’ collateral, has been declining since prior to the petition date. Accordingly, the new money DIP advances during the chapter 11 proceedings, which primed the prepetition lenders’ interests in their collateral, amount to diminution. And if the cases were converted, the Debtors’ Liquidation Analysis indicates that those adequate protection claims must be satisfied from unencumbered proceeds as there would be insufficient proceeds from encumbered assets following repayment of the DIP claim. Despite the Committee’s arguments to the contrary, this application is consistent with the Final DIP Order.⁴⁵

Given that the Court finds that there will be no value available for distribution to unsecured creditors in a hypothetical chapter 7 liquidation, it concludes that the Best Interests Test has been satisfied and it need not address further arguments of the parties on this issue, including whether Kingfisher and the Business Interruption Insurance Claim are encumbered and whether the prepetition lenders have a chapter 11 adequate protection claim on account of cash collateral usage or a so-called chapter 7 adequate protection claim as alleged.

C. Feasibility Under Section 1129(a)(11)

Section 1129(a)(11) requires that “[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.” For a debtor to satisfy its burden under this subsection, the evidence presented must be credible

⁴³ Interpreting section 506(a)(1), the United States Supreme Court has held that the “proposed disposition or use of the collateral is of paramount importance to the valuation question.” *Rash*, 520 U.S. at 962. As the *Rash* Court explained, this standard “distinguishes retention from surrender and renders meaningful the key words ‘disposition or use.’” *Id.* at 962; *accord In re Heritage Highgate, Inc.*, 679 F.3d 132, 141 (3d Cir. 2012) (“If that language is to be afforded any significance, then, the appropriate standard for valuing collateral must depend upon what is to be done with the property – whether it is to be liquidated, surrendered, or retained by the debtor.”).

⁴⁴ *Rash*, 520 U.S. at 960.

⁴⁵ See Final DIP Order ¶ 14(d) (“[N]otwithstanding anything to the contrary in the Interim Order or this Final Order, the DIP Agent and the Prepetition Agents, as applicable, shall satisfy the . . . claims for Diminution in Collateral Value . . . , if any, *first* from assets other than the Unencumbered Assets.” (emphasis added)).

and persuasive that the proposed plan offers a “reasonable assurance of success.”⁴⁶ This is a low threshold. Various factors may be assessed by a court in deciding feasibility, including the following:

- (i) the adequacy of the debtors’ capital structure; (ii) the earning power of its business; (iii) economic conditions; (iv) the ability of the debtor’s management; (v) the probability of the continuation of the same management; and (vi) any other related matters which determine the prospects of a sufficiently successful operation to enable performance of the provision of the plan.⁴⁷

Chippewa argues that the Debtors’ Plan is not feasible because it does not address the post-emergence funding of ongoing environmental issues related to groundwater monitoring and reclamation at Auburn. However, the record indicates that the reorganized Debtors will have sufficient liquidity after satisfying their Plan obligations to conduct their business operations. Indeed, in addition to liquidity generated from operations, the reorganized Debtors will have approximately \$50 million available under their exit facility to satisfy obligations as they come due. Chippewa has not offered any evidence to the contrary. Accordingly, the Court finds that there is reasonable assurance that the Plan will be a success and that the reorganized Debtors will be able to satisfy their future obligations, including those that might arise for Chippewa if the Debtors fail to perform their ongoing environmental obligations.

D. Good Faith Under Section 1129(a)(3) and the Provision of Adequate Means for Implementation Under Section 1123(a)(5)

Under section 1129(a)(3), a plan must be “proposed in good faith and not by any means forbidden by law.” The term “good faith” is undefined in the Bankruptcy Code, but the Third Circuit has found that “the important point of inquiry is the plan itself and whether such a plan will fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code.”⁴⁸ Accordingly, courts generally require that a plan “be proposed with honesty and good intentions and with a basis for expecting that reorganization can be achieved . . . [or with] fundamental fairness in dealing with the creditors.”⁴⁹ In determining whether a plan is proposed in good faith, courts consider the totality of the circumstances, focusing “more to the process of plan

⁴⁶ *In re Indianapolis Downs*, 486 B.R. 286, 298 (Bankr. D. Del. 2013); *see also In re Elec. Components Int’l*, No. 10-11054, 2010 WL 3350305, at *9 (Bankr. D. Del. May 11, 2010) (providing that a court may find that a plan is feasible if “the information in the [d]isclosure [s]tatement, the [s]upporting [d]eclaration, and the evidence proffered or adduced at the Confirmation Hearing (i) is persuasive and credible, (ii) has not be controverted by other evidence, and (iii) establishes that the [p]repackaged [p]lan is feasible and that there is a reasonable prospect of the [r]eorganized [d]ebtors” being able to meet their financial obligations.).

⁴⁷ *In re Paragon Offshore PLC*, No. 16-10386, 2016 WL 6699318, at *17 (Bankr. D. Del. Nov. 15, 2016).

⁴⁸ *In re Combustion Eng’g, Inc.*, 391 F.3d 190, 246 (3d Cir. 2004).

⁴⁹ *Stonington Partners, Inc. v. Official Committee of Unsecured Creditors (In re Lernout & Hasupie Speech Prods. N.V.)*, 308 B.R. 672, 676 (D. Del. 2004).

development than the content of the plan.”⁵⁰ “Good faith is shown when the plan has been proposed for the purpose of reorganizing the debtor, preserving the value of the bankruptcy estate, and delivering that value to creditors.”⁵¹ On the other hand, “[g]ood faith has been found to be lacking if a plan is proposed with ulterior motives.”⁵²

The Committee contends that the Plan has not been proposed in good faith because of the failure to conduct a sale process, the circumstances surrounding the negotiation and proposal of the RSA and Plan, and the inclusion of the Class 6 deathtrap.⁵³ The Court disagrees. The weight of the evidence suggests that the negotiations surrounding the formulation and entry into the RSA, the related formation of the Special Restructuring Committee and the selection of its members, and the subsequent pursuit of the out-of-court restructuring and current proposed Plan were the result of good faith, arms-length, and meaningful negotiations among the Debtors’ key stakeholders and rooted in the Debtors’ sound business judgment. While the Committee highlighted that there was a power imbalance between the Debtors and their out-of-the money secured lenders during the restructuring negotiations, this fact alone does not taint the negotiations or suggest bad faith on the part of the Debtors for pursuing the Plan and its proposed restructuring. Indeed, the Plan’s structure is common in circumstances like the ones presented here, and a sales process is not required as previously discussed.

Moreover, the Plan proposed is intended to preserve the Debtors’ operations and deliver as much value as possible to those creditors entitled to it. Pursuant to the Debtors’ accepted valuation, unsecured creditors are unfortunately not able to receive a distribution. While the failed Class 6 deathtrap may have seemed unsavory to those creditors who stood only to receive pennies on the dollar if they accepted, the offer was intended to encourage consensus and presented an opportunity to which the claimholders were not otherwise entitled. Under such circumstances, the Court does not find the deathtrap impermissible or indicative of a lack of good faith.⁵⁴

Chippewa asserts that the Debtors’ failure to state with specificity their intention with respect to future operations at Auburn, which is currently idled, violates the Bankruptcy Code’s requirement that the Plan set forth “adequate means” for its implementation under section 1123(a)(5) and likewise, the Bankruptcy Code’s good faith requirement. Additionally, Chippewa submits that the Plan will be implemented in violation of non-bankruptcy environmental laws because of its silence regarding groundwater monitoring, reclamation, and related bonding.

⁵⁰ *Genco*, 513 B.R. at 261 (quoting *Chemtura*, 439 B.R. at 608).

⁵¹ *Id.*

⁵² *Id.*

⁵³ In support of its section 1129(a)(3) argument, the Committee also points the Court to the commitment in the RSA for the reorganized Debtors to grant the releases and exculpation agreed to therein if not approved in connection with the Plan. The RSA and the agreements therein are not before the Court. However, the record does not support that the commitment was made in bad faith.

⁵⁴ See, e.g., *Lambert Brussels Assocs. Ltd. v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 140 B.R. 347, 350 (S.D.N.Y. 1992), *aff’d* 138 B.R. 714 (Bankr. S.D.N.Y. 1992); *In re Adelpia Comm. Corp.*, 368 B.R. 140 (Bankr. S.D.N.Y. 2007); *In re Zenith Elec. Corp.*, 241 B.R. 92, 106 (1999).

Again, the Court disagrees. The Plan provides that Auburn will vest in the reorganized Debtors on the effective date to be used or disposed of in the Debtors' business judgment. Moreover, as the Debtors have noted, nothing in the Plan promotes, procures, or creates any legal violation. The record indicates that the Debtors are working to remedy their permit violations, and nothing suggests that they will stop post-confirmation. However, if they do, the Plan addresses how Chippewa can pursue relief. It can pursue its remedies⁵⁵ either through the claims' reconciliation and treatment process provided for in the Plan or, with respect to any non-dischargeable obligations, in the ordinary course.⁵⁶

E. Third-Party Releases

Finally, the Court turns to objections lodged by the U.S. Trustee, SEC, and the Committee to the Plan's proposed third-party releases.⁵⁷ The Debtors' Plan proposes that certain creditors and interest holders provide third-party releases to a number of non-debtor parties. Namely, Article X, Section B.2 of the Plan provides that, unless they complete and return a form ("Opt-Out Form")

⁵⁵ See, e.g., *In re Gen. Dev. Corp.*, 135 B.R. 1002, 1007 (Bankr. S.D. Fla. 1991) (overruling a municipality's objection to a proposed plan because the objectors could fully recover under the proposed plan).

⁵⁶ Indeed, at the confirmation hearing, the Debtors represented to the Court and the parties that any confirmation order proposed will include the following comfort language for Chippewa and others similarly situated:

Nothing in this Confirmation Order, the Plan or any implementing plan documents (collectively, the "Plan Documents") discharges, releases, precludes, or enjoins: (1) any liability to any Governmental Unit that is not a "claim" as defined in 11 U.S.C. § 101(5) ("Claim"); (2) any Claim of a Governmental unit arising on or after the Effective Date; (3) any police or regulatory liability to a Governmental Unit that any Entity would be subject to as the owner or operator of property after the Effective Date; or (4) any liability to a Governmental Unit (including a Claim) on the part of any Person other than the Debtors or the Reorganized Debtors. Nor shall anything in the Plan Documents; (1) enjoin or otherwise bar a Governmental Unit from asserting or enforcing, outside this Court, any liability described in the preceding sentence; (2) enjoin or affect any Governmental Unit's setoff rights under federal law as recognized in Section 553 of the Bankruptcy Code, and recoupment rights, and such rights shall be preserved and are unaffected; (3) divest any tribunal of any jurisdiction it may have under police or regulatory law to interpret the Plan Documents or to adjudicate any defense asserted under the Plan Documents; (4) excuse the payment of interest, to the extent not paid in full on the Effective Date, on administrative expense claims of any Governmental Unit allowed pursuant to the Plan or the Bankruptcy Code and interest shall accrue at the applicable statutory rate on such claims from the Effective Date; (5) expand the scope of the estimation procedures set for in Section 502(c) of the Bankruptcy Code; or (6) be construed as a compromise or settlement of any Claim, liability, cause of action or interest of any Governmental Unit. . . .

⁵⁷ In their confirmation objections, the U.S. Trustee and the Committee also objected to the propriety of the Debtors' releases proposed under the Plan. At the confirmation hearing, however, the parties did not press their objections to these releases. For the U.S. Trustee, its objection was resolved prior to the conclusion of the hearing. Nov. 8, 2019 Hr'g Tr. 96:5-8. The Committee did so without prejudice to later object should this Court deny confirmation of the Plan and the Debtors subsequently seek confirmation of a further amended plan. *Id.* at 82:14-83:4.

or ballot indicating their affirmative opt-out, holders of general unsecured claims in Class 6 and holders of the Partnership's equity interests in Class 9 will be deemed to have consented to the release and waiver of current and future claims against the "Released Parties" (which include HPS and Insight). The ballots sent to the creditors, and the Opt-Out Form sent to the interest holders, provided conspicuous notice of how to opt-out and the implication of the failure to do so.

Here, the Debtors assert that the third-party releases are consensual and accordingly they have not attempted to meet the factors set forth in *Continental* required for the approval of nonconsensual releases.⁵⁸ The Debtors argue that they should be approved as typical, customary, and routine. The objecting parties disagree, asserting that consent cannot be inferred by the failure of a creditor or equity holder to return a ballot or Opt-Out Form. The Court agrees with the objecting parties.

For the reasons highlighted by the objections and those carefully set forth by, among others, the courts in *In re Chassix Holdings, Inc.*, *In re SunEdison, Inc.*, and *In re Washington Mutual, Inc.*,⁵⁹ it cannot be said with certainty that those failing to return a ballot or Opt-Out Form did so intentionally to give the third-party release, and that is what the Court must find under the law to approve a third-party release absent the satisfaction of the *Continental* standard.

For the Court to infer consent from the nonresponsive creditors and equity holders, the Debtors must show under basic contract principles that the Court may construe silence as acceptance because (1) the creditors and equity holders accepted a benefit knowing that the Debtors, as offerors, expected compensation; (2) the Debtors gave the creditors and equity holders reason to understand that assent may be manifested by silence or inaction, and the creditors and equity holders remained silent and inactive intending to accept the offer; or (3) acceptance by the creditors and equity holders can be presumed due to previous dealings between the parties.⁶⁰ The Debtors cannot do so. The Class 6 creditors and Class 9 equity holders are receiving no distribution under the Plan and no previous dealings between the parties are in evidence. Moreover, while the Debtors included on the ballot and Opt-Out Form notice to the recipients of the implications of a failure to opt-out, the Court cannot on the record before it find that the failure of a creditor or equity holder to return a ballot or Opt-Out Form manifested their intent to provide a release. Carelessness, inattentiveness, or mistake are three reasonable alternative explanations.

The Court understands that its position is a minority amongst the judges of this District. However, the Court must respectfully disagree with its colleagues who have held differently as it has concluded that a waiver cannot be discerned through a party's silence or inaction unless specific circumstances are present. A party's receipt of a notice imposing an artificial opt-out requirement, the recipient's *possible* understanding of the meaning and ramifications of such

⁵⁸ See *Continental*, 203 F.3d at 214 ("The hallmarks of permissible non-consensual releases – fairness, necessity to the reorganization, and specific factual findings to support these conclusions – are all absent here.").

⁵⁹ See, e.g., *In re Chassix Holdings, Inc.*, 533 B.R. 64, 78 (Bankr. S.D.N.Y. 2015); *In re SunEdison, Inc.*, 576 B.R. 453 (Bankr. S.D.N.Y. 2017); *Wash. Mut.*, 442 B.R. at 355; *Zenith Elecs. Corp.*, 241 B.R. at 111.

⁶⁰ See Restatement (Second) of Contracts § 19 (Am. Law Inst. 1981); see also *Klaassen v. Allegro Dev. Corp.*, 106 A.3d 1035, 1045-48 (Del. 2014).

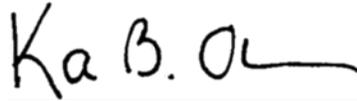
notice, and the recipient's failure to opt-out simply do not qualify. All hope is not lost of course for those seeking the benefit of a plan's third-party release mechanism because if there is an appropriate bankruptcy justification for the releases in the absence of affirmative consent, a debtor may proceed under *Continental*. Here, the Debtors have not done so. Accordingly, the Court will not approve the third-party releases as proposed.

Finally, the U.S. Trustee lodged an objection to the scope of the exculpation clause⁶¹ proposed in the original plan. The Debtors have limited the clause in second plan amendment⁶² and agreed to further do so at the confirmation hearing.⁶³ With such modifications, the Court is satisfied and will approve the Plan's exculpation provision as revised.⁶⁴

IV. CONCLUSION

For the foregoing reasons, with the exception of the proposed third-party releases, the Court finds that the Debtors have carried their burden to demonstrate that the Plan is fair and equitable, satisfies the Best Interests Test, has been proposed in good faith, and otherwise is sufficient for confirmation. An appropriate order will follow denying confirmation so that the third-party release provision may be revised.

Dated: December 5, 2019



Karen B. Owens
United States Bankruptcy Judge

⁶¹ See Plan, Art. X, Section E.

⁶² See *id.*, Art. C (limiting the scope of "Exculpated Parties" to only estate fiduciaries plus certain related parties).

⁶³ Nov. 7, 2019 Hr'g Tr. 108:1-14 (agreeing to limit all exculpated parties (including those related to the estate fiduciaries) to those acting as estate fiduciaries).

⁶⁴ The U.S. Trustee also took issue with the length of the Plan's discharge provisions in Article X, Section D of the Plan and, in particular, the injunctions included therein. To the extent that such objection is extant, see Nov. 7, 2019 Hr'g Tr. 95:16-17 ("I don't know that I necessarily have a problem with that injunction . . ."), the Court finds such section acceptable.