

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

<i>In re</i>	:	Chapter 11
	:	
TAYLOR-WHARTON	:	Case Number 09-14089 (BLS)
INTERNATIONAL LLC, <i>et al.</i> ,	:	
	:	Hearing Date: 2/16/10 at 10:30 a.m.
Debtors	:	Objection Deadline: 2/9/10 at 4:00 p.m.

**UNITED STATES TRUSTEE’S OBJECTION TO CONFIRMATION
OF DEBTORS’ JOINT CHAPTER 11 PLAN OF REORGANIZATION
DATED AS OF DECEMBER 4, 2009 (D.I. 77)**

In support of her Objection to Confirmation of the Debtors’ Joint Chapter 11 Plan of Reorganization Dated as of December 4, 2009 (the “Plan”), Roberta A. DeAngelis, Acting United States Trustee for Region 3 (“UST”), by undersigned counsel, avers as follows:

1. This Court has jurisdiction to hear this Objection.
2. Pursuant to 28 U.S.C. § 586, the UST is charged with overseeing the administration of Chapter 11 cases filed in this judicial district, including, at the UST’s discretion, monitoring plans filed in Chapter 11 cases and filing comments in connection with hearings on such plans pursuant to 28 U.S.C. § 586(a)(3)(B). This duty is part of the UST’s overarching responsibility to enforce the bankruptcy laws as written by Congress and interpreted by the courts. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that UST has “public interest standing” under 11 U.S.C. § 307, which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the UST as a “watchdog”).
3. Pursuant to 11 U.S.C. § 307, the UST has standing to be heard on this Objection.

BASIS FOR RELIEF

Relevant Procedural Law

4. “After notice, the court shall hold a hearing on confirmation of a plan.” 11 U.S.C. § 1128(a).

5. “A party in interest may object to confirmation of a plan.” 11 U.S.C. § 1128(b).

6. An objection to confirmation is governed by Rule 9014 and “shall be filed and served on the debtor, the trustee, the proponent of the plan, any committee appointed under the Code and any other entity designated by the court, within a time fixed by the court.” FED.R.BANKR.P. 3020(b)(1).

7. “The court shall rule on confirmation of the plan after notice and hearing as provided in Rule 2002. If no objection is filed, the court may determine that the plan has been proposed in good faith and not by any means forbidden by law without receiving evidence on such issues.” FED.R.BANKR.P. 3020(b)(2). However, the Court has an independent duty to determine whether a plan complies with the appropriate sections of the Bankruptcy Code even if no objection is filed. *In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 599 (Bankr. D. Del. 2001).

Relevant Substantive Law

8. The Court may confirm a plan under Chapter 11 only if each of the thirteen enumerated requirements of 11 U.S.C. § 1129(a) are met. A limited exception is made if the requirements of 11 U.S.C. § 1129(a)(8) (requiring acceptance by all impaired classes of claims or interests) is not met, permitting confirmation under 11 U.S.C. § 1129(b) (the “cram-down” provision) if the provisions of that subsection are met.

Grounds for Relief

Exculpation

9. Section 5.1 of the Plan, governing exculpation, purports to release the Debtors, the Reorganized Debtors, and the other Released Parties¹ from liability for acts or omissions taking place during the case, excluding from the scope of the release only “intentional acts that constitute fraud or willful misconduct.” Section 5.1 contains no exclusion for acts or omissions constituting gross negligence. In *Genesis, supra*, the Court disapproved similar language when it failed to exclude wilful misconduct and gross negligence from its effect. 266 B.R. at 607, *citing In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000). An exclusion for gross negligence must be added to Section 5.1.

The Debtors’ Releases

10. Section 5.2 of the Plan provides for the release and waiver by the Debtors, the Reorganized Debtors and their estates, of all claims and causes of action against each of the Released Parties arising in whole or in part from any act, omission, transaction, event or other occurrence taking place before the effective date of the Plan, relating in any way to the Debtors, the Chapter 11 Cases, the Plan and the Disclosure Statement, excepting only claims or liabilities arising from acts or omissions finally determined by a court of competent jurisdiction to constitute willful misconduct

¹ The Plan defines “Released Parties” as the Debtors, the Pre-Petition Agent, the Pre-Petition Credit Agreement Secured Parties, the DIP Agent, the DIP Lenders, the Pre-Petition Subordinated Noteholders, and the Investor PIK Note Purchasers (each in their capacity as such), and the “Related Persons” of each such person or entity. “Related Persons” are defined in the Plan as predecessors in interest, successors, assigns and present or former affiliates (whether by operation of law or otherwise) and each of their respective present and former members, partners, equity-holders, officers, directors, managers, employees, representatives, advisors, attorneys, agents and professionals, acting in such capacity, and any person claiming by or through any of them.

or gross negligence. This broad release is in addition to the exculpation provision set forth in Section 5.1.

11. The Debtors should be required to meet their burden of demonstrating the propriety of such releases. See *In re Zenith Electronics Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999); see also *Genesis*, 266 B.R. at 606-609 (Bankr. D. Del. 2001) (discussing *Zenith*).

12. In *Zenith, supra*, the Court addressed the issue of debtor releases of third parties. The *Zenith* Court adopted the five part test enunciated in *Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930 (W.D. Mo. 1994) to determine the propriety of allowing a release of a third party as a part of a plan of reorganization. These factors are:

(1) an identity of interest between the debtor and the third party, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) substantial contribution by the non-debtor of assets to the reorganization; (3) the essential nature of the injunction to the reorganization to the extent that, without the injunction, there is little likelihood of success; (4) an agreement by a substantial majority of creditors to support the injunction, specifically if the impacted class or classes “overwhelmingly” votes to accept the plan; and (5) provision in the plan for payment of all or substantially all of the claims of the class or classes affected by the injunction.” 168 B.R. at 937

241 B.R. at 110. The enumerated factors must be separately applied to each of the entities that the Debtors seek to release; absent such a showing, and appropriate finding by the Court, the release set forth in Section 5.2 renders the Plan unconfirmable. Some proposed releasees may qualify for the protection afforded by the provision and some may not.

13. In *Genesis*, the Court examined a similar provision and tested its applicability as to each party to be affected by the provision. For example, the Court rejected an attempt to release the debtor’s post-petition management from claims arising from pre-petition conduct, stating

As to the debtor's management personnel here, there is no showing that the individual releasees have made a substantial contribution of assets to the reorganization. ... The officers and directors of the debtors no doubt made meaningful contribution to the reorganization by designing and implementing the operational restructuring of the companies, and negotiating the financial restructuring However, the officers, directors and employees have been otherwise compensated for their contributions, and the management functions they performed do not constitute contributions of "assets" to the reorganization.

266 B.R. at 606-07). Accordingly, the *Genesis* Court struck the proposed release as to the debtor's management and certain other proposed releasees.

14. Here, the Plan recites that the Section 5.2 release is given "for good and valuable consideration, including the service of the Released Parties to facilitate the expeditious reorganization of the Debtors, and the implementation of the restructuring contemplated by the Plan."

15. Although the Disclosure Statement describes certain compromises made by the pre-petition lenders and noteholders which might serve as consideration for a release of the Debtors' claims against them, the Disclosure Statement does not describe the consideration given by the other Released Parties. Absent adequate consideration from these entities on account of the releases, the Plan is unconfirmable.

Involuntary Third Party Releases

16. Section 5.3 of the Plan provides that each holder of a Claim that votes to accept the Plan, and "to the fullest extent permissible under applicable law, as such law may be extended or interpreted after the Effective Date, each person or entity (other than a Debtor), which has held, holds or may hold a Claim or Equity Interest in or relating to the Debtors" will be deemed to have released

all of the Released Parties from any and all claims, causes of action, liabilities, etc., relating in any way whatsoever to the Debtor or this Chapter 11 case.

17. To the extent that this third party release provision binds only claimants who vote to accept the Plan, the UST does not object. However, Article 5.3 purports to bind all holders of Claims or Equity Interests, including those who vote to reject the Plan or are deemed to reject it, “to the fullest extent permissible under applicable law, as such law may be extended or interpreted after the Effective Date, each person or entity (other than a Debtor), which has held, holds or may hold a Claim or Equity Interest in or relating to the Debtors.”

(a) Section 5.3 permits the Debtors to seek interpretation of the scope of the release set forth in Section 5.3 by non-bankruptcy courts, far removed in time and place from this Court, regardless of those other courts’ competency in bankruptcy matters.

(b) This provision shifts to persons who reject (or are deemed to reject) the Plan the risk of a non-bankruptcy court’s competency in bankruptcy matters, as well as the risk that a release which would be impermissible today might in the future become permissible and therefore bind them.

(c) The rights of holders of Claims and Equity Interests should be fixed by the Plan and the order of confirmation, not by future legal developments extraneous to this case.

18. As a general rule, third-party claims against non-debtors cannot be released without “*the affirmative agreement of the creditor affected.*” *Zenith, supra*, 241 B.R. at 111 (citations omitted); *see also Gillman v. Continental Airlines, (In re Continental Airlines)*, 203 F.3d 203, 214 (3d Cir. 2000) (citing *Zenith* with approval).

19. The “hallmarks” of permissible non-consensual third-party releases are fairness, necessity to the reorganization, and specific factual findings to support these conclusions. *Continental Airlines, supra*, 203 F.3d at 214. Absent such hallmarks, a plan providing for non-consensual third-party releases cannot be confirmed.

20. The Plan and the accompanying Disclosure Statement do not themselves demonstrate the existence of the requisite hallmarks of permissible non-consensual third-party releases, nor do they indicate what facts the Debtors intend to prove at the confirmation hearing to demonstrate the existence of those hallmarks. The Debtors must be put to their proofs at the confirmation hearing, and the Court must make the requisite findings of fact, before the involuntary third-party releases may be imposed. Otherwise, the third party releases should be stricken with respect to any party in interest that did not vote to accept the plan.

Injunction Related to Plan Releases

Section 5.4 of the Plan purports to impose an injunction against, among other things, asserting a right of setoff, right of subrogation or recoupment of any kind against any debt, liability or obligation due to the Debtors.

21. Where parties in interest have diligently asserted their setoff rights prior to confirmation, it would be inequitable to extinguish those setoff rights while permitting the estate to retain claims and causes of action against those parties. *In re DeLaurentiis Entertainment Group, Inc.*, 963 F.2d 1269, 1277 (9th Cir. 1992); *cf. In re Continental Airlines*, 134 F.3d 536, 541-42 (3d Cir. 1998)(distinguishing *DeLaurentiis*, holding that setoff right extinguished when not asserted prior to plan confirmation). The Plan should be modified to preserve all timely-asserted setoff claims.

22. The right of recoupment is a defense, as opposed to an affirmative claim. *Folger Adam Security, Inc. v. DeMatteis/MacGregor*, 209 F.3d 252, 260-61 (3d Cir. 2000); *Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir. 1984). There is no authority in the Bankruptcy Code for impairing a party's defenses, particularly in an injunction provision buried in the plan. The Plan should be modified to remove the purported injunction against asserting rights of recoupment.

23. The Plan provides in Sections 5.4 and 5.6 that by accepting distributions under the Plan, holders of claims will be deemed to have consented to the releases and injunction set forth in Article V of the Plan. These provisions should be stricken.

(a) To the extent holders of claims are already entitled to participate in distributions under the Plan, such distributions cannot serve as consideration for "consent" to an injunction; incremental consideration, or a vote in favor of the Plan, is required. Otherwise, the Plan's injunction provisions, like the proposed third-party releases, are non-consensual as to holders of Claims who do not vote to accept the Plan.

WHEREFORE, the UST requests that this Honorable Court deny confirmation unless and until the Debtors meet their burdens of proof with respect to both the Debtors' release and the involuntary third- party release, and otherwise modify the Plan consistent with this objection, and grant such other relief as this Court deems appropriate.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

Dated: February 9, 2010

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CERTIFICATE OF SERVICE

I certify that, on February 9, 2010, I caused a copy of the United States Trustee's Objection to Confirmation of the Debtors' Joint Chapter 11 Plan of Reorganization Dated as of December 4, 2009 to be served via facsimile to the following persons:

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