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Cramdown of Subordination Rights After In re Tribune: The Interplay Between 11 U.S.C. 510(a) and 1129(b)(1)

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Cramdown of Subordination Rights After *In re: Tribune Co.*, 972 F.3d 228 (3d Cir. 2020)

October 20, 2021

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Varieties of Subordination

Debtholders can subordinate their claims to those of other creditors in several distinct ways. The particular mode of subordination can have significant implications in and outside of bankruptcy.

	Concept	Contexts	Implications
Lien	— Agreement among secured creditors to establish the priority of their respective liens on common collateral — Senior secured creditor is entitled to value of the common collateral and the proceeds thereof until paid in full in cash	— Capital structures with multiple tranches of secured debt (e.g., 1L credit facility and 2L notes; ABL and term loan credit facilities with "crossing" liens) — Typically documented in intercreditor agreement between the agent/trustee for each tranche of secured debt (on behalf of the holders it represents), and acknowledged and agreed to by the debtor	— Generally entitles 1L representative to exercise and control the rights and prerogatives of secured creditors in bankruptcy (e.g., adequate protection, consent to use of cash collateral and DIP financing, etc.) — Effectively affords the 1L holders priority over all junior lien and general unsecured creditors, including ordinary-course non-financial creditors not party to the ICA — Conversely, affords the 1L holders no priority over junior lien and other creditors with respect to assets outside of the collateral package
Payment[1]	— Contractual agreement between senior and junior debtholders to subordinate the junior creditor's right to payment to the senior creditor's — Upon default, the senior debtholder is contractually entitled to collect from the junior debtholder all payments made by the debtor on the junior debt until the senior debt is paid in full • Represents a contractual right of the senior debtholder against the junior debtholder • The junior debtholder's rights against the debtor are unaffected	— Capital structures with senior and subordinated debt securities • Typically documented in an article of the indenture governing the subordinated debt securities, of which senior bondholders are third-party beneficiaries — Also characteristic of unitranche loans, in which multiple secured lenders share a single lien but order their payment priorities by contractual agreement among themselves • In this context, typically documented in an "Agreement Among Lenders," or "AAL"	— Establishes priority with respect to any payments by the debtor, whether or not from proceeds of common collateral — Only establishes relative priority of debtholders in contractual privity (i.e., both senior and subordinated holders typically rank *pari passu* with ordinary-course non-financial creditors)
Structural	— Effective subordination of one debt obligation to another resulting from differences in obligors — A claim against a parent company (regardless of its nominal priority against such parent) is effectively junior to all claims against a subsidiary	— Mezzanine financing — Certain out-of-court restructuring transactions (*e.g.*, JCrew)	— Incurrence of structurally senior debt may be limited by negative covenants in existing debt — Subject to such restrictions, however, structural subordination can be achieved without the consent of the debtholder to be subordinated — Potential risk of substantive consolidation, avoidance, etc. in bankruptcy

1. Sometimes referred to "contractual" or "claim" subordination.

Overview of Subordination Agreements

— As noted above, subordination agreements can provide for two distinct types of subordination:
  - Claim (or payment) subordination; and
  - Lien subordination.

— Bankruptcy courts have varied in their willingness to enforce waiver, limitation, and prohibitions on a junior holder's ability to act in a bankruptcy proceeding.
  - The inconsistent rulings have largely resulted from uncertainty as to:
    - The balance between the public policies underlying the bankruptcy laws and the public policy favoring freedom of contract between sophisticated parties, i.e., the extent to which parties can agree by contract to deviate from the statutory scheme set out by Congress in the Bankruptcy Code; and
    - The scope of section 510(a), *i.e.*, whether it covers only specific subordination provisions or all the related provisions of subordination agreements.

— Over time, bankruptcy courts have become increasingly willing to enforce clear and unambiguous subordination provisions, with some exceptions.
  - However, there is still conflicting authority and the cases addressing these issues have arisen generally in lower courts whose decisions do not constitute binding precedent; thus, significant uncertainty remains.
  - As a result, lenders often resolve disputes consensually in the context of a larger settlement in a way that may deviate from the strict language of the subordination agreement and without a court ruling.

Enforceability of Subordination Agreements

Examples of inconsistent case law include:

Right(s) Waived	Enforced	Not Enforced
Right to Challenge Validity of Liens	• *In re ION Media Networks, Inc*. (Bankr. S.D.N.Y. 2009) • *In re Centaur* (Bankr. D. Del. 2010)	• No Cases
Right to Seek Relief from the Automatic Stay	• No Cases	• *In re Hart Ski Mfg. Co., Inc*., (D. Minn. 1980)
Right to Adequate Protection	• No Cases	• *In re Hart Ski Mfg. Co., Inc.* (D. Minn. 1980)
Voting Rights	• *In re Coastal Broad. Sys., Inc.* (Bankr. D. N.J. 2012) • *Blue Ridge Inv'rs, II, LP v. Wachovia Bank N.A. & Aerosol Packaging, LLC* (*In re Aerosol Packaging, LLC*) (Bankr. N.D. Ga. 2006) • *In re Curtis Ctr. Ltd. P'ship* (Bankr. E.D. Pa. 1996) • *In re Inter Urban Broad. of Cincinnati, Inc.* (E.D. La. 1994) • *In re Avondale Gateway Ctr. Entm't, LLC* (D. Ariz. 2011)	• *In re Sw Boston Hotel Venture, LLC,* (Bankr. D. Mass. 2011), *vacated on other grounds, Prudential Ins. Co. of Am. v. SW Boston Hotel Venture, LLC (In re Boston Hotel Venture, LLC*), (B.A.P. 1st Cir. 2012)) • *In re Croatan Surf Club, LLC*, (Bankr. E.D.N.C. Oct. 25, 2011) • *Bank of Am., Nat'l Assoc. v. North LaSalle St. Ltd. P'ship* (*In re 203 N. LaSalle St. P'ship*), (Bankr. N.D. Ill. 2000) • *In re Fencepost Prods., Inc.* (Bankr. D. Kan. 2021)
Right to Object to Use of Cash Collateral	• *Aurelius Capital Master, Ltd. v. TOUSA Inc.* (S.D. Fla. Feb. 6, 2009) • *In re Empire Generating Co, LLC* (Bankr. S.D.N.Y. 2019)	• No Cases
Right to Object to Plan of Reorganization	• *In re ION Media Networks, Inc.* (Bankr. S.D.N.Y. 2009)	• No Cases
Right to Propose a Cramdown Plan	• *In re Consul. Rest. Corp.* (Bankr. D. Minn. 1992)	• *In re TCI 2 Holdings, LLC* (Bankr. D.N.J., 2010) • *In re Tribune Co.* (Bankr. D. Del. 2012)
Right to Object to 363 Sales	• *In re RadioShack Corp.* (Bankr. D. Del. 2015) • *In re Alta Mesa Res. Inc.* (Bankr. S.D. Tex. 2020)	

Case Law Developments Leading up to *In re: Tribune*

— Courts have struggled to determine whether to recognize contractually agreed upon deviations from the Bankruptcy Code; with respect to determining whether cramdown plans of reorganization are confirmable, courts have tended to disregard violations of intercreditor provisions.

- Section 1129(b), which sets out the cramdown requirements, begins with "notwithstanding section 510(a)."
- Based on this language, the court in *In re TCI 2 Holdings* (Bankr. D.N.J. 2010) allowed junior lienholders to propose a plan of reorganization notwithstanding that the proposed plan violated certain terms of the intercreditor agreement where the plan otherwise complied with the requirements of section 1129.
  - Senior lienholders objected to joint cramdown plan proposed by junior lienholders and debtor, arguing that the intercreditor agreement barred the junior lienholders from proposing such a plan.
  - Court found that it need not decide if intercreditor was violated in deciding whether plan was confirmable under 1129(b) because of the "notwithstanding" clause.
  - However, the court carved out of the third-party release the release of claims arising under the intercreditor.

— The upshot of these cases is that, in the context of confirmation of a cramdown plan, the court may disregard violations of the intercreditor agreement.

- However, this does not necessarily preclude lenders from litigating these issues for damages as between themselves in or out of bankruptcy court. Thus, disregarding an intercreditor agreement for the purposes of confirmation does not render the intercreditor agreement moot.

Section 510

— Section 510(a): A subordination agreement is ***enforceable in a case under this title*** to the same extent that such agreement is enforceable under applicable nonbankruptcy law.

Legislative History for Section 510(a)

— "Subsection (a) ***requires the court to enforce subordination agreements***. A subordination agreement will not be enforced, however, in a reorganization case ***in which the class that is the beneficiary of the agreement has accepted, as specified in proposed 11 U.S.C. 1126, a plan that waives their rights under the agreement***. Otherwise, the agreement would prevent just what chapter 11 contemplates: that seniors may give up rights to juniors in the interest of confirmation of a plan and rehabilitation of the debtor."

H.R. REP. No. 595, 95th Cong., 1st Sess. 359 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315

Section 1129(b)

— Section 1129(b) provides:

— (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) [providing that each class has accepted or is not impaired under the plan] 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***.

— (2)(B) With respect to a class of unsecured claims —

- (i) With respect to a class of secured claims, the plan provides—
  - (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
  - (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property [. . .]

Legislative History for 1129(b) – Unfair Discrimination

— **One aspect of this [unfair discrimination] test that is not obvious is that whether one class is senior, equal, or junior to another class is relative and not absolute**. Thus from the perspective of trade creditors holding unsecured claims, claims of senior and subordinated debentures may be entitled to share on an equal basis with the trade claims. However, from the perspective of the senior unsecured debt, the subordinated debentures are junior.

— This point illustrates the lack of precision in the first criterion which demands that a class not be unfairly discriminated against with respect to equal classes. From the perspective of unsecured trade claims, there is no unfair discrimination as long as the total consideration given all other classes of equal rank does not exceed the amount that would result from an exact aliquot distribution. **Thus if trade creditors, senior debt, and subordinate debt are each owed $100 and the plan proposes to pay the trade debt $15, the senior debt $30, and the junior debt $0**, the plan would not unfairly discriminate against the trade debt nor would any other allocation of consideration under the plan between the senior and junior debt be unfair as to the trade debt as long as the aggregate consideration is less than $30. The senior debt could take $25 and give up $5 to the junior debt and the trade debt would have no cause to complain because as far as it is concerned the junior debt is an equal class.

— **However, in this latter case the senior debt would have been unfairly discriminated against because the trade debt was being unfairly over-compensated**; of course the plan would also fail unless the senior debt was unimpaired, received full value, or accepted the plan, because from its perspective a junior class received property under the plan. **Application of the test from the perspective of senior debt is best illustrated by the plan that proposes to pay trade debt $15, senior debt $25, and junior debt $0. Here the senior debt is being unfairly discriminated against with respect to the equal trade debt even though the trade debt receives less than the senior debt. The discrimination arises from the fact that the senior debt is entitled to the rights of the junior debt which in this example entitle the senior debt to share on a 2:1 basis with the trade debt.**

Report of the Committee on the Judiciary, House of Representatives, to Accompany H.R. 8200, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977)

Background to the Third Circuit's *Tribune* Decision: "The Deal from Hell"[1]

— Tribune was the largest media conglomerate in the country. It owned newspapers, such as the *Chicago Tribune* and the *Los Angeles Times*, as well as television and radio stations.[2]

— In 2008, a failed leverage buyout left the company almost $13 billion in debt.

— In 2009, Tribune filed for bankruptcy.

— At the time of filing:

- Tribune owed $1.283 billon to Senior Noteholders, who held unsecured notes.
- The Senior Noteholders were beneficiaries of subordination agreements with the holders of Tribune's PHONES and EGI notes.
  - The subordination agreements stated that if Tribune declared bankruptcy, any distributions to the holders of the PHONES and EGI notes would be paid to the Senior Noteholders first, until the Senior Noteholders had been paid in full.

1. Samuel Zell, the architect of the Tribune LBO, called the 2007 leveraged buyout of Tribune the"Deal From Hell". (*See Bloomberg Businessweek,* July 30, 2008). www.bloomberg.com/bw/stories/2008-07-29/sam-zell-speaks-his-mind.
2. *In re Trib. Co*., 972 F.3d 228, 233 (3d Cir. 2020).

The EGI Subordination Agreement

— EGI-TRB, LLC Subordination Agreement provided:

- **2. <u>Subordination</u>**. The Subordinated Obligations are subordinate and junior in right payment to all Senior Obligations to the extent provided in this Agreement. No part of the Subordinated Obligations shall have any claim ***to the assets of the Company*** on a parity with or prior to the claim of the Senior Obligations. Unless and until the obligations to extend credit to the Company under the Senior Documents shall have been irrevocably terminated and the Senior Obligations have been paid in full in cash, the Subordinating Creditor will not take, demand or receive from the Company, and the Company will not make, give or permit, directly or indirectly, by set-off, redemption, purchase or in any other manner, any payment of (of whatever kind or nature, whether in cash, property, securities or otherwise), whether in respect of principal, interest or otherwise, or security for the whole or any part of the Subordinated Obligations.
- **6. <u>Payments Received by Subordinating Creditor</u>**. Except as to payments or distributions which the Company is permitted to pay to Subordinating Creditor or which Subordinating Creditor is permitted to accept and retain pursuant to this Agreement, ***all payments or distributions upon or with respect to any Subordinated Obligations which are made by or on behalf of the Company or received by or on behalf of the Subordinating Creditor in violation of or contrary to the provisions of this Agreements shall be received in trust for the benefit of the holders of Senior Obligations*** and shall be paid over upon demand to such holders for application to the Senior Obligations until the Senior Obligations shall have been paid in full in cash.

The Provisions (PHONES Indenture)

— PHONES Indenture Provisions:

- **Section 14.02**. Upon ***any distribution of assets of the Company*** in the event of [any bankruptcy case]; then and in such event:
  - (A) the ***holders of Senior Indebtedness shall be entitled to receive payment in in full*** of all amounts due or to become due on or in respect of all Senior Indebtedness, or provision shall be made for such payment in cash, ***before the Holders or the Securities of any series are entitled to receive any payment*** on account of the principal amount, interest or other such amounts as may be provided for in Section 3.01, if any, in respect of the Securities of such Series; and
  - (B) any payment or distribution of assets of the Company of any kind or character, whether in cash, property or securities, by set-off or otherwise, to which the Holders or the Trustee would be entitled but for the provisions of this Article Fourteen, including any such payment or distribution which may be payable or deliverable by reason of the payment of any other Indebtedness of the Company being subordinated to the payment of the Securities of such series, ***shall be paid by the liquidating trustee or agent or other Person making such payment or distribution, whether a trustee in bankruptcy, a receiver or liquidating trustee or otherwise, directly to the holders of Senior Indebtedness*** or their representative or representatives or to the trustee or trustees under any indenture under which any instruments evidencing any of such Senior Indebtedness may have been issued, ratably according to the aggregate amounts remaining unpaid on account of the principal of (and premium, if any) and interest on the Senior Indebtedness held or represented by each, to the extent necessary to make payment in full of all Senior Indebtedness remaining unpaid, after giving effect to any concurrent payment or distribution to the holders of such Senior Indebtedness or provision therefor.
  - In the event that, notwithstanding the foregoing provisions of this Section 14.02, the Trustee or the Holder of any Security of any series ***shall receive any payment or distribution of assets of the Company*** of any kind or character [. . .] ***before all Senior Indebtedness is paid in full*** or payment thereof provided for [. . .] ***then and in such event such payment or distribution shall be paid over*** or delivered forthwith to the trustee in bankruptcy, receiver, liquidating trustee, custodian, assignee, agent or other Person making payment or distribution of assets of the Company ***for application to the payment of all Senior Indebtedness***[.]

The Plan: Sharing Recoveries from Subordinated Creditors

— The Plan organized Tribune's unsecured creditors into distinct classes.[1]
  - Class 1E: Senior Noteholders
  - Class 1F: The Swap Claim, the Retirees, and the Trade Creditors (over 700 unsecured creditors in total)
  - Junior Creditors: The holders of PHONES and EGI notes who entered into subordination agreements with the Senior Noteholders

— The Plan shared the recoveries from the subordinated creditors between Classes 1E and 1F.

— Under the Plan, the Senior Noteholders received about .9% less than if the subordination provisions had been enforced in full.[2]

1. Senior Noteholder's Brief at 7-9.
2. Tribune Brief at 8.

Background to the Third Circuit's *Tribune* Decision

— On April 9, 2012, the Bankruptcy Court entered the Allocation Disputes Ruling, which found that the "Plan's equal treatment of the Senior [Noteholder Claims] and the Other Parent Claims does not amount to unfair discrimination under Bankruptcy Code §1129(b)."

- In connection with this determination, the Bankruptcy Court also concluded that the Swap Claim constituted both "Senior Indebtedness," as defined by the PHONES Notes Indenture, and "Senior Obligations," as defined by the EGI-TRB Subordination Provisions.
- However, based upon its unfair discrimination ruling, the Bankruptcy Court concluded that it need not decide whether the Retiree Claims or any other category of Other Parent Claims falls within the foregoing definitions of "Senior Indebtedness" and "Senior Obligations."

— Pursuant to the terms of the Confirmed Plan:

- (1) there were no distributions under the Plan allocable or otherwise payable to PHONES Notes Claims or EGI-TRB LLC Notes Claims (including, without limitation, proceeds from the pursuit or settlement of Preserved Causes of Action); and
- (2) no amounts allocable or otherwise payable to PHONES Notes Claims or EGI-TRB LLC Notes Claims resulting from the pursuit or settlement of Disclaimed State Law Avoidance Claims were subject to turnover to the Senior Noteholders, as such amounts were determined to not constitute assets of the Debtors.

Tribune's Relevant Plan Provisions

Debt	Class	Amount (Approx.)	Plan Recovery %*	Before EGI and PHONES Subordination	If Class 1E Benefits from Subordination
Senior Noteholder Claims	1E	$1.283B	33.6%	21.9%	35.9%
Other Parent Claims	1F	$264M (Swap Claim - $150.9M) (Retirees - $105M) (Trade - $8.8M)	33.6% 33.6% 33.6%	24.4% 21.9% 21.9%	24.4% 21.9% 21.9%
EGI-TRB LLC Notes Claims	1I	$235M	0%	17.5%	0%
PHONES Notes Claims	IJ	$759M	0%	17.5%	0%

* Source: Docket No. 11015-1 (Appendix B, Subordination Scenario Recovery Charts)

Senior Noteholders Objected to the Plan, Claiming Unfair Discrimination[1]

— The Senior Noteholders objected to the plan, arguing that:
  - (1) The plan violated 1129(b)(1) because the plan did not fully enforce the subordination agreements
  - (2) the plan unfairly discriminated against the Senior Noteholders.

— The Bankruptcy Court and the District Court both found that the text of 1129(b)(1) does not require cramdown reorganization plans to enforce subordination agreements.

— The Senior Noteholders appealed to the Third Circuit, challenging the bankruptcy court's confirmation of the reorganization plan.

1. Senior Noteholder's Brief at 13.

Interplay between § 510(a) and § 1129(b)(1)

- Section 510(a) provides that "a subordination agreement is enforceable" to the "same extent that such agreement is enforceable under applicable nonbankruptcy law."
- Section 1129(b)(1) begins with the phrase **"[n]otwithstanding section 510(a)** of this title." It then lays out the conditions for approving a cramdown plan over the objection of a dissenting class of creditors. §1129(b)(1) states that the plan cannot "discriminate unfairly" and the plan must be "fair and equitable."

Senior Noteholders' Argument:

Section 1129(b)(1) Requires Enforcement of Subordination Agreements[1]

— The Senior Noteholders argued that the plain meaning of 1129(b)(1) is:

- "if a plan is otherwise confirmable, the 'notwithstanding' proviso means that the enforcement of subordination agreements, as required by Section 510(a), shall not be deemed to make the plan into one that discriminates unfairly or is not fair and equitable."

— In other words, **because subordination by definition leads to a difference in outcomes** and therefore "unfair discrimination" in the outcomes, the Code makes clear that to prevent cramdown, **the "discrimination" must be from something OTHER than enforcement of contractual subordination provisions.**

1. Senior Noteholder's Brief at 18, 23.

The Third Circuit's Decision:
Subordination Clauses Do Not Need To Be Strictly Enforced[1]

- In a textual reading of § 1129(b)(1), the Third Circuit held that the introductory phrase "[n]ot withstanding § 510(a)" means that § 1129(b)(1) "overrides § 510(a) because that is the plain meaning of '[n]otwithstanding."
- Therefore, so long as a plan met all other requirements, a court could cram it down on a dissenting class, **"in spite of" or "without prevention or <u>obstruction</u> from or by" §510(a).**
- In effect, a bankruptcy court is not strictly required to abide by the terms of a pre-petition subordination agreement to confirm a plan.
- The Court also stated that the purpose of §1129(b)(1) supports this interpretation, because it was intended to "provide the flexibility to negotiate a confirmable plan" even in cases with a "complex web" of intercreditor rights.

1. *In re Trib. Co.*, 972 F.3d 228, 236 (3d Cir. 2020).

Senior Noteholders' Claim of Unfair Discrimination[1]

— The parties disagreed on the proper benchmark for unfair discrimination because while the Senior Noteholders received some benefit from the subordination agreements, they did not receive all that they were owed per the agreements.
  - Both the Senior Noteholders and Class 1F received 33.6% of their allowed claim amount.
  - 21.9% of the Senior Noteholders recovery was from the Tribune estate, and the remaining 11.7% of the recovery was from the partial enforcement of subordination agreements.
  - The Senior Noteholders claimed that the district court should have found unfair discrimination by considering the difference between recovery from the Tribune estate between classes (21.9%) and (33.6%), rather than comparing recovery after partial enforcement of subordination agreements.

— The Bankruptcy Court compared the Senior Noteholders total percentage recovery of their claim, including partial subordination (33.6%) to their total percentage recovery if the subordination agreements were fully enforced (35.9%). The court found this difference in recovery to be immaterial.

1. Senior Noteholder's Brief at 13, 38.

Dispute Over Proper Benchmark for Discrimination[1]

Stipulated Recovery Percentage:		Class 1E Senior Notes ($1.283B claim)	Class 1F (claim)		
			Swap Claim ($150.9M)	Retirees ($105M)	Trade ($8.8M)
1	Under the Plan	33.6%	33.6%	33.6%	33.6%
2	Before subordination of PHONES and EGI claims	21.9%	24.4%	21.9%	21.9%
3	If Class 1E benefits from subordination	35.9%	24.4%	21.9%	21.9%
4	If Class 1E and the Swap Claim benefit from subordination	34.5%	36.9%	21.9%	21.9%
5	If Class 1E, the Swap Claim, and Retirees benefit from subordination	33.7%	36.1%	33.7%	21.9%

1. *In re Trib. Co.*, 972 F.3d 228, 234 (3d Cir. 2020).

Bankruptcy Court: Rebuttable Presumption Test[1]

— A rebuttable presumption of unfair discrimination exists when there is:
  - (1) a dissenting class
  - (2) another class of the same priority; and
  - (3) a difference in the plans that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net value of all payments or (b) regardless of percentage of recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

— Under this test, presumption may be overcome if the court finds:
  - A lower recovery for the dissenting class is consistent with the results that would obtain outside of bankruptcy, or
  - That a greater recovery for the other class is offset by contributions from the class to the reorganization, or
  - Risks are allocated consistent with the pre-bankruptcy expectations of the parties.

1. *In re Trib. Co.*, 972 F.3d 228, 241 (3d Cir. 2020).

Third Circuit: Eight Principles of Unfair Discrimination[1]

1) a subordination agreement need not be strictly enforced in a cramdown, so long as the allocation is not presumptively unfair (and, if so, the presumption is not rebutted);
2) unfair discrimination applies only to classes that dissent, not individual creditors;
3) unfair discrimination is determined from the perspective of the dissenting class;
4) classes must be aligned correctly as classification is often a precursor to an unfair discrimination argument;
5) a court should measure recoveries in terms of net present value of all payments or the allocation of materially greater risk in connection with the proposed distribution;
6) a court should include subordinated sums in the plan distribution when comparing recovery between classes;
7) there is a presumption of unfair discrimination where there is a materially lower percentage recovery for the dissenting class or a materially greater risk to the dissenting class in connection with the proposed distribution—what "material" means is left to the bankruptcy courts to decide, and;
8) a presumption of unfair discrimination may be rebutted, but the court declined to give more specifics and explicitly left it to the bankruptcy courts to decide

1. *In re Trib. Co.*, 972 F.3d 228, 242-245 (3d Cir. 2020).

Conclusion: "Unfair Discrimination is Rough Justice"[1]

- The Court noted that while class-to-class comparison is preferable, **neither the text of 1129(b)(1) nor the rebuttable presumption test require the discrimination analysis to only a class-to-class comparison.**
- If class-to-class comparison is difficult (as in this case), a "court may opt to be **pragmatic** and look to the discrepancy between the dissenting class's desired and actual recovery."
- Thus, while the Bankruptcy Court compared desired and actual recovery (34.5% vs 33.6%) to evaluate unfair discrimination, this is not necessarily an error.
- The Third Circuit noted that while unfair discrimination is "rough justice", the flexibility of the test is balanced with the Code's "inherent concern with equality of treatment."

1. *In re Trib. Co.*, 972 F.3d 228, 244 (3d Cir. 2020).

Practical Considerations

- If subordination agreements do not need to be strictly enforced, then **debtors may have increased bargaining power** as "plan proponents would have the power to make senior creditors offers they can't refuse, and every incentive to trigger cramdowns in which they need not respect creditors' subordination rights."[1]
- Since creditors may dispute to what extent subordination agreements should be enforced, there is a **potential for increased litigation**.
- **Senior lenders may be less likely to be supportive of bankruptcy** because their full recovery will not be guaranteed by subordination agreements.
- **Debtors may alter subordination agreements** in response.
- Subordinated lenders may **begin contesting the enforcement of subordination agreements.**
- Creditors may seek to enforce contractual remedies **against other creditors** outside a bankruptcy plan, which may implicate **third party releases**.

1. Senior Noteholder's Reply Brief at 9.


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