

Chapter 6

Valuation Procedure, the Influence of Equity, and the Inclination Toward Settlement

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¶ 6.01 Introduction

The preceding five chapters consider *why* bankruptcy law values estate assets, focusing on the numerous circumstances in which valuation occurs. They also explore the law's general attitudes toward valuation, and gages the present law's level of sophistication and precedential development in this area. In this way, the chapters reflect the general legal theory developed (as it may be today) underpinning valuation in corporate bankruptcy.

Stripped of the philosophical flourish, however, bankruptcy is often the business of calloused hands, counting pennies, and assessing loss. In this world, legal theory often is forced to give way for pragmatism and business necessity. Bankruptcy law reflects this reality in, among other ways, its own form of quick-paced adjudication before a "court of equity" charged with advancing legal principle toward an always-hoped-for global settlement. Indeed, to be complete, any authoritative discussion of bankruptcy valuation should also consider *how* the

bankruptcy courts procedurally go about the job of implementing applicable legal theory.

¶ 6.02 Valuation Procedure

[1] Contested Matters

Most disagreements in bankruptcy are adjudicated as either “contested matters” or “adversary proceedings.”¹ Depending on the case circumstances, valuation disputes may be resolved under either procedure. For example, estate assets may be valued as part of a contested matter related to nonconsensual use of cash collateral, involuntary priming of liens in favor of postpetition financing, the appointment of an Official Committee of Equity Security Holders, or cramdown plan treatment.² Or, estate assets may be valued as part of an adversary proceeding commenced by a lender seeking a declaratory judgment determining the extent of its lien or commenced by an estate representative seeking to avoid a transfer as a fraudulent conveyance or preference.³

Contested matters are initiated by motion.⁴ This is a regular occurrence in bankruptcy cases. Indeed, all matters outside the ordinary course of the debtor’s business requires bankruptcy court approval, and that approval is largely obtained through promptly-adjudicated motion practice, typically initiated by the debtor in possession.⁵ This is true in even the largest bankruptcy cases: matters having

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¹ Compare Fed. R. Bankr. P. 9014 (a contested matter is any dispute in a bankruptcy case not qualifying as an adversary proceeding), with Fed. R. Bankr. P. 7001(1)–(10) (generally, an adversary proceeding in a bankruptcy case is a proceeding (1) to recover money or property, (2) to determine the validity, priority and extent of a lien, (3) to sell property in which both the estate and a co-owner have an interest, (4) to object to or revoke a discharge, (5) to revoke an order confirming a chapter 11, 12 or 13 plan, (6) to determine the dischargeability of a debt, (7) to obtain an injunction or other equitable relief, (8) to subordinate any allowed claim or interest, (9) obtain a declaratory judgment of any of the foregoing, and (10) to determine a claim or cause of action removed pursuant to 23 U.S.C. § 1452).

² See, e.g., *In re Megan-Racine Assocs.*, 202 B.R. 660 (Bankr. N.D.N.Y. 1996) (collateral valuation as part of contested matter over disputed use of cash collateral); *In re Stoney Creek Techs., LLC*, 364 B.R. 882 (Bankr. E.D. Pa. 2007) (collateral valuation as part of contested matter over lien priming in favor of postpetition financing); *In re Spansion, Inc.*, 421 B.R. 151 (Bankr. D. Del. 2009) (valuation of estate assets as part of contested matter concerning request for the appointment of an Official Committee of Equity Security Holders); Official Comm. of Unsecured Creditors of Motor Coach Indus. Int’l v. Motor Coach Indus. Int’l (*In re Motor Coach Indus. Int’l*), 2009 U.S. Dist. LEXIS 10024 (D. Del. Feb. 10, 2009) (valuation of estate assets as part of contested matter over cramdown of plan of reorganization).

³ See Fed. R. Bankr. P. 7001(1), (2).

⁴ See Fed. R. Bankr. P. 9014(a) (“relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought”); see, e.g., *PW Enters., Inc. v. Kaler (In re Racing Servs.)*, 332 B.R. 581 (B.A.P. 8th 2005) (when party in interest objected to motion, matter became a contested matter under Rule 9014); see also 11 U.S.C. § 1109(b) (establishing the statutory right of any party in interest to raise and appear and be heard on any issue in a chapter 11 case).

⁵ Bankruptcy Code section 363(b)(1), for example, requires bankruptcy court approval before the

direct bearing on, perhaps, billions of dollars in value and thousands of jobs are often adjudicated at the trial court level in only a matter of weeks. Disputed financing arrangements and plan cramdown are two primary examples, as discussed in Chapter 1.

This is not to say that basic notions of due process and fundamental fairness are extinguished in contested matters.⁶ But, the stakes are high in corporate bankruptcy: employees, creditors, customers, vendors, retirees, taxing authorities all feel very real pain in protracted insolvency and, all too often, litigation is used by parties for value-deteriorative “hold-up” bargaining leverage.⁷ So, here, the law is intentionally flexible, balancing the rights and needs of litigants advancing facially valid objections with the basic needs of a distressed business (and unhappy parties in interest) caught in the middle. Litigation is quick, but in many respects similar to other forms of federal court civil trial practice, as discussed in later chapters of this book.

Final adjudication of a contested matter may involve a trial on the merits, with the movant typically bearing the burden of admissible proof, consistent with the Federal Rules of Evidence.⁸ Parties may compel in-court testimony through the issuance of trial subpoenas.⁹ Moreover, as discussed more fully in Chapter 16, contested matter litigants are afforded many of the discovery rights established by the Federal Rules of Civil Procedure, including the right to demand document production and depositions under oath. But, to facilitate rapid adjudication, bankruptcy courts are afforded broad discretion to limit the extent (both as to

debtor may use, sell, or lease property of the estate outside the ordinary course of business. Such approval is provided through motion practice, notice and hearings. The goal is to ensure that all interested parties have the right to be heard before a debtor disposes of property. *See* Fed. R. Bankr. p. 6004 (describing notice and procedure required for use, sale or lease of property).

⁶ *See, e.g.,* PW Enters., Inc. v. Kaler (*In re* Racing Servs.), 332 B.R. 581, 586 (B.A.P. 8th 2005) (party in interest had filed an objection and bankruptcy court abused its discretion when it approved a stipulation without holding a hearing).

⁷ *See, e.g., In re* Adelpia Communications Corp., 368 B.R. 140, 146–159 (Bankr. S.D.N.Y. 2007) (Adelpia consisted of 230 related entities and each creditor group contested the valuation of its claim. Valuation was very difficult with no way to “assuage the concerns of one creditor faction without further alienating another This effectively froze progress on the confirmation of a reorganization plan”); *see also* Richard L. Cupp, Jr., *Asbestos Litigation & Tort Law: Trends, Ethics & Solutions: Asbestos Litigation and Bankruptcy: A Case Study for Ad Hoc Public Policy Limitations on Joint and Several Liability*, 31 Pepp. L. Rev. 203, 219 (2003) (“Employees, managers and other businesses all suffer ripple effect losses when a corporation declares bankruptcy.”).

⁸ *See, e.g., In re* Henkel, 408 B.R. 699, 701 (Bankr. N.D. Ohio 2009) (movant bears the burden of proof in a contested matter); *Stauder v. eCast Settlement Corp. (In re* Stauder), 396 B.R. 609, 610 (Bankr. M.D. Pa. 2008) (movant bears burden of persuasion in a contested matter); *In re* DeSoto, 181 B.R. 704, 707 (Bankr. D. Conn. 1995) (general rule that movant bears burden of proving basis for relief requested); *In re* Green, 89 B.R. 466, 474 (Bankr. E.D. Pa. 1988) (claimant bears the burden of proving its case by a preponderance of the evidence).

⁹ *See* Fed. R. Bankr. P. 9016.

breadth and timing) of discovery, and many of the rules regarding pre-trial expert disclosure and discovery are rendered inapplicable in contested matters.¹⁰

[2] Adversary Proceedings

Adversary proceedings are lawsuits subsumed within the overarching bankruptcy case. An adversary proceeding is commenced by a plaintiff filing and serving a complaint, just as in nonbankruptcy federal court litigation.¹¹ Continuing with the procedural parallel, adversary proceedings are governed by the Federal Rules of Civil Procedure, made applicable by the 7000 series of the Federal Rules of Bankruptcy Procedure. Discovery rights established under the Federal Rules of Civil Procedure are available to litigants in adversary proceedings,¹² again as discussed in Chapter 16. Final adjudication will involve a bench trial before the bankruptcy judge, consistent with the Federal Rules of Evidence.¹³

Adversary proceedings may or may not advance quickly to trial, often depending on whether adjudication essentially is a condition precedent to advancement of the bankruptcy process. If, for example, a large portion of the debtor's secured debt benefits from liens delivered in the 90 days preceding bankruptcy (and, thus, may be subject to preference attack), the negotiation and/or confirmation of a plan of reorganization may depend on the extent to which such debt is allowed as secured debt. Under that particular circumstance, the bankruptcy court may press the parties for a near-term trial (as if the matter was raised in a contested matter, as opposed to an adversary proceeding), including on complex questions of enterprise value at the time of the transfers in question. Marshalling the court's docket in this way is well within the bankruptcy judge's discretion.¹⁴

¹⁰ See Fed. R. Bankr. P. 7026; see also Fed. R. Bankr. P. 9014(c) (Federal Rule of Civil Procedure 26(a)(2), which guides disclosures of expert testimony, and is incorporated by Federal Rule of Bankruptcy Procedure 7026, does not apply in a contested matter); Khachikyan v. Hahn (*In re Khachikyan*), 335 B.R. 121, 126 (B.A.P. 9th Cir. 2005) (in a contested matter, less time is afforded for discovery and rules regarding disclosures, discovery plans, and conferences do not apply).

¹¹ See Fed. R. Bankr. P. 7003.

¹² See Fed. R. Bankr. P. 7026.

¹³ See Fed. R. Bankr. P. 9017.

¹⁴ See Bernard Trujillo, *Self-Organizing Legal Systems: Precedent and Variation in Bankruptcy*, 2004 Utah L. Rev. 483, 499 (bankruptcy court judges directing complex proceedings are "called upon to be both managers and umpires").

¶ 6.03 The Influence of Equity

It is a well-recognized and an often-stated maxim that bankruptcies are proceedings in equity and, in turn, that bankruptcy courts are essentially acting “Courts of Equity.”¹ To the legal purist, this may be more of a contextual (even perhaps colloquial) description of bankruptcy adjudication, since bankruptcy is substantively derived from statute and bankruptcy courts certainly render legal judgments, including awards of damages, consistent with governing statutes.² The notion that bankruptcy is an “equity-like” proceeding seems driven by certain of its overarching purposes: (1) fair and just allocation of estate value among competing interests owed more than is available; (2) a process directed toward consensual resolution, where possible; and (3) preservation and maximization of estate value, even if the bankruptcy court must restrain otherwise valid and appropriate litigation to that end.³

Again, in bankruptcy, time (and time-consuming litigation) equates not only with money; too often it equates with pain. As Judge Friendly succinctly put it many years ago, the “conduct of bankruptcy proceedings not only should be right but must seem right.”⁴ When viewed from this vantage point, the bankruptcy judge is often given a far more complicated and delicate task assignment than simply applying fact to legal principle; her job often involves judicial balancing, procedural forethought, and far-seeing wisdom. Bankruptcy courts are thus often

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¹ Historically, courts of equity were most often distinguished from courts of law by the remedies they could award. A court of equity typically provided injunctive relief, while a court of law provided damages. *See, e.g.*, Suja A. Thomas, *A Limitation of Congress: “In Suits at Common Law,”* 71 Ohio St. L.J. 1071, 1074 (2010). While bankruptcy courts cannot claim roots in the old English system of courts of equity, *see* Marcia Krieger, “*The Bankruptcy Court is a Court of Equity*”: *What does that Mean?*, 50 S.C. L. Rev. 275, 292 (1999), the traditions of courts of equity are tightly integrated into the American bankruptcy system. *See id.* at 295; *see also* *Granfinanciera v. Nordberg*, 492 U.S. 33, 81, 109 S. Ct. 2782, 106 L. Ed. 2d 26 (1989) (“Bankruptcy Courts are inherently proceedings in equity.”) (quoting *Katchen v. Landy*, 382 U.S. 323, 336, 86 S. Ct. 467, 15 L. Ed. 2d 391 (1966)).

² Bankruptcy Code section 105 is commonly cited when a bankruptcy court invokes its equitable power. *See* 11 U.S.C. § 105(a) (“[The bankruptcy] court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”) Judge Marcia Krieger noted that this usage is not necessarily accurate, arguing that “[d]escribing the bankruptcy court as a court of equity is traditional and convenient, but it is not accurate. . . . From historical, procedural, jurisprudential, and practical perspectives the Bankruptcy Court is not a court of equity.” Marcia Krieger, “*The Bankruptcy Court is a Court of Equity*”: *What does that Mean?*, 50 S.C. L. Rev. 275, 310 (1999). This does not stop Bankruptcy Judges from routinely invoking the powers and social purpose of the courts of equity in rendering judgment. *See id.* at 275–76.

³ *See, e.g.*, *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 190 (3d Cir. 2001) (“strong public policy in favor of maximizing debtor’s estates and facilitating successful reorganization”) (quoting *In re Continental Airlines*, 91 F.3d 553, 565 (3d Cir. 1996)).

⁴ *Knapp v. Seligson (In re Ira Haupt & Co.)*, 361 F.2d 164, 168 (2d Cir. 1966).

heroically seen as functioning “Courts of Equity” when they wisely see beyond the particulars of a single contested matter or adversary proceeding, adjudicating fairly toward a larger case good. But, by the same token, this type of “equitable” adjudication has been criticized as fraught with human frailty, involving the advertent or inadvertent introduction of subjectivity and results-orientation into what should otherwise be cold calculation, resonant with market efficiency.⁵

Equity’s procedural imprint is even more pervasive at a granular level. A bankruptcy judge who lives with a complicated case for an extended period of time most assuredly develops a view about the nature of the case and the parties appearing before the court. As explained in Chapter 20, judicial dispensation may not be so readily available to parties that, over time, advocate positions contrary to the facts or logic, obviously laboring to deconstruct for “hold-up” leverage, to the general case detriment. Indeed, in a very real sense, valuation arguments are sometimes won or lost on something as opaque and unquantifiable as the “smell” (good or bad) permeating the evidence or the context surrounding the dispute. On this point, two important valuation decisions are particularly instructive.

[1] *In re Oneida Ltd.*

In *In re Oneida Ltd.*, the debtor filed for bankruptcy with a prenegotiated plan of reorganization that paid all unsecured debt and delivered all reorganized debtor stock to its prepetition secured lenders.⁸ The plan was, essentially, a “second-stage” reorganization; prior to the bankruptcy filing, the secured lenders had agreed to compromise a significant portion of their debt in exchange for 62 percent of the company’s stock and the right to nominate six of the nine members of the company’s Board of Directors.⁹ This unusual fact pattern prompted the bankruptcy court to conclude that the case lacked the “checks and balances” present in most cases and that, therefore, the appointment of an Official Committee of Equity Security Holders was warranted.¹⁰ Indeed, “a due regard for appearances [] warrants the appointment of an equity committee, if only to dispel any implication that, here, a group of creditors took control of the Board of Directors in the first stage of a two-stage restructuring, neutralized the general unsecured creditors and then took for itself the value of the remaining equity.”¹¹

Hours prior to the confirmation hearing, one member of the Official Equity Committee and a partnering hedge-fund offered to buy the enterprise for an

⁵ See, e.g., Keith Scharfman, *Judicial Valuation Behavior: Some Evidence from Bankruptcy*, 32 Fla. St. U. L. Rev. 387, 397 (2005); Stuart C. Gilson, Edith S. Hotchkiss & Richard S. Ruback, *Valuation of Bankrupt Firms*, 13-1 Rev. of Fin. Stud. 43, 45 (2000).

⁸ *In re Oneida, Ltd.*, No. 06-10489, 2006 Bankr. LEXIS 780, at *4–5 (Bankr. S.D.N.Y. May 4, 2006).

⁹ *Id.* at *7.

¹⁰ *Id.* at *9–11.

¹¹ *Id.* at *10–11.

amount sufficient to pay all debt in full and yield “an element of consideration” for stockholders.¹² But, this form of offer was contingent on completion of due diligence.¹³ The case then proceeded along a dual track: (1) a trial on plan confirmation, focusing predominantly on enterprise valuation; and (2) a court-compelled section 363 M&A sales process.¹⁴

But, neither track proceeded well for the Official Equity Committee. Over six trial days, the Committee’s valuation thesis was attacked by a barrage of opposing experts; each opposing expert not only largely corroborated the debtor’s valuation, they also corroborated each other’s attack on the Equity Committee’s valuation.¹⁵ There was a suggestion that the Equity Committee’s expert may have manipulated his DCF analysis to achieve a desired result, which further hampered his credibility.¹⁶ Finally, the court found particularly noxious a results-oriented “success” fee incorporated into the expert’s engagement letter.¹⁷ Taken together, the court found that the Equity Committee’s valuation lacked credibility.¹⁸

This conclusion was only reinforced by the outcome of the M&A process, which was given breath and opportunity by the case delay imposed by an extended valuation trial. In the end, a firm offer was not delivered (including especially by the member of the Official Equity Committee), and successive indications of interest never yielded more than a vague value potential for stockholders.¹⁹ This prompted the court to observe, “people who must back their beliefs with their purses are more likely to assess the value of the [asset] accurately than are people who simply seek to make an argument.”²⁰ Ultimately, the court concluded that, “[a]lthough the Equity Committee has had an opportunity to subject the Debtors’ plan to the closest scrutiny (at the Debtor’s expense), it has come up with no reason to delay the proceedings any further or to deny confirmation of this Plan.”²¹

This is perhaps an understatement: the Official Equity Committee was provided both ample opportunity to prove its case or put forth an alternative solution. To

¹² See Transcript of Confirmation Hearing, Vol. 1 at 6–7, *In re Oneida, Ltd.*, 2006 Bankr. LEXIS 780 (Bankr. S.D.N.Y. July 13, 2006) (No. 06-10489), ECF No. 370.

¹³ *Id.* at *6.

¹⁴ *Id.* at *30–31.

¹⁵ See Transcript of Confirmation Hearing, Vols. 1–8, *In re Oneida, Ltd.*, 2006 Bankr. LEXIS 780 (Bankr. S.D.N.Y. July 13–14, 18, 24, 26, 2006) (No. 06-10489), ECF Nos. 369-70, 373-75, 377-78, 385.

¹⁶ *In re Oneida, Ltd.*, 351 B.R. 79, 88–90 (Bankr. S.D.N.Y. 2006).

¹⁷ *Id.* at 91–92.

¹⁸ *Id.* at 88.

¹⁹ *Id.* at 93.

²⁰ *Id.* (quoting *In re Central Ice Cream Co.*, 836 F.2d 1068, 1072 n.3 (7th Cir. 1987)).

²¹ *Id.*

recap, the court: (1) ordered the appointment of an Official Equity Committee (based on a lack of case “checks and balances,” not clear proof that estate value reached equity) to protect whatever value entitlement stockholders then had;²² (2) ordered a full market testing of the company to prove or disprove the various valuation theories proffered by the experts;²³ and (3) afforded the Equity Committee six trial days to prove their case by expert evidence, just in case the market test failed to yield the desired result.²⁴ The Equity Committee did not just have “an opportunity” to scrutinize the debtor’s plan; arguably, it had extraordinary opportunity to prove its case.

[2] *In re Nellson Nutraceutical, Inc.*

The opinion in *In re Nellson Nutraceutical* reflects what must have been one of the most frustrating valuation contests ever placed before a bankruptcy court. Here, the debtor was wholly owned by a private-equity firm that pervasively exploited its control over the company to ensure that management projections would result in residual value returning to the stockholder, at the end of the bankruptcy process.²⁵ Besides evidence of intentional manipulation and undue stockholder influence in the preparation of the projections (prompting the court to repeat a common Wall Street refrain: “garbage in, garbage out”),²⁶ the equity sponsor also laid a heavy hand on the company’s selection of a valuation expert, whose testimony was ultimately excluded on *Daubert* grounds,²⁷ as discussed in Chapter 18. Making matters even more difficult (1) the company’s then recent performance was far more dour than predicted, engendering even further skepticism toward DCF analytics;²⁸ and (2) there were apparently precious few recent transactions involving truly comparable companies (while the debtor produced “private label” nutrition and sports bars and powders, the experts were

²² See *In re Oneida, Ltd.*, 2006 Bankr. LEXIS 780, at *9–11 (Bankr. S.D.N.Y. May 4, 2006).

²³ See Transcript of Pretrial Conference at 10–14, 32–33, *In re Oneida, Ltd.*, 2006 Bankr. LEXIS 780 (Bankr. S.D.N.Y. July 6, 2006) (No. 06-10489), ECF No. 368.

²⁴ See Transcript of Confirmation Hearing, Vols. 1-8, *In re Oneida, Ltd.*, 2006 Bankr. LEXIS 780 (Bankr. S.D.N.Y. July 13-14, 18, 24, 26, 2006) (No. 06-10489), ECF Nos. 369-70, 373-75, 377-78, 385.

²⁵ *In re Nellson Nutraceutical, Inc.*, 2007 Bankr. LEXIS 99, at *4 (Bankr. D. Del. Jan. 18, 2007) (Finding that business plan was “manipulated at the direction of and in cooperation with the Debtors’ controlling shareholder to bolster the perceived value of the Debtors’ business solely for purposes of this litigation.”).

²⁶ *Id.* at *4–5 (“all of the experts have necessarily arrived at concluded enterprise values for the Debtors that are themselves somewhat unrealistic. This effect was succinctly described by one of the experts: ‘garbage in . . . garbage out’”).

²⁷ *Id.* at *40, n.3.

²⁸ *In re Nellson Nutraceutical, Inc.*, 356 B.R. 364, 376 (Bankr. D. Del. 2006) (Debtors’ expert’s “use of EBITDA minus [company’s projections of capital expenditures, which are more volatile than projections of EBIT and EBITDA] to determine terminal value under a DCF analysis is not reliable and, thus, must be excluded.”).

forced to draw comparisons to “transactions involving companies engaged in making cat food, salad dressing, ‘frozen griddle products,’ and canned vegetables”).²⁹ In sum, the evidence simply was unavailable for the court to readily draw a valuation conclusion.

The law accounts for situations like these, and not in ways that force a bankruptcy judge to lose one moment of sleep. Axiomatic, the judge is not a party to the litigation; his job is to hear admissible evidence and apply the facts to legal principle.³⁰ If the parties fail to prove their case, then judicial dispensation simply is not granted. If case developments suggest a systemic problem or that a process shift is in order, the court has tools at its disposal: the judge may continue the trial, prompting the parties to submit additional evidence or briefing; he may send the parties to mediation, or otherwise prod them along the path to settlement; he might instead order the appointment of a court expert, an examiner even a chapter 11 trustee; if matters are sufficiently grave, he can convert the case to a chapter 7 proceeding or simply dismiss the bankruptcy case.³¹

But, Delaware Bankruptcy Judge Christopher Sontchi here chose a remarkably different path. Instead of dismissing the contested matter as unproven and leaving the parties to pick up the pieces, Judge Sontchi himself assumed the heavy case burden. He noted at the forefront of his opinion that the evidentiary difficulties were largely created by the company and that, by the time of the valuation contest, the litigation and bankruptcy time delay had already caused substantial value erosion.³² This prompted him to conclude that enabling any further litigation would essentially “reward the very persons who have created the conundrum (management and the controlling shareholder) at the expense of the creditors.”³³

So, he dug in deep, devoting 23 days to the valuation trial, over four months. His opinion is lengthy and detailed, evaluating each item of admissible evidence. In light of the evidentiary frailties, Judge Sontchi did not find a single expert

²⁹ *Nellson Nutraceutical*, 2007 Bankr. LEXIS 99, at *114.

³⁰ *See id.* at *117–18 (“Court must examine the qualifications of the experts and the credibility of their testimony to determine the weight to give the admissible evidence.”); *see also Nellson Nutraceutical*, 356 B.R. at 367 (“Applying the well-settled law on the admissibility of expert testimony to these facts, the Court finds that the . . . opinion of the Debtors’ expert witness as to the Debtors’ enterprise value [is] inadmissible.”).

³¹ *See* 11 U.S.C. § 105(a) (court can *sua sponte* “tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement Court orders or rules, or to prevent an abuse of process”); Fed. R. Bankr. P. 7015 (supplemental pleadings); Fed. R. Bankr. P. 7016 (pre-trial procedure); Fed. R. Bankr. P. 9019 (compromise and arbitration); Fed. R. Evid. 706 (court expert); 11 U.S.C. § 1104(c) (examiner); 11 U.S.C. § 1104(e) (chapter 11 trustee); 11 U.S.C. § 1112 (conversion or dismissal).

³² *Nellson Nutraceutical*, 2007 Bankr. LEXIS 99, at *6 (noting company’s continuing poor performance).

³³ *Id.*

opinion independently persuasive, but he did find their modeling helpful for discerning reasonable assumptions and valuation approaches.³⁴ Combining favorable attributes of each expert's opinion, Judge Sontchi essentially developed his own valuation model, including a subjective adjustment for poor recent performance.³⁵ One of the many important lessons learned from *In re Nellson Nutraceutical* is that bankruptcy courts sometimes do, in fact, approach the valuation exercise as courts of equity and will, under appropriate circumstances, labor mightily to render as wise and as firm a ruling as available, notwithstanding the frailty of the evidence offered, for the collectively benefit of parties in interest.

³⁴ *Id.* at *122-24.

³⁵ *Id.*

¶ 6.04 The Law's Inclination Toward Settlement

[1] Permissive Standard of Review

Virtually any matter of dispute may be settled in bankruptcy, either as consensual resolution of a contested matter (via modification of the relief requested by the movant) or as a stand-alone settlement brought separately before the bankruptcy court for approval. Bankruptcy Rule 9019 specifically authorizes the debtor to move the court for approval of any form of settlement, and Bankruptcy Code section 1123(b)(3)(A) provides that a plan may provide for the settlement of any estate claim or cause of action.

In evaluating a proposed settlement, the court need not conduct a mini-trial on the underlying dispute.¹ Rather, the debtor needs to produce evidence sufficient for the court to objectively determine if the settlement is “fair and equitable,” meaning that “the compromise falls within the reasonable range of litigation possibilities.”² This is a “canvassing” of issues to “see whether the settlement falls below the lowest point in the range of reasonableness.”³ Considerations include (1) the likelihood a party will prevail at trial; (2) the prospect of complex and protracted litigation if the settlement is not approved; (3) the proportion of class members support or objecting to the settlement; (4) the competency and experience of counsel supporting the settlement; (5) the relative benefits to be received by individuals or groups within a class; (6) the nature and breadth of releases to be delivered; and (7) the extent to which the settlement is truly the product of arm’s-length bargaining.⁴

Valuation matters are not outside the ambit of bankruptcy settlement. Quite the contrary, as Chapter 20 discusses, the law encourages parties in a valuation contest to find a way of settling their differences.

[2] The Order of Analysis: Settlement vs. Section 1129 Requirements

As discussed at length in Chapter 1, confirmation requires an evidentiary

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¹ See *In re Spansion*, 2009 Bankr. LEXIS 1283, at *7 (Bankr. D. Del. 2009) (“In evaluating [a] proposed settlement, the Court’s task is not to ‘decide issues of law or fact raised by the [objections] but rather to canvass the issues to see whether the settlement fall[s] below the lowest point in the range of reasonableness.’”) (citing *In re Exide Technologies*, 303 B.R. 48, 68 (Bankr. D. Del. 2003)).

² See *Spansion*, 2009 Bankr. LEXIS 1283, at *13–14 (debtors must “[persuad[e] the bankruptcy court that the compromise is fair and equitable and should be approved”) (quoting *Key3Media Group, Inc. v. Pulver.com, Inc.* (*In re Key3Media Group, Inc.*), 336 B.R. 87, 93 (Bankr. D. Del. 2005)); see also *In re World Health Alternatives, Inc.*, 344 B.R. 291, 296 (Bankr. D. Del. 2006) (In approving a settlement, the “court must conclude that the settlement is ‘within the reasonable range of litigation possibilities.’”) (quoting *In re Penn Cent. Transp. Co.*, 596 F.2d 1102, 1114 (3d Cir. 1979)).

³ *Spansion*, 2009 Bankr. LEXIS 1283, at *22.

⁴ See *In re Texaco Inc.*, 84 B.R. 893, 902 (Bankr. S.D.N.Y. 1988).

finding that a plan serves the “best interests” of all dissenting creditors and that it complies with the “absolute priority” rule respecting classes that are not provided a recovery.⁵ Occasionally, a plan objector will contend that the estate possesses extraordinary value in the form of contingent assets, such as viable causes of action, that are being released or otherwise settled under the plan.⁶ The objector will further argue that, if these contingent assets are valued appropriately, the plan must fail the “best interests” test and/or the “absolute priority” rule, since there would be significant additional value available for distribution. Chapter 16 delves into the methods of valuing estate causes of action, but here it is appropriate to consider the order of the analysis: should the court first consider settlement approval or claim valuation and section 1129 standards?

Since the law so fervently encourages settlement, it perhaps should not be surprising that it first considers settlement approval and, only thereafter, considers section 1129 standards. This principle was articulated in *In re Best Products Co., Inc.*, and has been reaffirmed several times since.⁷ Thus, once the settlement is approved, the settlement quantum is the value input for analysis under the “best interests” test and the “absolute priority” rule.⁸

⁵ See 11 U.S.C. § 1129(a)(7), (9).

⁶ See, e.g., *In re Capmark Fin. Group Inc.*, 438 B.R. 471, 475 (Bankr. D. Del. 2010) (Official Committee of Unsecured Creditors opposed Debtor’s proposed settlement with secured creditors arguing that the Debtor was settling litigation claims “too cheaply.”); *Texaco Inc.*, 84 B.R. at 899–900 (impaired shareholders objected to Debtor’s plan that proposed to settle derivative actions and granted releases and indemnities to directors and officers).

⁷ See *In re Best Prods. Co.*, 168 B.R. 35, 72 (Bankr. S.D.N.Y. 1994), *appeal dismissed*, 177 B.R. 791 (S.D.N.Y. 1995), *aff’d* 68 F.3d 26 (2d Cir. 1995) (“Once the Court determines to approve the settlements, the claims and the values paid to satisfy them may be deleted from the model and the best interest of creditors test may be applied to the balance of the claims and values available.”).

⁸ See *Best Prods. Co.*, 168 B.R. at 72.