By Vincent J. Roldan and Ava Goldberger

Eletson Results: SDNY Bankruptcy Court Issues Decision on New Value

Coordinating Editor
Vincent J. Roldan
Mandelbaum Barrett PC; Roseland, N.J.

Ava Goldberger
Mandelbaum Barrett PC; Roseland, N.J.

Vincent Roldan is a partner, and Ava Goldberger is a law clerk, with Mandelbaum Barrett PC in Roseland, N.J.

It is well-established that creditors with higher priority must be paid in full before junior creditors can receive a distribution. The Bankruptcy Code codifies this so-called "absolute-priority rule," and the result is this: Equity owners typically cannot retain their interests in a debtor unless creditors either consent or are paid in full.

However, courts have developed a common law exception to the absolute-priority rule under which equityholders may retain their interest in a debtor when they provide "new value." In *Eletson Holdings Inc.*, the U.S. Bankruptcy Court for the Southern District of New York[1] provided a thorough analysis of the new-value exception and demonstrated roadblocks faced by equity owners, particularly when confronted with a competing plan.

Background

A nonconsensual plan can be confirmed under § 1129(b), as long as such a plan has at least one impaired accepting class, 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."[2] A plan is fair and equitable *vis-à-vis* unsecured creditors if the plan pays them in full or, alternatively, the plan satisfies the absolute-priority rule; junior creditors or equity interest-holders do "not receive or retain under the plan on account of such junior claim or interest any property...."[3] However, under the new value exception to the absolute-priority rule, a debtor's shareholders may retain an interest in the reorganized debtor — even if unsecured creditors have not been paid in full.

The Second Circuit Court of Appeals in *Coltex Loop Central Three Partners*[4] set forth five requirements for the new-value exception.[5] The capital contribution from equityholders must be (1) new (2) money or money's worth (3) that is substantial and (4) necessary for a successful reorganization, and (5) reasonably equivalent to the property that equityholders of the debtor are retaining or receiving.[6] In *Coltex*, the debtor's plan permitted the equityholders to contribute capital; in return, they could retain their interest in the reorganized debtor. The Second Circuit held that the equityholders' contribution was not considered new value because the debtor had not pursued other avenues of funding.[7] Consequently, the court found that the debtor's plan allowed equityholders to receive an interest in the reorganized debtor on account of their prior subordinate position rather than on account of new value.[8]

In *203 N. LaSalle*,[9] the U.S. Supreme Court further analyzed the absolute-priority rule and the new-value exception. The court established that junior interest-holders cannot receive opportunities to retain interest in a reorganized debtor without outside prospective bidders' involvement.[10] The Court reasoned that a competitive-bidding process ensures that equityholders are not given advantages over unsecured creditors in violation of the absolute-priority rule and, at the same time, serves as a market valuation of the reorganized debtor's enterprise.[11]

Eletson Holdings

Against this backdrop, *Eletson* is the latest court to opine on new value. In *Eletson*, the debtors were an international gas-shipping enterprise that owned and operated a fleet of gas tanker ships.[12] They were forced into bankruptcy involuntarily by a group of petitioning creditors after the debtors defaulted on two restructuring-support agreements.[13] Following the termination of the debtor's exclusivity period to propose a chapter 11 plan, the petitioning creditors put forward competing plans.

The debtors offered a new-value plan whereby their shareholders would receive 100 percent of the equity of the newly reorganized debtors (the "debtor plan").[14] In exchange, the shareholders proposed to contribute $37 million in cash. The debtor plan would also provide creditors a percentage of pro-

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1 *In re Eletson Holdings Inc.*, No. 23-10322 (JPM), 2024 WL 4579441 (Bankr. S.D.N.Y. Oct. 25, 2024), at *1.
2 *Id.* at 28 (citing §§1129(a)(8), (a)(10), (b)(1)).
3 *Id.* (citing 11 U.S.C. § 1129(b)(2)(B)(ii)).
4 *In re Coltex Loop C. Three Partners LP*, 138 F.3d 39 (2d Cir. 1998), at 41.
5 *Id.*
6 *Id.*
7 *Id.* at 42.
8 *Id.* at 46.
9 *Bank of Am. Nat. Tr. and Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434 (1999), at 443.
10 *In re Eletson Holdings Inc.*, No. 23-10322 (JPM), 2024 WL 4579441 (Bankr. S.D.N.Y. Oct. 25, 2024), at 30.
11 *Id.*
12 *In re Eletson Holdings Inc.*, No. 23-10322 (JPM), 2024 WL 4579441 (Bankr. S.D.N.Y. Oct. 25, 2024), at 11.
13 *Id.* at 16.
14 *Id.* at 19.

ing out of a contemplated award resulting from a pending arbitration relating to ownership of preferred shares. This distribution was to be guaranteed in the amount of $40 million.[15]

The petitioning creditors proposed two plans. Their first plan was based on the debtor plan, except that the litigation trust would receive increased funding and the shareholder new-value contribution would be replaced by an outside infusion of capital. In addition, the petitioning creditors escrowed $43.5 million in cash and provided a commitment letter from their funder to backstop up to $53.5 million in cash in support of their plan.[16]

The petitioning creditors' other plan (defined in *Eletson* as the "petitioning creditor plan") was funded by a $53.5 million equity rights offering. General unsecured creditors would be provided rights to purchase up to 75 percent of the reorganized debtors' equity.[17] The petitioning creditors were to escrow $43.5 million to provide assurance of performance. The rights offering was also supported by a backstop commitment agreement.[18]

The court allowed creditors to vote on more than one plan and rank the plans in order of preference. The petitioning creditor plan ultimately received the majority of votes from the impaired classes of claims.

The Debtor Plan's Viability Under the New-Value Exception

The petitioning creditors and the committee of unsecured creditors objected to the debtor plan on the grounds that it violated the absolute-priority rule, and the contributions proposed under the debtor plan did not qualify as "new value." The *Eletson* court then analyzed the debtor plan in the context of *Coltex* and *203 N. LaSalle*.[19]

First, the *Eletson* court considered whether the shareholders' proposed new value was in fact "new." Contributions are only "new" under *Coltex* if they come from outside the debtor's business.[20] In this case, the debtors proposed $37 million of funding in cash and various other buckets of funds from shareholders. The court concluded that only the $37 million cash qualified as "new." However, the funds from shareholders did not meet the standard for "new," since those funds were coming from inside the debtors' capital structure.[21]

Second, the court considered whether the debtors were offering "money or money's worth." To satisfy this requirement, the "new value" must be a *present* contribution; promises of future services and promissory notes do not constitute new value. Here, the debtor plan proposed several modes of contributions: "distribution of revenue from the nondebtor subsidiaries," a percentage of recovery on a judgment from an arbitration award, and a guaranty by the debtor's shareholder of up to $40 million to be escrowed at $1 million per month for the next 40 months.[22] The court agreed with the petitioning creditors that these contributions may not be considered "money or money's worth" because they are all "contingent future payments."[23] However, the $37 million cash portion of the new-value contribution might be regarded as "money or money's worth," since it is up-front cash.[24]

Third, the court analyzed whether the shareholder new-value contribution was considered substantial. Courts analyze whether a new-value contribution is "substantial" by comparing the contribution to the unsecured claims being disposed of under the plan.[25] Under the debtor plan, the shareholder new-value contribution consisted of $37 million in funding, compared to $505 million in general unsecured claims — about 7.3 percent of the unsecured claims pool.[26] The debtors asserted that the claims pool would be reduced through the claims-objection process. The court rejected this argument and pointed out that it had already granted the debtors' claim objection, thus the amount of undisputed unsecured claims was about $505 million.[27] The court concluded that a new value contribution of 7.3 percent of the unsecured creditors' claims was not "substantial."[28]

Fourth, the court considered whether the proposed new-value contribution is "reasonably equivalent" to the reorganized debtor's value. Both *Coltex* and *203 N. LaSalle* "mandate that a debtor market-test a proposed transaction in order to demonstrate that the purported new value was necessary and reasonably equivalent, and was not merely an exclusive opportunity for old equity to gain advantages at the expense of creditors."[29] Here, the debtors terminated exclusivity and exposed the case to the competing plan process.[30] The court acknowledged that this might be a proper method to potentially confirm a "new value" plan, but under the precedent set in *203 N. LaSalle*, competing plan processes might not be sufficient to satisfy this requirement.[31]

In any event, the court concluded that the debtor plan did not provide sufficient value because the petitioning creditors were offering more. Petitioning creditors valued the debtors' enterprise at between $103.9 million and $116.4 million, with a midpoint of $110.2 million. The debtors had proposed that their shareholders acquire 100 percent of the equity in the reorganized debtor in exchange for $37 million.[32]

In contrast, under the petitioning creditor's plan, unsecured creditors had an option to purchase up to 75 percent of the equity; after a discount to the mid-point, the plan equity value would be up to $62 million. The petitioning creditors asserted that they were paying "top dollar," while no other plan set forth contribution capital at their valuation.[33] Essentially, the court concluded that the debtors' proposed new value cannot constitute reasonably equivalent value when competing plans put forward greater contributions.[34]

15 *Id.* at 21.
16 *Id.* at 22.
17 *Id.*
18 *Id.*
19 *Id.* at 27.
20 *Id.* at *33.
21 *Id.* at 31.
22 *Id.*

23 *Id.*
24 *Id.* at *33.
25 *Id* at *34.
26 *Id.*
27 *Id.* at *36.
28 *Id.*
29 *Id.* at *37.
30 *Id.*
31 *Id.*
32 *Id.* at *35.
33 *Id.* at *36-37.
34 *Id.* at *37.

continued on page 59

Fifth, the court analyzed whether the debtor's contributions were "necessary." The petitioning creditors contended that the new value is not *necessary* to fund the debtor plan because creditors are offering two competing plans that provide more funding than the debtor plan and greater distributions.[35] The debtors asserted that the mere existence of a competing plan does not doom the debtors' plan; there are cases where a new-value plan is confirmed over a competing plan.[36] The court emphasized that the "necessary" prong of the new-value exception turns on the amount of money a party is willing to contribute. To satisfy the "necessary" requirement under *Coltex*, "old equity must be willing to contribute more money than any other source or it must be the lender of "last resort."[37]

Further, "the market must be tested for other sources of funding and the debtor must be able to satisfy the bankruptcy court, with tangible proof, that the debtor would be unable to obtain funds from any other source or that no other source was willing to infuse the same amount of capital as old equity."[38] Again, for the purposes of the analysis, only the $37 million cash contribution constitutes new value under the debtor plan.[39] The court simply concluded that the petitioning creditors' alternative plan would provide greater funding ($41 million), plus better recoveries for creditors than the debtor plan.[40] The court agreed with the petitioning creditors contention that the shareholders' new value contribution was not "necessary."

Conclusion

The existence of a confirmable competing plan — one that had been accepted by an overwhelming majority of creditors entitled to vote — arguably doomed the debtor plan. The *Eletson* court noted, "[t]he Court is unaware of any case post-*LaSalle* where the court has confirmed a new value plan despite a confirmable competing plan ... particularly where, as here, the creditors are willing to contribute more capital than the Debtors."[41] Thus, the court determined that the debtor plan does not satisfy the new-value exception to the absolute-priority rule and cannot be confirmed.[42]

The *Eletson* decision illustrates the power dynamic between equityholders and creditors — and, particular to this case, well-funded petitioning creditors who forced the debtor into an involuntary bankruptcy. *Eletson* demonstrates that insiders can provide a debtor with capital, but bankruptcy courts will favor a marketing process and alternative competing plans that provide greater distributions to creditors and a substantial ratio of cash relative to unsecured claims.

Eletson provides a pathway for equity owners to retain their interests in a reorganized entity through the new-value exception, albeit a narrow one. Through this thorough analysis, the *Eletson* court made clear that the proposed "new value" must be in readily available cash or cash equivalents, and the debtors must go through some market testing. However, the *Eletson* court left some questions unanswered.

For example, what constitutes a "substantial" contribution? Would 10 percent constitute "substantial"?[43] Also, does the competing plan process necessarily satisfy the requirement that new value can be market-tested? Ultimately, can a "new value" plan ever be approved over a competing plan filed by the debtors' creditors? Although theoretically possible, under instructions laid out by the Supreme Court and Second Circuit precedent, it appears unlikely. abi

35 *Id.* at *36.
36 *Id.* at *38.
37 *Id.* (citing *In re Coltex Loop C. Three Partners LP*, 138 F.3d 39 (2d Cir. 1998)).
38 *Id.*
39 *Id.*
40 *Id.* at 37.
41 *Id.* at *40.
42 *Id.*
43 *Eletson* cited *In re Abeinsa Holding Inc.*, B.R. 265, 275 (Bankr. D. Del. 2016), which found that 15.9 percent was substantial.