



Financial Restructuring Group Client Alert

BEIJING FRANKFURT HONG KONG LONDON LOS ANGELES MUNICH NEW YORK SINGAPORE TOKYO WASHINGTON, DC

BANKRUPTCY COURT DENIES COMMITTEE PLAN PREMISED ON REINSTATEMENT OF SECURED DEBT AND CONFIRMS SECURED LENDER-SUPPORTED DEBT-FOR- EQUITY PLAN¹

The United States Bankruptcy Court for the Southern District of New York recently confirmed the chapter 11 plan (the “Debtors’ Plan”) proposed by Young Broadcasting, Inc. (“YBI”) and its affiliates (collectively, the “Debtors”) and supported by the Debtors’ prepetition secured lenders (the “Lenders”), while denying confirmation to a competing plan (the “Committee Plan”) proposed by the Official Committee of Unsecured Creditors (the “Committee”). Milbank represented Wachovia Bank, N.A., as agent for the Lenders.

As of the date of the Debtors’ bankruptcy filing, their capital structure was straightforward: (a) approximately \$338.5 million owed to the Lenders under a credit agreement secured by first priority liens on substantially all of the Debtors’ assets, with a maturity date of November 2012; (b) approximately \$484.3 million owed to the holders (the “Noteholders”) under two series of senior subordinated notes; and (c) approximately \$20 million of other general unsecured claims.

Initially, the Debtors intended to sell substantially all of their assets pursuant to section 363 of the Bankruptcy Code. Through a Court-approved sale process, the Debtors selected the Lenders’ \$200 million stalking horse bid as the winning bid, and such bid was approved by the Court. However, in a marked reversal of recent trends, the Court then held that the improved market conditions and the Debtors’ cash flow compelled it to find that exigent circumstances justifying the sale of substantially all of the Debtors’ assets outside of the plan process no longer existed, and to direct the Debtors and the Lenders to consummate the previously approved sale under a chapter 11 plan.

¹ *In re Young Broadcasting Inc., et al.*, Case No. 09-10645 (AJC) (Bankr. S.D.N.Y.); *Confirmation Opinion* (Docket No. 907, filed Apr. 19, 2010).

Please feel free to discuss any aspect of this Client Alert or the cases discussed herein with your regular Milbank contacts or with any of the members of our Financial Restructuring Group, whose names and contact information are provided at the end of this alert.

In addition, if you would like copies of our other Client Alerts, please visit our website at www.milbank.com and choose the “Client Alerts & Newsletters” link under “Newsroom/Events.”

This Client Alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel. © 2010 Milbank, Tweed, Hadley & McCloy LLP. All rights reserved.

Attorney Advertising.
Prior results do not guarantee a similar outcome.

April 30, 2010

Subsequently, the Committee proposed its own plan, and both plans proceeded to confirmation on the same schedule.²

Debtors' Plan

The Debtors' Plan was a simple debt-for-equity plan that provided for (i) payment in full in cash of all allowed administrative expense claims, priority claims, and secured claims other than the Credit Agreement claims; (ii) distribution to the Lenders, in full and complete satisfaction of their Credit Agreement claims of 100% of the equity in the reorganized company; (iii) the holders of general unsecured claims (including the Noteholders) sharing *pro rata* \$1 million in cash; (iv) distribution of warrants for equity in the reorganized company to the Noteholders if the Noteholders, as a class, voted to accept the Debtors' Plan; and (v) no distribution to the old equity.

Committee Plan

The Committee Plan provided for (i) the same treatment of allowed administrative, priority, secured (other than claims of the Lenders), and general unsecured (other than claims of Noteholders) claims as the Debtors' Plan; (ii) reinstatement of the Credit Agreement debt, including accrued post-petition interest at the non-default rate and principal amortization payments (collectively, the "Reinstated Debt"); (iii) distribution to the Noteholders of a *pro rata* share of 10% of equity interests in the reorganized company (consisting of Class A shares) and giving them an opportunity to participate in a rights offering for (a) additional 80% of the new equity (consisting of Class A shares) and (b) \$45.6 million of preferred stock; (iv) a \$45.6 million cash backstop of the rights offering by certain Noteholders to fund payments under the Committee Plan and for working capital and general corporate needs of the Debtors; and (v) issuance of a 10% equity interest in the reorganized company (consisting of Class B stock convertible to 10% of Class A stock once the Reinstated Debt was paid in full) to Vincent Young, the Debtors' founder.

Section 1124(2) of the Bankruptcy Code allowing for the reinstatement of secured debt under the plan or reorganization has not been used much even as a credible threat until recently with the new filings by companies that had obtained, in the borrower market of the 1990s, "covenant light" secured debt with below market interest rates. There is an obvious advantage to such debtors' other creditors in attempting to reinstate such below market debt and in capturing any potential upside of reorganization. That is what the Noteholders attempted.

However, the Credit Agreement, although typically "light" on other covenants, had rather typical change of control restrictions. Specifically, it required that (i) Mr. Young, together with certain other individuals (collectively, the "Young Group") at all times had more than 40% of the "Voting Stock" in the company; (ii) if any person or group acquired more than 30% of the outstanding Voting Stock, the Young Group had to own more than 30% or alternatively, the right or ability to elect or designate for election a majority of the YBI's board of directors; and (iii) during any two-year period, those individuals who were directors at the beginning of such period had to constitute the majority of directors at the end of such period (the foregoing, collectively, the "COC Provisions").

² Once the Committee Plan was presented to the Debtors' Board of Directors, the Board determined that its fiduciary duties compelled it to support the Committee Plan. As a result, the Debtors actively supported the Committee Plan and left the Lenders to argue for the confirmation of the Debtors' Plan (the Debtors asked the Court to confirm the Debtors' Plan only if the Committee Plan was unconfirmable).

April 30, 2010

In an attempt to comply with the COC Provisions, the Committee Plan provided that the Board of the reorganized company would consist of seven Class A directors and one Class B director, and that each of the 5 million Class A shares had the right to cast 20 votes for Class A directors and one vote for Class B directors, while Mr. Young, the sole Class B shareholder, had the right to cast 1,000 votes for each of his 500,000 shares for the Class B director and one vote for the Class A directors. The Committee maintained that the foregoing voting scheme allowed Mr. Young 82% of the overall vote “by numbers,” which exceeded the minimum requirements of the COC Provisions.³

Lenders’ Objections and Court’s Denial of Confirmation to Committee Plan

The Lenders objected to the Committee Plan on several grounds, asserting that such plan was not confirmable under the applicable Bankruptcy Court standards. The Court agreed on almost all counts.

1. Reinstatement under Section 1124(2)

First, the Lenders argued that the Committee Plan was unconfirmable because the claims under the Credit Agreement could not be reinstated in compliance with section 1124(2) of the Bankruptcy Code. The Lenders argued that the corporate governance provisions of the Committee Plan violate the COC Provisions and thus, upon reinstatement, the Credit Agreement would be in immediate default.

The Lenders also argued that the Committee’s super-technical interpretation of the COC Provisions eviscerates the protections specifically negotiated by the Lenders to ensure that Vincent Young retained control over the YBI Board. “Voting Stock” was defined in the Credit Agreement as “Capital Stock . . . pursuant to which the holders thereof have the general voting power under ordinary circumstances to elect the board of directors.” The Lenders argued that while, under the Committee Plan, Mr. Young technically retained 82% of the vote “by numbers,” such vote would only allow him to control the election of one Class B director, while the Noteholders would control the overwhelming majority of the board. Accordingly, Mr. Young’s Class B stock would not give him “general voting power” as required by the Credit Agreement.⁴

The Court agreed with the Lenders’ interpretation of the COC Provisions, choosing substance over form, and agreeing that “general voting power” meant the power to influence the composition of the board of directors – which the Young Group would no longer have under the Committee Plan.

This decision comes on the heels of Judge Peck’s decision in *Charter Communications*⁵ (that both the Lenders and the Committee cited in support of their respective position) where the court allowed reinstatement of secured debt containing similar change of control provisions. There, the contested plan provided for

³ The Committee further submitted that, to the extent the Court found that its plan violated the COC Provisions, an alternative structure contained in a footnote to the Committee’s Supplement to the Disclosure Statement should become operative.

⁴ The Lenders also argued that the Committee Plan violated the other two COC Provisions by allowing the Noteholders that backstopped the rights offering to control more than 30% of the Voting Stock when the Young Group lost its control of the Board and by disturbing the staggered Board nomination scheme.

⁵ *JPMorgan Chase Bank, N.A. v. Charter Commc’ns Operating LLC (In re Charter Commc’ns)*, 419 B.R. 221 (Bankr. S.D.N.Y. 2009).

April 30, 2010

divorcing the economic and voting rights appurtenant to the new equity, thus allowing the old control group to retain the *quantum* of the voting rights that complied with the credit agreement that was being reinstated, while not allowing such group to retain any economic interest in the reorganized company. The Court read *Charter* the same way as the Lenders did, *i.e.* to stand for the proposition that, to allow reinstatement, strict compliance with the COC Provisions and with the absolute priority rule is required. This reading obviously makes future attempts at reinstatement problematic.

The Court also refused to consider the proposed alternative structure, finding that a change of the Committee Plan regarding the selection of the Board of directors was not a technical fix but a material modification that most likely would require re-solicitation of the creditor vote. However, the Court did not actually rule on whether such re-solicitation would not be required in light of the Court's findings with respect to the other aspects of the Committee Plan that made it unconfirmable.

2. Cramdown Standards Under Section 1129(b)

The Lenders also argued that the Committee Plan was not confirmable because it did not comply with the cramdown standards of section 1129(b) of the Bankruptcy Code. Since the class of general unsecured creditors other than Noteholders (the "Dissenting Class") voted against the Committee Plan, such plan could only be confirmed under the cramdown provisions, which require that, in order to be confirmable, the Committee Plan (a) could not "discriminate unfairly" against the holders of claims in the Dissenting Class, and (b) be "fair and equitable" with respect to such holders.

According to section 1129(b)(1), a plan discriminates unfairly when it provides disparate treatment of similar claims without a reasonable basis for such disparate treatment. The Lenders pointed out that, under the Committee Plan, the creditors in the Dissenting Class were to share \$1 million in cash (an estimated 5% recovery), while the Noteholders – who were also general unsecured claimants – were to receive 10% of the new equity and additional subscription rights, which potentially constituted a higher recovery. The Lenders argued that this constituted unfair discrimination with respect to the members of the Dissenting Class.

The Committee responded that the Noteholders' projected recovery was approximately only 2%, and that there was a rational basis for the disparate treatment since the Noteholders and the trade creditors had bargained for different forms of recovery. However, the Court found that the Committee failed to carry its burden of proof by failing to provide any evidence either (a) regarding the value of the Noteholders' subscription rights, or (b) to substantiate its assertion that the Noteholders and the trade creditors had bargained for different forms of recovery.

Furthermore, under section 1129(b)(2)(B)(ii), a plan is fair and equitable with respect to a class of unsecured claims if the claims in such class are either paid in full or no claims or interest junior to the claims in such class not receive or retain any property on account of such junior claim or interest.

The Lenders pointed out that the Committee Plan violated this absolute priority rule because, while the claims in the Dissenting Class were not paid in full, Mr. Young, a current equity holder, received 10% of equity in the reorganized Debtors.

April 30, 2010

Although the Committee tried to defend its plan by asserting that Mr. Young was not receiving new equity “on account of” his preexisting equity interest, but rather on account of his future work and his cooperation with respect to complying with the COC Provisions, the Court found that the Committee failed to carry its burden of proof with respect to this assertion.

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

Finally, the Lenders argued that the Committee Plan could not be confirmed because it was not feasible within the contemplation of section 1129(a)(11) of the Bankruptcy Code in that the reorganized Debtors would not be able to repay (either through a sale or refinancing) the Reinstated Debt on its reinstated 2012 maturity date. The Lenders relied on the testimony of its expert witness, while arguing that the testimony to the contrary of the Committee’s expert witness, Tom Kuhn of Allen & Company, was inadmissible and unreliable.⁶

In order for the Court to make the feasibility determination, it had to determine which expert’s testimony it found more persuasive.

The Court found that the testimony of the Committee’s expert regarding valuation of the reorganized company was not admissible because the so-called “levered discounted cash flow” valuation method⁷ Mr. Kuhn used was not a method tested or relied upon by other experts and had never been subjected to peer review or discussed in any publication. The Court pointed out that the potential error rate with respect to a method that relied on multiple novel and untested assumptions was simply unknown. As a result, the testimony of the Lenders’ expert, Peter Cohen of Blackstone Advisory Partners, regarding valuation – that the Debtors were worth less than the outstanding secured debt – remained unrebutted. The Court’s use of the *Daubert*⁸ standards to find certain of Mr. Kuhn’s testimony and opinions inadmissible continues a recent trend in bankruptcy courts of applying these evidentiary standards to expert testimony.

While the Court found the testimony of Mr. Kuhn with respect to the feasibility of the Committee Plan admissible, it found it unreliable. After determining that the Debtors’ projections of revenue were too aggressive and overly optimistic, the Court found unreliable the expert’s predictions, based on the discredited projections, that the purchase price that a potential buyer would be willing to pay for the reorganized company in 2012, or (b) the funds that the reorganized company would be able to raise from a refinancing would be sufficient to satisfy the Reorganized Debt.

⁶ Notably, the Debtors did not have a valuation or feasibility expert of their own. They initially were going to use the testimony of the investment bankers that had acted as their financial advisor throughout the case. However, once the Court agreed with the Lenders’ assertion that, once the investment bankers testified on these broad issues, any privilege with respect to such investment bankers’ work product would be waived retroactively to the petition date, the Debtors withdrew them as designated experts. This underscores the importance of retaining separate experts for giving testimony of this sort.

⁷ The Court pointed out that, despite the terminology used by Mr. Kuhn in describing this method, there were practically no similarities between it and the generally accepted DCF valuation methodology.

⁸ See *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993).

April 30, 2010

Based on the foregoing, the Court found that the Committee Plan was not feasible as the Committee failed to establish that the reorganized company would be in the position to satisfy the Reinstated Date upon maturity, and thus could not be confirmed.

Conclusion: Implications

The Young Broadcasting confirmation opinion has significant implications for the ability of plan proponents to pursue confirmation of reorganization plans providing for reinstatement of secured debt over the objection of the holders of such debt. Such plan proponents must make sure that their plans do not violate any provisions of the underlying debt documents. Such documents routinely contain restrictions on the change of control that could be easily triggered by a plan transferring control of the reorganized debtor to a creditor group.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Financial Restructuring Group, whose names and contact information are provided below.

New York

One Chase Manhattan Plaza
New York, NY 10005

Dennis F. Dunne	+1-212-530-5770	ddunne@milbank.com
Matthew S. Barr	+1-212-530-5194	mbarr@milbank.com
Evan R. Fleck	+1-212-530-5567	efleck@milbank.com
Wilbur F. Foster, Jr.	+1-212-530-5058	wfoster@milbank.com
Tyson Lomazow	+1-212-530-5367	tlomazow@milbank.com
Abhilash M. Raval	+1-212-530-5123	araval@milbank.com

Los Angeles

601 South Figueroa Street
Los Angeles, CA 90017

Paul S. Aronzon	+1-213-892-4377	paronzon@milbank.com
Gregory Bray	+1-213-892-4470	gbray@milbank.com
Thomas R. Kreller	+1-213-892-4463	tkreller@milbank.com
Robert J. Moore	+1-213-892-4501	rmoore@milbank.com
Fred Neufeld	+1-213-892-4344	fneufeld@milbank.com
Mark Shinderman	+1-213-892-4411	mshinderman@milbank.com

Offices Worldwide

Beijing Frankfurt Hong Kong London Los Angeles Munich New York Singapore Tokyo Washington, DC