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Electronically Filed September 18, 2012

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re AMERICAN WEST DEVELOPMENT, INC., a Nevada corporation, fdba Castlebay 1, Inc. fdba Development Management, Inc. fdba Fairmont 1, Inc. fdba Glen Eagles 3, Inc. fdba Heritage 1, Inc. fdba Inverness 5, Inc. fdba Kensington 1, Inc. fdba Kingsbridge 1, Inc. fdba Promontory Estates, LLC fdba Promontory Point 4, Inc. fdba Silverado Springs 1, Inc. fdba Silverado Springs 2, Inc. fdba Tradition, Inc. fdba Windsor 1, Inc., Debtor.	Case No. BK-S-12-12349-MKN Chapter 11 **DEBTOR'S REPLY TO THE UNITED STATES TRUSTEE'S OBJECTION TO DEBTOR'S CHAPTER 11 PLAN OF REORGANIZATION** [Relates to Docket Nos. 263, 637] Hearing Date: September 25, 2012 Hearing Time: 10:00 a.m.

TO THE HONORABLE MIKE K. NAKAGAWA, THE OFFICE OF THE UNITED STATES TRUSTEE AND ALL PARTIES IN INTEREST:

American West Development, Inc. ("AWDI" or "Debtor"), debtor and debtor in possession in the above-captioned chapter 11 bankruptcy case (the "Chapter 11 Case"), by and through its counsel, the law firm of Fox Rothschild, LLP, hereby submits Debtor's Reply (the "Reply") to the Objection

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[Docket No. 637] (the "Objection") filed by the Office of the United States Trustee (the "UST") to the Debtor's Chapter 11 Plan of Reorganization [Docket No. 263] (the "Plan").

This Reply is made and based upon the following memorandum of points and authorities, the Debtor's separate and concurrently filed memorandum of law in support of confirmation of the Plan (the "Confirmation Brief"), the Declaration of Robert Evans filed in support of the Confirmation Brief and in support of this Reply (the "Evans Declaration"), all other papers and pleadings on file with the Court in this Chapter 11 Case, and any oral arguments the Court may entertain at the Plan's confirmation hearing.

DATED this 18th day of September 2012.

FOX ROTHSCHILD LLP

By */s/ Brett A. Axelrod*
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I.[1]

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF REPLY

The UST raises several objections to the Plan, the majority of which are either founded upon a flawed understanding of the mechanics of the Plan's provisions, constitute unfounded collateral attacks on orders previously entered by this Court, or are based on an incomplete or inaccurate reading of the Plan's provisions. Further, the limited case law that is cited to by the UST in support of its objections is inapplicable to the facts at hand. Each of the UST's objections is addressed in full, below.

/ / /

/ / /

[1] All capitalized terms not otherwise defined herein shall have the same meaning ascribed to them in the Plan.

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II.

OBJECTIONS RAISED BY THE UST ARE WITHOUT MERIT

A. Plan's "Severability" Provisions are Unambiguous; UST's Position that Plan Must be Confirmed on a "Take it or Leave It" Basis Is Unsupported Both by the Provisions of the Plan and by Applicable Law.

The UST states, without substantiating, that where provisions of a plan of reorganization are ambiguous, such provisions must be construed against the plan proponent. *Objection*, p. 2:25-3:14. Taking its argument one step further, and doing so again without support, the UST sets forth that as a result of purported ambiguities in the severability provision of the Plan, the Court must confirm the Debtor's Plan on a "take or leave it" basis. *Objection*, p. 3:1 ("the Plan must rise or fall in its entirety"). Ironically, in both its initial premise and in its subsequent assertion regarding the Plan's "ambiguities," the UST fails to differentiate between a "confirmed plan" and a "proposed plan." As a preliminary matter, as detailed below, courts have only "construed provisions of a plan against a plan proponent" in the context of interpreting provisions of an already confirmed plan. Further, the Plan's severability provision is unambiguous and, as such, even if this Court were required to construe ambiguous provisions against the Debtor there exists no such "ambiguous" provision to construe.

The UST's position that ambiguous plan provisions should be construed against the plan proponent presumably derives from the basic tenant of contract law that provides that ambiguous provisions in an otherwise enforceable contract must be construed against the contract's drafter. *See*, *In re Miller*, 253 B.R. 455, 459 (Bankr. N.D. Cal. 2000) ("The ambiguity in the plan should be resolved against the Debtor because Debtor drafted the [confirmed] plan. California law provides than an ambiguous contractual provision should be construed against the party responsible for the ambiguity. Some bankruptcy court decisions apply the same rule in interpreting chapter 11 plans without expressly relying upon state law.") (internal citations omitted).

In fact, in all cases where this concept has been applied, bankruptcy courts were interpreting provisions of already confirmed plans. *See*, *In re NVF Co.*, 309 B.R. 698, 704 -705 (Bankr. D. Del. 2004) ("Delaware contract law states that ambiguous provisions are construed against the drafter. Therefore, in this case where the Plan is considered an enforceable contract the interpretation of the ambiguous provisions will be construed against NVF as the Plan proponent.") (emphasis added); s*ee*

also, *In re Holywell Corp.,* 71 B.R. 636, 638 (Bankr. S.D. Fla. 1987) ("The Bank also argues that the substantive consolidation of the five estates, which was provided in the plan confirmed in August 1985, extinguished these debtor claims. The plan, which must be strictly construed against its proponent. . . ."). For these reason, even if the Plan did suffer from any purported "ambiguities," the UST's position that this Court should construe provisions of the Debtor's *proposed* plan against the Debtor in the context of these plan confirmation proceedings is unfounded.

Notably, the Plan's provision regarding the severability of its provisions is unambiguous. *See*, *Plan*, § 13.7. Any "ambiguity" in the Plan's provision regarding severability results from the UST's inattention to the Plan's distinction between a confirmed and unconfirmed plan. *Id.* Section 13.7 of the Plan clearly provides that prior to confirmation the Bankruptcy Court shall, generally, have the authority to make any needed changes to the provisions of the Plan and that "[n]otwithstanding any such holding, alteration or interpretation, the remainder of the terms and provisions of the Plan will remain in full force and effect. . . ." *Id.* In other words, prior to confirmation, the provisions of the Plan are fully severable. Section 13.7 of the Plan further provides that only after confirmation are the provisions of the Plan deemed "nonseverable and mutually dependent." *Id.*

Finally, even if the provisions of the Plan were deemed, at this juncture, to be nonseverable, § 13.1 of the Plan generally authorizes the Debtor to modify the Plan so long as such modifications do not conflict with the terms of that certain Restructuring, Lock-Up and Settlement Letter Agreement entered into by the Debtor and its secured lenders (as previously approved by this Court). In other words, should any of the provisions of the Plan require alteration, the Plan itself provides the Debtor with the authority to make such modifications, including to remedy any ambiguities. For this further reason, there is no merit to the UST's argument that the Court must consider whether to confirm the Plan on a "take it or leave it" basis.

B. The Plan, As Presently Drafted, Provides that All 28 U.S.C. § 1930(a)(6) Fees Shall Be Paid on Or Before the Effective Date.

The UST objects to the Plan on the basis that "[f]ees assessed pursuant to 28 U.S.C. § 1930(a)(6) are not synonymous with administrative expenses allowed pursuant to 11 U.S.C. § 503(b)." *Objection*, p. 3:18-19. More specifically, the UST fears that by including fees assessed

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pursuant to 28 U.S.C. § 1930(a)(6) as part of its definition of "Administrative Claims," the Debtor intends to subject such fees to a special allowance procedure, rather than committing to their payment in full on the Effective Date. *Id.* at 3:21-22.

In fact, the Plan separately defines the term "US Trustee Fees" to mean "fees payable pursuant to 28 U.S.C. § 1930." *Plan*, *Definition No. 136*. Moreover, Section 2.2(a)(3) of the Plan provides, in relevant part, that:

> Notwithstanding the foregoing or anything to the contrary in this Plan . . . Debtor shall pay, or cause to be paid, all accrued US Trustee Fees on or before the Effective Date; and following the Effective Date, Reorganized Debtor shall be responsible for timely payment of all US Trustee Fees until such time as the Final Decree closing the Chapter 11 Case is entered and all US Trustee Fees due are paid in full.

Nevertheless, so as at alleviate any remaining concerns of the UST, the Debtor herein reaffirms that the Plan does not seek to subject 28 U.S.C. § 1930(a)(6) fees to any allowance procedure process. *See*, *Evans Declaration*, ¶18. Notably, throughout the pendency of this Case the Debtor has routinely and without fail timely remitted all UST fees. *Id.* Moreover, as of the date of the drafting of this Reply, there are no outstanding UST fees due by the Debtor. *Id.* Finally, the Debtor anticipates that it will have available to it $2,500,000 on the Effective Date, which funds will be more than sufficient to fund all outstanding and accruing UST fees. *Id.*

C. The Timeframe for Filing of the Plan Supplement Was Approved by Previous Order of this Court; The UST Cannot Through this Reply Collaterally Attack this Court's Previous Order; Moreover, All Real Parties In Interest Were Given Opportunity to Comment on the Plan Supplement Prior to the Passage of the Deadline to Object to the Plan.

The UST asserts that the plan confirmation process that was approved as part of that certain Disclosure Statement Order[2] entered by this Court violates the due process rights of parties in interest. *See*, *Objection*, ¶¶ 10-15. More specifically, the UST takes issue with the provisions of the Disclosure Statement Order that authorized the Debtor to file its Plan Supplement after the passage of the deadline

[2] *See* "Order*: (I) Approving (A) Adequacy Of Master Disclosure Statement, (B) Adequacy And Use Of Home Owner Disclosure Statement As Plan Summary, (C) Procedures And Schedule For The Solicitation, Submission And Tabulation Of Votes, (D) Form And Scope Of Notices, And (E) Form Of Ballots And Related Documents; (II) Scheduling Confirmation Hearing And Related Deadlines; And (III) Granting Related Relief*" [Docket No. 366] (the "Disclosure Statement Order")

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for parties in interest to object to the Plan's confirmation (the "Plan Objection Deadline"). *Id.* at ¶ 11. The heart of the UST's concern centers on the fact that parties in interest were purportedly not provided with "Operative Documents" concerning the Plan prior to the Plan Objection Deadline. *Id.* at ¶¶ 10-15.

1. UST's Impermissible Collateral Attack On a Final Order of this Court.

Any attempt by the UST to question the manner in which the Plan process has proceeded to confirmation, and the ramifications of the same, constitutes an impermissible collateral attack on a prior final order of this Court. Specifically, the Disclosure Statement Order was entered by this Court on July 16, 2012, as part of a "core" proceeding and, accordingly, constitutes a "final order" of this Court. *See*, 28 U.S.C. §§ 157(b)(1), (c)(2); *see generally, Disclosure Statement Order*.

On May 29, 2012, the UST was served with the Notice of Motion [Docket No. 266] and Motion [Docket No. 265] (the "Disclosure Statement Motion") that ultimately resulted in this Court's entry of the Disclosure Statement Order. *See*, *Affidavit of Service re Notice of Motion and Motion* [Docket No. 268], p. 7 of 583. The Disclosure Statement Motion clearly set forth all plan confirmation deadlines, including the Plan Objection Deadline and the deadline for the filing of the Plan Supplement. *See*, *Disclosure Statement Motion*, p. 4, table at lines 20-28. No party in interest, including not the UST, objected to the Disclosure Statement Motion. *See generally*, the Docket in this Case. Subsequently, on July 16, 2012, the UST was served with Notice of Entry of the Disclosure Statement Order [Docket No. 378], which notice likewise included all deadlines and procedures established by the Court that govern these Plan confirmation proceedings. *See*, *Affidavit of Service re Notice of Entry of Disclosure Statement Order* [Docket No. 441], p. 9 of 72.

Despite having been provided with ample notice of all applicable dates and deadlines related to these Plan confirmation proceedings, the UST now disregards the Federal Rules of Bankruptcy Procedure ("FRBP") and Federal Rules of Civil Procedure ("FRCP") in pursuing an impermissible and last ditch effort to derail the confirmation of a plan that has been developed, coordinated, and negotiated over the course of years. Specifically, FRCP 60 (made applicable to these proceedings pursuant to FRBP 9024) provides that relief from a final order of this Court must be brought "on motion and just terms." *FRCP* 60(b). The UST's attempt to collaterally attack the Disclosure Statement Order fails not only as a result of not having been brought by noticed motion, but also because such attack is not

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timely. *See*, *FRCP* 60(c) (requiring that any motion for relief from a final order of this Court "must be made within a reasonable time").

Hearings on the adequacy of the Disclosure Statement and the Plan solicitation materials have come and passed, the deadline for voting on the Plan has come and passed, each of the impaired classes under the Plan has voted to accept the Plan, the Debtor's Confirmation Brief is properly before this Court, and the hearing on confirmation of the Plan is imminent. Yet, the UST chooses to *only now* raise concerns as to matters that were decided and made readily apparent several months back. Reversal of the Court's Order at this juncture would threaten to undo the months of progress that this Debtor has made towards its imminent successful reorganization and only serve to increase administrative costs, needlessly prolonging the case longer than necessary in order to confirm what is an almost universally-supported Plan. For this additional reason, the UST must be estopped from presenting any arguments which substantively serve as a collateral attack on the Disclosure Statement Order.

2. "Due Process" Concerns are Without Merit.

Even if the UST could get past what amount to be patent defects in its attempted collateral attack of the Disclosure Statement Order, there is no substantive basis that would support the UST's contention that the Debtor failed to comply with the provisions of 11 U.S.C. § 1125. *See*, *Objection*, ¶¶ 13-14.

Section 1125 of Title 11 of the United States Code (the "Bankruptcy Code", or the "Code") simply requires the disclosure of "information of a kind, and in sufficient detail, as far as is reasonably practicable. . .[to allow for] an informed judgment [to be made] about the plan." 11 U.S.C. § 1125(a)(1) (emphasis added). In setting forth the standards for soliciting the acceptance or rejection of a plan, the Bankruptcy Code further reaffirms the idea that "adequate disclosure" does not require the transmittal of the complete plan. *See*, 11 U.S.C. § 1125(b). Rather, the Bankruptcy Code sets forth that solicitation requires only the transmittal of "the plan or a summary of the plan, and a written disclosure statement approved . . . by the court." *Id.* In fact, this is exactly what the Debtor provided to all claimants in conjunction with its solicitation package.

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The UST focuses on the Plan's definition of "Operative Documents" in a failed effort to establish an inflated importance of the Plan Supplement. *Objection*, ¶ 10 ("the Plan recognizes the significance of the Plan Supplement in the overall implementation and operation of the Plan"). Contrary to the UST's assertions, a close examination of the relevant definitions contained in the Plan illustrates that the Plan Supplement contains few "Operative Documents" – all of which were appropriately described in the Disclosure Statements approved by this Court [Docket Nos. 261, 262] (the "Disclosure Statements") and also provided to all real parties in interest for their review and comment prior to the Plan Objection Deadline.

The term "Operative Documents" is defined in the Plan to mean any "contract, instrument, release, settlement agreement or other agreement or document, if any, that is reasonably necessary to effectuate and implement the transactions provided for in the Plan, including the Key Transaction Documents." *Plan*, *Definition No. 95*. Because no "contract, instrument, release, settlement agreement or other agreement or document reasonably necessary to effectuate and implement the transactions provided for in the Plan" is included in the Plan Supplement, only "Key Transaction Documents" that are contained within the Plan Supplement would be deemed "Operative Documents." *See*, *Plan*, Definition Nos. 81 & 102. The only documents fitting such criteria are (x) the New Secured Loan Documents, (y) Reorganized Debtor's Bylaws or amended certificates of incorporation, and (z) the Construction Defect Trust Declaration, together with the Trust Distribution Procedures attached thereto.

As noted, all of these documents were appropriately described in the Disclosure Statements approved by this Court. Specifically, and in addition to actual copies of such documents being attached to the Declaration of Robert Evans filed on the first day of this Chapter 11 Case in support of the Debtor's first day motions, descriptions of the New Secured Loan Documents that were approved by the Secured Lenders pre-petition were included in both the "Master Disclosure Statement" [Docket No. 261] and in the "Short Form Disclosure Statement" [Docket No. 262]. *See*, *Omnibus Declaration of Robert M. Evans in Support of First Day Motions* [Docket No. 56]; s*ee*, *also*, *Master Disclosure Statement*, Article I.C; *see also*, *Short Form Disclosure Statement*, Article II.A.D. Further, the Reorganized Debtor's Bylaws – which contain no extraordinary terms or provisions – were referenced in the Master Disclosure. *See*, *Master Disclosure Statement*, Article V.C.5. Finally, the Disclosure

Statements contain descriptions of the primary functions of the Construction Defect Trust, including detailing Home Owners' option for a Cash Out Election, Home Owners' ability to forego the Cash Out Election and to instead have their Construction Defect Claims processed by the Construction Defect Trust, the manner in which the Construction Defect Trust will be funded, and the proposed Trustee of the Construction Defect Trust and his qualifications. *See*, *Short Form Disclosure Statement*, p. 3 & Article II.B; *see also*, *Master Disclosure Statement*, Article V.D.

Moreover, Debtor's counsel provided all real parties in interest – including counsel for the Secured Lenders, counsel for Zurich-American Ins. Co., and counsel to the Future Claim Representative – with an opportunity to comment on the aforementioned documents in advance of the Plan Objection Deadline. *See*, *Evans Declaration,* ¶20. Some of the aforementioned counsels' comments were subsequently incorporated into the Construction Defect Trust and Trust Distribution Procedure documents. *Id.*

For these reasons, the UST's "due process" concerns – even if they could properly be raised at this juncture – are moot. Furthermore, the Debtor does not believe there can be any good faith and rational objection to what appears in the Plan Supplement. Nevertheless, the Debtor hereby reserves its rights to oppose any objections the UST may later raise with respect to the Plan Supplement.

D. The Plan Does Not Prohibit Construction Defect Claimants from Seeking Administrative Priority Claims on Account of Defect Claims Attributable to the Debtor's Post-Petition, Pre-Confirmation, Actions.

The UST objects to the Plan on the notion that the Plan does not account for the possibility of a Construction Defect Claim that rises to the level of an Administrative Claim. *Objection*, ¶¶ 16-17. Relying on *Reading Co. v. Brown*, 391 U.S. 471 (1968), the UST aptly points out that defect claims which arise from the Debtor's post-petition, pre-confirmation, actions ("Administrative Construction Defect Claims") would likely rise to the level of an Administrative Claim. *Id.*

Nothing in the Plan purports that Construction Defect Claims are mutually exclusive of Administrative Claims. To the extent that a holder of a Construction Defect Claim believes its claim is entitled to treatment as an administrative claim, Section 2.2(a)(1) of the Plan provides that such claimant must file its notice of Administrative Claim on or before the Administrative Claim Bar Date. The Administrative Claims Bar Date has not passed. The Administrative Claims Bar Date is defined as

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that date which is thirty (30) days after the Effective Date. *Plan*, Definition No. 4. Any allowed Administrative Construction Defect Claims shall receive the same treatment afforded to all other allowed Administrative Claims.

Notably, the Debtor has not been notified of the existence of any Administrative Construction Defect Claims and does not believe that any such claims exist. *See*, *Evans Declaration,* ¶21. Accordingly, the Debtor does not believe that the prospect of Administrative Construction Defect Claims will have any material impact on the Debtor's successful reorganization. *Id.* Finally, the Debtor believes that it has sufficient cash available to satisfy any Administrative Construction Defect Claims that may be allowed. *Id.*

E. The UST's Distinction Between a "Pre-Confirmation Date" Discharge and a "Pre-Effective Date" Discharge is Immaterial as the Plan Contemplates that the Effective Date Shall Be The Confirmation Date.

Without support, the UST sets forth that "[b]y statute, any discharge entered in Debtor's bankruptcy case, at most, could arguably apply to debts arising prior to the date of the Plan's confirmation." *Objection,* ¶ 18 (*citing*, 11 U.S.C. § 1141(d)(1)(A)). In fact, the Ninth Circuit Court of Appeals has expressly recognized the ambiguity inherent in § 1141(d) of the Bankruptcy Code. *See*, *In re Zilog, Inc.*, 450 F.3d 996 (9th Cir. 2006). The Ninth Circuit, in dicta, explains:

> We are uncertain whether post-confirmation debts can in fact be discharged in bankruptcy. The "[e]xcept as otherwise provided" clause in section 1141 can be read in either of two ways. One way would be to read the clause as modifying the words "any debt." Under that reading, all pre-confirmation debts are dischargeable, except as limited by the plan or the code. Alternatively, one could read the "[e]xcept as otherwise provided" clause as modifying the phrase "before the date of such confirmation." Under that reading, even post-confirmation debts could be discharged if that were provided for in the reorganization plan.
>
> We have not located a case addressing which reading is correct. Nor have we found an answer in the statute's legislative history. Although we find the first alternative more plausible, we need not decide the matter here.

In re Zilog, Inc., 450 F.3d at 1002, fn. 5 (internal citations omitted). To the Debtor's counsel's knowledge, no controlling case law exists on this issue.

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Nevertheless, the UST's battle is without cause. The UST's objection is premised on the misconception that the Debtor seeks to discharge itself of post-confirmation debts. *Objection,* ¶ 18. Specifically, the UST states that "Debtor's Plan seeks to sweep within the ambit of any discharge Debtor may obtain in this case all debts arising prior to the Effective Date of the Plan, including a period of time that necessarily postdates entry of the confirmation order." *Id.*

Substantively, the Plan defines the "Effective Date" so as to coincide with the date on which the Confirmation Order becomes a Final Order.[3] Accordingly, the UST's distinction between a "pre-confirmation date discharge" and a "pre-Effective Date discharge" is without significance. Finally, the terms of the Plan themselves limit the scope of the § 1141(a) discharge "to the fullest extent permitted" by the Bankruptcy Code. *See*, *Plan*, § 12.2.

F. The Channeling and Related Injunctions Comport with the Governing Law of this Circuit.

The UST's argument that the exculpations, releases and injunctions contained in §§ 12.2 through 12.5 of the Plan violate Ninth Circuit law is misguided; the cases cited to by the UST are inapplicable to the facts at hand. *See*, *Objection*, ¶¶ 19-25. Contrary to the UST's assertions, the channeling injunction contained in § 12.5(d) of the Plan does not constitute a discharge of liabilities of non-debtors in violation of § 524(e) of the Code. Rather, the channeling injunction redirects creditors to an alternative fund established, through the Plan, for the satisfaction of their claims.

1. Equitable Doctrine of Marshaling.

The Court's power to redirect creditors in such fashion derives from the longstanding federal "equitable doctrine of marshaling [which] rests upon the principle that a creditor having two funds to satisfy his debt may not, by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." *Meyer v. United States*, 375 U.S. 233, 236 (1963) (*citing, Sowell v. Federal Reserve Bank*, 268 U.S. 449 (1925)). "In considering the relevance of the doctrine here it is

[3] The Plan in fact defines the "Effective Date" to mean "the first Business Day after the date on which the conditions specified in Article X of the Plan have been satisfied in full or waived." *Plan*, Definition No. 64. Though Article X of the Plan contains a list of multiple conditions, all conditions set forth therein shall be satisfied prior to the date on which the Confirmation Order becomes a Final Order.

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well to remember that marshaling is not bottomed on the law of contracts or liens. It is founded instead in equity, being designed to promote fair dealing and justice.**"** *Id*. at 237.

This equitable doctrine has in fact been relied on by a number of bankruptcy courts in order to approve channeling injunctions of the exact type at issue in this reorganization case. *See*, *e.g.*, *In re A.H. Robins Co.*, 880 F. 2d 694, 702 (4th Cir.) cert. denied, 493 U.S. 959, 110 S.Ct. 376, 107 L.Ed.2d 362 (1989) ("**We think the ancient but very much alive doctrine of marshalling of assets is analogous here. A creditor has no right to choose which of two funds will pay his claim. The bankruptcy court has the power to order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other creditors.**"); *In re Dow Corning Corp.*, 280 F. 3d 658 (6th Cir. 2002); *see*, *also*, *Victor Gruen Assoc., Inc. v. Glass*, 338 F.2d 826, 829 (9th Cir. 1964) ("A bankruptcy court can invoke the doctrine of marshaling since it applies equitable principles."); *In re Medina*, 205 B.R. 215 (B.A.P. 9th Cir. 1996) ("The doctrine of marshalling is an equitable remedy which the bankruptcy court may apply in its discretion.").

While the UST implicitly recognizes and takes no issue with those creditors that, through their acceptance of the Plan, voluntarily relinquished their rights to pursue certain third parties for payment of their debts, the UST presents that this Court is without authority to prohibit non-consenting creditors from taking actions which jeopardize the global settlement and reorganization structure proposed under the Plan. Its is precisely in situations such as these – where the actions of certain non-cooperative creditors threaten a "Pareto inefficient" outcome for all – that the federal doctrine of marshaling is most applicable.[4] The Ninth Circuit Court of Appeals has succinctly stated "marshaling of assets is an equitable doctrine which comes into application where there are two or more creditors which seek satisfaction from one debtor and one of the creditors can reach two funds held by the debtor, whereas the other creditor can reach only one of the funds." *Victor Gruen Assoc., Inc. v. Glass*, 338 F.2d at 829. In such a case, marshaling shall be applied "if it can be done without prejudice to him or inequity to third parties." *Id.* In this case, both of these elements are met.

[4] A Pareto inefficient outcome is one where it is possible to change the allocation of assets (for example) and achieve a result where some individuals are being made "better off" while no individual is made worse off.

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2. Application of the Doctrine in this Case.

The majority of courts that have approved channeling injunctions have done so where the injunction "allows a settlement that forms the basis of a chapter 11 plan to take effect, where the entire settlement and hence the plan hinges on the parties being free from the very claims that the injunction would prohibit . . . ." *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 985 (1st Cir. 1995) (*citing*, *A.H. Robins Co.*, 884 F.2d 694); *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285 (2d Cir. 1992); *see, also*, *In re The Roman Catholic Church of Diocese of Tucson a/k/a the Diocese of Tucson*, Case. No. 4-04-bk-04721-JMM (Bankr. D. Ariz. August 1, 2005) (Order Confirming the Third Amended and Restated Plan of Reorganization dated May 25, 2005, Proposed by the Roman Catholic Church of the Diocese of Tucson [Docket No. 791]).

a. Approval of Consensual Settlements.

Here, the Ballots cast in acceptance of the Plan form the framework for a global settlement of claims in this Chapter 11 Case. The Ballots approved by this Court transparently disclose: "Under Section 12.4 of the Plan, by voting to accept the Plan you will be agreeing to grant the release set forth therein." *See*, *Disclosure Statement Order*, Exhibit 'D'. Likewise, §§12.4(b) & (c) of the Plan provide that every Holder of a Claim or Interest that votes to accept the Plan voluntarily elects to release the Released Parties from all claims or interests that could be asserted on behalf of, or against, the Debtor.

By consenting to the releases set forth in the Plan, these Holders of Claims and Interests have each agreed to settle their claims with the Released Parties and to look to only one source of funds – the Construction Defect Trust – for the satisfaction of their claims. The releases set forth in Section 12.4 of the Plan are appropriately and consensually given in exchange for the consideration provided to Holders of Allowed Claims who vote in favor of the Plan. Namely, in exchange for the consensual releases, the Released Parties have contributed assets (including all insurance policies) and new capital (in the amount of $1,500,000) to the Construction Defect Trust so as to ensure the availability of proceeds to satisfy Construction Defect Claims in accordance with the provisions of the Plan.

Consensual releases of the type contained in the Plan do not implicate the § 524(e) of the Code. *See*, *Resorts International, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F. 3d 1394 (9th Cir. 1995). In fact, these sorts of settlements are routinely approved in the context of plan confirmation proceedings

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pursuant to this Court's authority both under § 105(a) of the Code and FRBP 9019. *See*, *In re Pacific Gas & Elec. Co.*, 304 B.R. 395, 416-18 (Bankr. N.D. Cal. 2004) (confirming plan providing for governmental agency's release of debtor's parent entity and its officers and directors because agency consented to release); *In re Hotel Mt. Lassen, Inc.*, 207 B.R. 935, 941 (Bankr. E.D. Cal. 1997); *see, also, In re Stations Casinos, Inc.*, Case No. 09-52477 (Bankr. D. Nev. June 8, 2011) (Findings of Fact and Conclusions of Law Regarding Confirmation of "First Amended Prepackaged Joint Chapter 11 Plan of Reorganization for Subsidiary Debtors, Aliante Debtors and Green Valley Ranch Gaming, LLC (Dated May 24, 2011)" with respect to GVR [Docket No. 3423]; Order Confirming Plan [Docket No. 3423]); *In re Stations Casinos, Inc.*, Case No. 09-52477 (Bankr. D. Nev. June 8, 2011) (Findings of Fact and Conclusions of Law Regarding Confirmation of "First Amended Joint Chapter 11 Plan of Reorganization for Station Casinos, Inc. and Its Affiliated Debtors (Dated July 28, 2010)" [Docket No. 2038]; Order Confirming Plan [Docket No. 2039]).

The settlements effectuated through the Plan benefit the Debtor and its creditors, by avoiding the time, expense, and uncertainty of years of protracted litigation, while at the same time providing the means necessary for the equitable treatment of claims. *See*, *Evans Declaration,* ¶12. Moreover, the formation of the Construction Defect Trust benefits not only the consenting Creditors and Holders of Interests, but in fact benefits even those creditors and interest holders who have not voted to accept the Plan. *Id.* Absent the settlement of the Construction Defect Claims, the pool of assets available to satisfy creditors' claims would be substantially diminished and so, in turn, would creditors' distributions. *Id.* The global settlements consummated through this Plan ensure that creditors will receive more under the Plan than they would receive in a chapter 7 liquidation. *Id.*

b. <u>The Injunctions are Necessary and Appropriate to Effectuate the Terms of the Global Settlement</u>.

The severance of the purported "impermissible" injunctions and releases from the Plan would, in theory, leave non-consenting creditors free to pursue both the Released Parties and the Construction Defect Trust for satisfaction of their claims. In contrast, creditors who have voted to accept the Plan would have only the Construction Defect Trust to turn to for the satisfaction of their claims. However, the Released Parties are unwilling to make their substantial contributions to the Construction Defect

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Trust under the Plan, absent the protections afforded by the channeling injunction. Moreover, the global settlement and the reorganization structure proposed under the Plan simply is unworkable without the proceeds resulting from the various settlements.

In other words, the ability of the non-consenting creditors to pursue the Released Parties in addition to all other sources of recovery provided for in the Plan, would jeopardize an otherwise workable and overwhelmingly approved global settlement and reorganization structure to the detriment of *all* creditors. Under the circumstances, the Court can, and should, apply the equitable doctrine of marshaling of assets to approve the channeling and related injunctions over the UST's objections and to compel all creditors to look only to the sources of recovery provided under the Plan for the payment of their alleged Construction Defect Claims.

3. Approval of the Injunction Set Forth in the Plan are Not Inconsistent with Ninth Circuit Precedent.

The UST contends that the injunctions contained in the Plan cannot be approved because "[t]he Plan impermissibly seeks to release third-party, non-debtors from liability . . . in contravention of governing circuit law . . . ." *Objection*, ¶ 19 (*citing*, *In re Lowenschuss*, 67 F. 3d 1394; *In re American Hardwoods, Inc.*, 885 F.2d 621 (9th Cir. 1989); *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985)). Contrary to the UST's assertions, the claims of creditors are not being extinguished or discharged. Rather, liabilities and assets in satisfaction of such alleged liabilities are being channeled to the Construction Defect Trust for their satisfaction. Based on this Court's exclusive jurisdiction over property of the estate (including the insurance policies that are proposed to be contributed to the Construction Defect Trust), the Court's equitable power to marshal assets for the benefit of all creditors, and the Court's statutory authority to approve settlements, this Court has the jurisdiction and the power to approve the injunctions as part of the Plan.

The circumstances and facts of the *Lowenschuss* case cited to by the UST are inapposite to those at hand. *See*, *Lowenschuss*, 67 F. 3d 1394. *Lowenschuss* amounted to no more than a two-party dispute between a single creditor and debtor. *Id.* The creditor in *Lowenschuss* was seeking to recover the proceeds from the debtor's alleged illegal tendering of the creditor's stock. *Id.* at 1396. Unable to ascertain the location of the proceeds, the creditor resorted to the filing of a proof of claim in the

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debtor's bankruptcy case. *Id.* at 1397. In an effort to deny the creditor any recovery, the debtor attempted to confirm a plan of reorganization which contained releases of not only the debtor, but also a pension plan under the debtor's control. *Id.* The creditor objected to the release provisions in the plan on the basis that the plan sought to "release claims against nondebtors, such as the Pension Plan." *Id.* Ultimately, upon the bankruptcy court's finding that the pension plan was not property of the debtor's estate and that the release provisions contained in the plan could not apply to immunize non-debtors, the creditor withdrew its claim. *Id.* at 1397-98. Subsequent to the withdrawal of the creditor's claim, the debtor sought to confirm the same plan which originally included the releases of third-parties. *Id.* at 1398. Despite its prior ruling to the contrary, the bankruptcy court confirmed the debtor's plan over the creditor's attempted objection. *Id.* The bankruptcy court held that since the creditor withdrew its claim it was no longer party in interest in the case and, therefore, was without a voice to object. *Id.* The creditor subsequently appealed the bankruptcy court's decisions and the Court of Appeals held, *inter alia*, that the bankruptcy court was without authority to discharge the pension plan's liability. *Id.* at 1401-1402.

Notably, by holding that the pension plan was not property of the debtor's estate and concurrently discharging the pension plan of any liabilities, the bankruptcy court in *Lowenschuss* left the creditor with absolutely no chance to recover its debt. Moreover, the discharge of the pension plan's liability was not part of a global settlement effectuated by the plan in that case, nor did the debtor's reorganization hinge on the approval of the release. In contrast, here, the Plan proposes to channel certain of the Debtor's assets (including the Debtor's insurance policies) to a trust specifically established for the satisfaction of Construction Defect Claims. The consummation of the Plan not only provides holders of such claims a source for recovery, but in fact ensures that such source is better funded and better equipped to provide meaningful distributions to *all* of those creditors.

In short, *Lowenschuss* is distinguishable from the instant case and simply does not apply. The Ninth Circuit Court of Appeals has not ruled on the propriety of a channeling injunction of the type at issue in this reorganization case under the facts and circumstances at hand. Likewise, in *American Hardwoods*, the Ninth Circuit expressly distinguished *A.H. Robbins* in reaching its holding that the bankruptcy court lacked the power to enjoin a creditor from enforcing a state court judgment against

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non-debtor guarantors. *In re American Hardwoods, Inc.*, 885 F.2d at 626 (*citing*, *In re A.H. Robings Co.,* 880 F.2d 694); *see, also, Underhill v. Underhill*, 769 F.2d 1426, 1432 (9th Cir. 1985) (bankruptcy court lacked power to enjoin action against non-debtor co-defendant). None of the cases cited to by the UST involved the circumstances of the instant case or a channeling injunction of the type at issue.

G. Release Of Future Claims Representative.

The UST raises a final objection to the release proposed to be granted to the Futures Claim Representative. *Objection*, ¶ 25. Specifically, the Plan proposes to release the Future Claims Representative from claims arising out of acts or omissions undertaken in this Chapter 11 Case, with the exception of acts of willful misconduct or gross negligence. The UST presents that the granting of such relief should not be based "on the theory of consent" because the Future Claim Representative should not be allowed to "vote[] to release and exculpate himself from liability." *Id.* In fact, releases of the sort proposed to be provided to the Futures Representative are routinely granted and need to be premised on a theory of "consent." *See*, *In re Western Asbestos Co.*, 313 B.R. 832 (Bankr. N.D. Cal. 2003) (approved release provision in favor of debtors, committee, futures representative, and their respective agents except for willful misconduct).

The Future Claims Representative is employed as a professional in this case by Order of this Court. *See*, *Order Appointing Future Claims Representative* [Docket No. 189]. In similar cases, courts have held that these types of release provisions provided "professionals [with] no more protection than they already had under the applicable provisions of the Bankruptcy Code." *In re Western Asbestos Co.*, 313 B.R. at 846 -847 (*citing*, *In re PWS Holding Corp.*, 228 F.3d 224, 246 (3rd Cir. 2000)); *see also*, *In re WCI Cable, Inc.*, 282 B.R. 457 (Bankr. D. Or. 2002) (extending release to non-debtor plan proponent); *In re Enron Corp.*, 326 B.R. 497 (S.D.N.Y. 2005) (bankruptcy court approved exculpation provision in favor of debtors, creditors' committee, employee committee, trustees, and their respective officers, employees, attorneys, and agents that excluded gross negligence or willful misconduct). Accordingly, the Futures Claim Representative should inure to the benefit of a release on par with that provided to all other professionals in this Chapter 11 Case.

The Future Claims Representative has alternatively undertaken to obtain a quote for insurance to cover the scope of claims proposed to be released. *See*, *Evans Declaration,* ¶22. To the extent that this

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release is removed from the Plan's provisions, the Debtor's estate may ultimately be required to cover the cost of such insurance coverage so at to ensure that the Plan can be effectuated as contemplated. *Id*.

III.

CONCLUSION

WHEREFORE, for all of the foregoing reasons, Debtor respectfully requests that the Court: (i) overrule the Objection, (ii) confirm the Plan as proposed, and (iii) grant such other and further relief as may be just and proper.

Dated this 18th day of September 2012.

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