BANKRUPTCY LAW360

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For Calpine Stakeholders, Plan Participation Was Key

Friday, Apr 25, 2008 --- One of the hallmarks of Chapter 11, and bankruptcy jurisprudence in general in the United States, is the fundamental right of creditors and other stakeholders to have a meaningful voice in the proceedings concerning matters that affect their economic interests.

In a Chapter 11 case, this means that any stakeholder has the right to bring to the court's attention any grievance or concern that it may have concerning any aspect of the bankruptcy case, including, among other things, any perceived inadequacy in measures proposed by the debtor-in-possession ("DIP") or trustee to protect a creditor's interest in collateral; the propriety of a DIP's request to use, sell, or lease estate property other than in the ordinary course of business; or a DIP's efforts to remain in control of the Chapter 11 process by obtaining extensions of its exclusive periods to propose and solicit objections for a Chapter 11 plan.

The ability of stakeholders to participate in the plan-confirmation process, either by voting to accept or reject a Chapter 11 plan or articulating their concerns regarding the terms of a proposed plan as part of a confirmation hearing, is arguably the most important right given to creditors and interest holders.

As demonstrated by a ruling recently handed down by a New York bankruptcy court, however, a stakeholder can forfeit its right to seek certain kinds of relief following confirmation of a Chapter 11 plan if it refuses to participate fully in the confirmation process.

In In re Calpine Corp., the bankruptcy court denied a request made by certain shareholders for a stay pending their appeal of an order confirming a Chapter 11 plan because even though the shareholders had voted against the plan, they chose not to participate in any other way in the confirmation process.

Right To Be Heard And Participate In Chapter 11

Among the chapters of the Bankruptcy Code, Chapter 11 is unique in explicitly conferring a broad right to participate in the case upon creditors, equity interest holders and other stakeholders.

Section 1109(b) provides that "[a] party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."

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Complementing this general right of access is the basic right of any stakeholder to participate in the plan-confirmation process.

Any creditor or interest holder whose claim or interest is "impaired" by a Chapter 11 plan (i.e., not paid in full and/or otherwise conferred with its full panoply of pre-existing rights) has the right to vote to accept or reject the plan, which can be confirmed by the bankruptcy court only if the requisite majorities of creditors and interest holders vote in favor of it and the plan otherwise satisfies certain statutory benchmarks designed to ensure that it is feasible and fair.

Apart from voting rights, all stakeholders have the right to participate in the confirmation process by voicing any objections that they may have to the terms of the proposed plan.

Both of these entitlements are important. Calpine demonstrates that reliance on only one of them is ill-advised, particularly if it appears that a stakeholder idly sits on its rights during the confirmation process and then, after confirmation, springs to action in a perceived effort to obtain a greater recovery.

Background

Major U.S. power producer Calpine Corporation and various affiliates ("Calpine") filed for Chapter 11 protection on Dec. 20, 2005, in New York.

In the months following the bankruptcy filings, the Office of the U.S. Trustee appointed an official committee of Calpine's unsecured creditors as well as an official equity security holders' committee.

Between March and September 2007, a group consisting of private equity and hedge funds as well as other sophisticated investors (the "Objecting Shareholders") collectively acquired more than 5 percent of Calpine's common stock.

Calpine filed a Chapter 11 plan and accompanying disclosure statement in June 2007.

After approving Calpine's disclosure statement in September 2007, the bankruptcy court implemented plan-solicitation procedures and established a discovery schedule to govern the confirmation proceedings.

The creditors' and equity committees engaged in extensive discovery and commissioned expert opinions concerning Calpine's anticipated enterprise value, as distributions to creditors and shareholders under the proposed plan depended on it.

The Objecting Shareholders did not participate in discovery or the confirmation hearing, nor did they object to confirmation. They simply voted against the plan, which initially distributed nothing to common stockholders.

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On Dec. 18, 2007, Calpine sought court approval of modifications to the plan that it characterized as "immaterial," such that votes on the plan need not be resolicited.

Under the revised plan, common stockholders were guaranteed the right to receive warrants for a portion of the 300 million shares of new Calpine stock to be issued to creditors under the plan.

With this revision, the equity committee settled its remaining objections, and the bankruptcy court confirmed Calpine's Chapter 11 plan on Dec. 19, 2007.

The Objecting Shareholders moved for reconsideration of the confirmation order on Dec. 31, 2007, claiming, among other things, that the plan modifications were material and that they had no meaningful opportunity to be heard in connection with confirmation, having relied on the equity committee to pursue any objections.

The bankruptcy court denied the motion, characterizing the request for a "do-over" as inappropriate:

Despite the size of their investments, the risks involved, the existence of notice of the confirmation hearing and all other applicable deadlines, the Objecting Shareholders as a matter of volition did not participate in the confirmation process and despite their acquired stake, apparently did not monitor the Chapter 11 Cases, nor request electronic notice.

The Objecting Shareholders appealed the confirmation order on Jan. 18, 2008. On that same date, they also filed a motion in the bankruptcy court seeking to stay that portion of the order providing for the distribution of stock and warrants pending the outcome of the appeal.

The Bankruptcy Court's Ruling

The bankruptcy court denied the motion for a stay pending appeal. Rule 8005 of the Federal Rules of Bankruptcy Procedure establishes the procedure for obtaining a stay of an order, judgment, or decree that is the subject of an appeal.

According to Second Circuit precedent, such a stay will be granted only if the party seeking it can satisfy the "heavy burden" of demonstrating that:

It would suffer irreparable injury if a stay were denied;

Other parties would suffer no substantial injury if the stay were granted;

The public interest favors a stay; and

There is a substantial possibility of success on the merits of the appeal.

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Most courts agree that all four criteria must be satisfied before a stay can be granted.

According to the bankruptcy court in Calpine, demonstration of irreparable harm is the "principal perquisite" for the issuance of a stay under Rule 8005.

The court rejected the Objecting Shareholders' contention that they would be irreparably harmed absent a stay because (i) their appeal would likely be mooted once new stock and warrants were issued under the plan, and (ii) Calpine was grossly undervalued. Given their "dilatory conduct" in refusing to participate in the confirmation process and the absence of any evidence submitted to support their undervaluation claims, the court emphasized, the risk that the Objecting Shareholders' appeal would be mooted by substantial consummation of the plan fell "well short" of the requirement that harm be "actual and imminent."

By contrast, the bankruptcy court explained, staying the confirmation order "would cause potentially substantial, irreparable injury" to Calpine, its creditors, and other stakeholders.

The court explained that Calpine's $7.6 billion exit-financing commitment was conditioned upon the absence of any stay of the order, and the costs of negotiating new exit financing and remaining in chapter 11 would be significant (as much as $250 million for professional fees and post-petition interest for a three-month delay in exiting bankruptcy).

Calpine's new common stock and warrant holders would also be harmed, the court emphasized, because the issuance of a stay would "inevitably drive down stock prices" and put the new warrants further out of the money.

The bankruptcy court further concluded that the Objecting Shareholders failed to demonstrate a substantial likelihood of success on the merits of their appeal.

They could not show that the court made a manifest error of law or fact, nor did they produce new evidence that would have changed the court's decision to approve the plan modification or enter the confirmation order.

Moreover, the bankruptcy court explained, the relief sought by the Objecting Shareholders was tantamount to a material modification of the confirmed plan, a remedy to which only a plan proponent or the reorganized debtor is entitled under the circumstances specified in section 1127(b) of the Bankruptcy Code, which requires, among other things, notice and a hearing.

Finally, given the appeal's apparent futility and motivation by private investment concerns, the bankruptcy court concluded that the public interest would be better served by allowing distributions under the plan to proceed in an expeditious manner.

"Clearly," the court remarked, "the public interest does not support favoring

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the interests of those who idly sit on their rights."

Analysis

At heart, Calpine is a cautionary tale concerning the consequences of a lack of diligence.

Even so, a strong subtext imbues the bankruptcy court's denial of what it considered to be dilatory tactics; having done nothing other than vote against the plan in connection with the confirmation process, the Objecting Shareholders sprang into action only when it appeared that there actually might be some value available for distribution in respect of their interests.

The court clearly viewed such 11th-hour tactics as being out of bounds.

Chapter 11 creates a framework of procedures for creditors, shareholders (either individually or through committees), and other stakeholders to participate in the plan-formulation and confirmation process.

Those who neglect to take full and timely advantage of these mechanisms do so at the risk of undermining the ultimate recovery on their claims or interests.

--By Mark Douglas, Jones Day

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In re Calpine Corp., 2008 WL207841 (Bankr. S.D.N.Y. Jan. 24, 2008).

ACC Bondholders v. Adelphia Communications Corp. (In re Adelphia Communications Corp.), 361 B.R. 337 (S.D.N.Y. 2007).

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