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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEVADA

In re: FRONT SIGHT MANAGEMENT LLC, Debtor.	Case No. 22-11824-abl Chapter 11

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTOR'S MOTION FOR ENTRY OF ORDER: (I) APPROVING DISCLOSURE STATEMENT; (II) APPROVING THE FORM OF BALLOTS AND PROPOSED SOLICITATION AND TABULATION PROCEDURES; (III) FIXING THE VOTING DEADLINE WITH RESPECT TO THE DEBTOR'S CHAPTER 11 PLAN; AND (IV) SCHEDULING A HEARING TO CONSIDER CONFIRMATION OF THE PLAN

The Official Committee of Unsecured Creditors (the "Committee") of the above-captioned debtor and debtor-in-possession (the "Debtor"), by and through its undersigned counsel, files this objection (the "Objection") to the *Debtor's Motion for Entry of Order: (I) Approving Disclosure Statement; (II) Approving the Form of Ballots and Proposed Solicitation and Tabulation Procedures; (III) Fixing the Voting Deadline with Respect to the Debtor's Chapter 11 Plan; and (IV) Scheduling a Hearing to Consider Confirmation of the Plan*

(the "Motion").[1] In support of its Objection, the Committee respectfully states as follows:

PRELIMINARY STATEMENT

1. The Disclosure Statement describes a plan sponsored by an affiliate of the DIP lender that provides for the Debtor's owner, Dr. Ignatius Piazza, to retain potentially significant value and, by virtue of the Reorganized Debtor's retention of all insider claims, receive the functional equivalent of a release. At the same time, all memberships will be cancelled and unsecured creditors will receive only a fractional recovery on their significant claims. The Committee is therefore concerned about whether the proposed plan is confirmable under these circumstances. At this stage, however, the Committee's primary issues rest solely with the inadequacies of the Disclosure Statement.

2. Most glaringly, the Disclosure Statement fails to provide any information supporting the legality of the Debtor's retention of insider claims without fair compensation to unsecured creditors, which the Debtor describes as an "important component" of the PrairieFire consideration. This thinly veiled release does not obviate the need for (i) the Plan to comport with controlling Ninth Circuit precedent prohibiting third-party releases; or (ii) the Disclosure Statement to include information regarding the nature of the claims being "retained" and the outcome of the investigation, if any, undertaken by the Debtor to determine their value. As this Court is aware, LVDF has made several allegations regarding potentially improper distributions and other mismanagement by Piazza, which were at the center of the four-year state court litigation that pushed the Debtor into bankruptcy in the first place. The Committee is undertaking an investigation into potential claims against Piazza and his affiliated insiders, which it intends to discuss with the Debtor as part of a broader conversation regarding its plan concerns.

[1] Docket No. 339. Capitalized terms not otherwise defined herein shall have the meanings ascribed to such terms in the *First Amended Disclosure Statement Describing Debtor's First Amended Chapter 11 Plan of Reorganization Dated September 9, 20222* (the "Disclosure Statement"). Docket No. 338.

3. The impropriety of the insider release is exacerbated by the fact that Piazza stands to retain substantial value under the plan. To the extent unsecured creditors are impaired and vote against the plan, Piazza's retention of value violates the absolute priority rule. The Disclosure Statement must provide an explanation of the basis for this disparate treatment.

4. The Disclosure Statement is similarly deficient with respect to any meaningful information regarding the anticipated financial condition of the Debtor upon emergence from bankruptcy. Given the uncertainty regarding the go-forward membership, it is unclear whether and to what extent the Reorganized Debtor will be able to generate operating income from new memberships. Further, there is no detail in the Disclosure Statement regarding whether $500,000 is sufficient to fund go-forward operations. Without a go-forward business plan, including financial projections, unsecured creditors are being asked to support future operations with no way to assess whether the Reorganized Debtor will have sufficient liquidity to implement a viable exit strategy.

5. The Disclosure Statement also fails to accurately provide creditors with information regarding what they will get under the plan. Although the Disclosure Statement estimates a claims pool of $10 million to $30 million, it is unclear how the Debtor arrived at this estimate given $1.25 billion of claims, not including claims from membership terminations.

6. Finally, the Committee has concerns regarding whether the solicitation proposed by the Debtor is adequate in this circumstance. While the Committee recognizes the budgetary constraints in this case, the last thing the Committee wants is for a solicitation issue to arise when the Court is considering plan confirmation.

7. The Disclosure Statement should be revised so that it adequately and properly discloses the requisite information for unsecured creditors to assess the transactions contemplated by the plan, the related risks, the treatment creditors are being afforded and the Reorganized Debtor's go forward operations.

BACKGROUND

I. General Background

8. On May 24, 2022 (the "Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code with this Court. Since the Petition Date, the Debtor has remained in possession of its assets and has continued to operate and manage its business as a debtor-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

9. On June 9, 2022, the Office of the United States Trustee for Region 17 appointed a five-member Committee consisting of: (i) Steven M. Huen; (ii) Gary Cecchi; (iii) David Streck; (iv) Thomas E. Donaghy; and (v) ALM Investments LLC.[2] The Committee selected Kelley Drye & Warren LLP as its proposed lead counsel and Carlyon Cica Chtd. as proposed local counsel. The Committee also selected Dundon Advisers, LLC as its proposed financial advisor.

II. Case Backrgound

10. Formed in 1996 by Ignatius Piazza ("Piazza"), the Debtor operates one of the largest private firearms training facilities in the world, located on 550 acres of owned real property in Pahrump, Nevada (the "Property").[3]

11. As of the Petition Date, the Debtor is purportedly indebted to LVDF in the amount of approximately $11 million, secured by a deed of trust on the Property, including all water rights (the "Prepetition Debt").[4]

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2 Docket No. 116.

3 *See Omnibus Declaration of Ignatius Piazza in Support of First Day Motions* (the "First Day Declaration"), ¶ 4. Docket No. 21.

4 *Id.* ¶ 26. The Prepetition Debt allegedly consists of: (a) $6.375 million of principal, (b) $2.9 million of interest, late fees and costs, and (c) $1.74 million of attorneys' fees. The Debtor disputes this claim.

12. The Prepetition Debt emanates from a relationship dating back to 2012, pursuant to which LVDF purportedly agreed to secure $150 million via an EB-5 immigration investment plan to finance the development of improvements on the Property, but ultimately delivered only $6.3 million of financing to the Debtor.[5]

13. In August 2018, the Debtor commenced litigation against LVDF in Clark County, Nevada, asserting claims for, among other things, fraud in the inducement, intentional misrepresentation, breach of fiduciary duty and conversion (the "LVDF Litigation").[6]

14. In response, LVDF filed a foreclosure action against the Debtor, as well as various counterclaims (the "LVDF Counterclaims"). The LVDF Counterclaims include, among others: (i) fraudulent transfer claims based on distributions from the Debtor to or for the benefit of Piazza; (ii) claims for conversion based on Piazza allegedly misappropriating the LVDF loan proceeds; and (iii) claims for corporate waste based on Piazza allegedly inducing the Debtor to improperly utilize the loan proceeds from LVDF.[7] The LVDF Counterclaims also include an assertion that Piazza is an alter ego of the Debtor, and therefore, seek to hold the Debtor liable for the assertions made against Piazza in the LVDF Counterclaims.[8]

15. Following four years of contentious litigation, the Debtor no longer had the resources to stave of LVDF's foreclosure efforts. Accordingly, the Debtor commenced this case on the eve of a foreclosure action by LVDF after failing to post a $9.7 million bond to secure a temporary restraining order.[9]

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5 *Id.* ¶¶ 12, 15.

6 *Id.* ¶¶ 17, 18. On June 23, 2022, the Debtor removed the LVDF Litigation to this Court, which is pending under Adv. Proc. No. 22-0111-abl.

7 *See Plaintiffs Notice of Removal to United Stated Bankruptcy Court of Litigation Pending in the District Court of Clark County, Nevada,* ¶¶ 3-6. Adv. Proc. No. 22-0111-abl, Docket No. 1.

8 *Id.*

9 First Day Declaration, ¶ 20.

III. The Original Plan

16. The Debtor filed this case seeking to consummate a plan of reorganization to restructure its operations and allow it to exit chapter 11 as a viable business entity. To maintain operations and finance this process, the Debtor secured $5 million of senior, post-petition financing from FS DIP, LLC (the "DIP Facility").[10]

17. On July 1, 2022, the Court entered an order approving the DIP Facility (the "DIP Order").[11] The DIP Order required the Debtor to adhere to certain milestones, including filing a plan by July 15, 2022 and confirmation of a plan by November 29, 2022.[12]

18. In line with the DIP milestones, the Debtor filed its initial chapter 11 plan on July 15, 2022 (the "Original Plan").[13] The Original Plan provided for Piazza to retain 100% of the equity of the reorganized Debtor in exchange for an unidentified new value contribution.

19. The Original Plan was premised on a new business model that offered existing members the option to enter into new membership agreements that would require annual and daily fees for use of the facility, thereby generating a source of operating income for the Debtor. Although not filed at the time, the Original Plan contemplated the submission of financial projections based, in part, on operating income to be generated from these new membership fees.

20. The claims of members who did not want to continue their memberships with the Debtor would share *pro rata* in an initial $500,000 plus "net operating cash flow" after senior creditors were paid in full.

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[10] First Day Declaration, ¶ 40.

[11] *See* Docket No. 228.

[12] DIP Order, ¶ 16.

[13] *See* Docket No. 270.

21. To test the feasibility of the Original Plan, Piazza emailed existing members requesting feedback on their willingness to pay for the continuation of their memberships. Unfortunately, Piazza did not obtain the feedback necessary to support pursuing the reorganization contemplated under the Original Plan. The Debtor, therefore, pivoted to the plan currently before the Court.

IV. The Amended Plan and Disclosure Statement

22. On September 9, 2022, the Debtor filed an amendment to the Original Plan (the "Amended Plan"), together with the Disclosure Statement. The Amended Plan provides for PrairieFire, an affiliate of FS DIP, LLC, to acquire 100% of the equity of the Reorganized Debtor for $24 million (the "New Equity Contribution"), which includes waiver or payment of the $5.2 million DIP Facility.[14]

23. Unlike the Original Plan, the Amended Plan provides for all existing memberships agreements to be cancelled, which includes payments made by certain members in exchange for the promise of developing timeshares, one-acre home sites and recreational vehicle lots.[15]

24. Holders of general unsecured claims will receive their *pro rata* share of $3 million, less the cost of reconciling and prosecuting objection to such claims.[16] Although the Debtor estimates the total general unsecured claims pool at $10 million to $30 million, the total claims filed against the Debtor currently exceeds $1.25 billion and additional claims are likely to be filed from the termination of all existing membership agreements.

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[14] Disclosure Statement, § I.1.

[15] *Id.*

[16] *Id.* § IV.C.3.

25. The New Equity Contribution includes a $15 million reserve on account of LVDF's $11.65 million claim and Meacher's $3.3 million claim, with an additional $1 million committed by PrairieFire to litigate those claims.[17] Notwithstanding the fact that unsecured creditors will not be paid in full, any excess from the $15 million escrow will be shared between PrairieFire and Piazza.[18]

26. Also pursuant to the Amended Plan, the Reorganized Debtor is to enter into a consulting agreement with Piazza on terms that are yet to be disclosed.[19]

27. The Amended Plan also provides for the Debtor to retain all preference claims, as well as any claims and causes of action against Piazza and his affiliated entities.[20] While characterized as the Debtor's retention of such claims, the result is a full release by the Debtor's estate of all preference claims and claims against the Debtor's insiders (the "Insider Release"). The Disclosure Statement does not provide information regarding the nature and value of such claims or the investigation conducted by the Debtor before determining it "does not believe that significant preferences were made" and "does not believe there is any value to its potential claims against insiders."[21]

28. Finally, the Amended Plan proposes just $500,000 to fund go-forward operating expenses of the Reorganized Debtor. [22] There is no information regarding whether and to what extent such amount is sufficient. Notwithstanding the fact that like the Original Plan, the success of the Reorganized Debtor rests on membership interest, the Disclosure Statement does

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17 *Id.* § IV.C.1.

18 *Id.* § III.C.6.

19 *Id.* § III.D.3.

20 *Id.* § IV.D.7.

21 *Id.*

22 *Id.* § IV.D.1.

not include or propose to provide financial projections. While PrairieFire asserts that it intends to invest "tens of millions of dollars" to further develop the Property, there is no information regarding how it intends to finance such development or that it has cash on hand or a commitment from a lender or parent company.[23]

V. The Solicitation Procedures

29. On September 9, 2022 the Debtor filed the Motion seeking to approve the Disclosure Statement and procedures to govern the solicitation of votes on the Amended Plan.

30. Pursuant to the Motion, the Debtor intends to solicit votes from approximately 3,000 general unsecured creditors (in addition to two mechanics lien claimants the Debtor classified as impaired), 2,600 of which are members that are listed as creditors on the Debtor's books and records. The Debtor does not propose to solicit votes from the remaining 250,000 members (including 77,400 members that paid for memberships with the Debtor) whose memberships will be cancelled under the Amended Plan.

OBJECTION

I. The Disclosure Statement Does Not Provide Adequate Information

31. Section 1125(b) of the Bankruptcy Code requires that a disclosure statement contain "adequate information" regarding a plan before it may be sent to creditors for the purpose of soliciting votes to accept or reject the plan.[24] Pursuant to section 1125(a)(1), "adequate information" means:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and of the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the

[23] *See* Disclosure Statement, Exhibit B—Membership Terms.

[24] 11 U.S.C. § 1125(b).

plan[.][25]

A debtor's requirement to provide sufficient information "cannot be overstated."[26]

32. In order to constitute "adequate information," a disclosure statement should set forth "all those factors presently known to the plan proponent that bear upon the success or failure of the proposals contained in the plan."[27] Further, a plan proponent has the burden to prove that its proposed disclosure statement contains adequate information.[28] While what constitutes adequate information is determined on a case-by-case basis and is ultimately in the court's discretion, at minimum, a disclosure statement must "provide information about the plan, how the provisions of the plan will be put into effect, and an explanation of why the proposed means of implementation will be adequate to the task."[29]

33. In determining whether a disclosure statement contains adequate information, courts have looked at whether the following topics are addressed:

- the events that led to the filing of the bankruptcy;
- a complete description of the available assets and their value;
- the present condition of the debtor while in Chapter 11;
- the anticipated future of the debtor, with accompanying financing information, valuations, and projections relevant to a creditors decision to accept or reject the plan;

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25 11 U.S.C. § 1125(a)(1).

26 *In re Radco Props., Inc.*, 402 B.R. 666, 682 (Bankr. E.D.N.C. 2009) ("[T]he importance of full disclosure and honest disclosure is critical and cannot be overstated").

27 *In re Jeppson*, 66 B.R. 269, 292 (Bankr. D. Utah 1986) ("[T]he parties should be given adequate disclosure of relevant information, and they should make their own decision on the acceptability of the proposed plan or reorganization").

28 *In re Sunshine Precious Metals, Inc.*, 142 B.R. 918, 920 (Bankr. D. Idaho 1992) (noting that it is the debtor's burden to show adequate disclosure over any creditor objection).

29 *Michelson*, 141 B.R. at 719 (Bankr. E.D. Cal. 1992) (emphasizing the importance of every disclosure statement providing an explanation why the proposed means of implementation for each plan provision will be "adequate to the task"); *Ferretti*, 128 B.R. at 19 (Bankr. D.N.H. 1991) (a disclosure statement should tell creditors "what [they are] going to get, when [they are] going to get it, and what contingencies there are to getting their distributions").

- the accounting and valuation methods used to produce the financial information in the disclosure statement;
- the collectability of accounts receivable;
- the actual or projected realizable value from recovery of preferential or otherwise avoidable transfers;
- the existence, likelihood, and possible success of non-bankruptcy litigation; and
- information relevant to the risks posed to creditors under the plan.[30]

A. Inadequate Information Regarding Plan Releases

34. The Disclosure Statement does not describe why the Debtor believes the Insider Release is appropriate under governing law. The Disclosure Statement attempts to disguise the Insider Release by characterizing it as the Debtor's retention of all insider claims and as an "integrated transaction" between the Debtor, Piazza and PrairieFire.[31] The Ninth Circuit, however, has repeatedly held that section 524(e) of the Bankruptcy Code prohibits "bankruptcy courts from discharging the liabilities of nondebtors" through a plan.[32] The Committee has concerns regarding whether the Insider Release renders the Amended Plan unconfirmable under controlling law. Characterizing the Insider Release as an important component of the PrairieFire deal does not overcome this clear precedent.

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30 *Jeppson*, 66 B.R. at 292 (listing factors and type of information that are often required to be disclosed in a disclosure statement).

31 Disclosure Statement, § IV.C.7.

32 *See Blixseth v. Credit Suisse*, 961 F.3d 1074, 1082 (9th Cir. 2020) ("We have interpreted [§ 524(e)] generally to prohibit a bankruptcy court from discharging the debt of a non-debtor"); *see also In re Lowenschuss*, 67 F.3d 1394, 1401 (9th Cir. 1995) (holding that the proposed chapter 11 plan that released claims against nondebtors could not be confirmed as it violated § 524(e) of the Bankruptcy Code); *In re Sun Valley Newspapers, Inc.*, 171 B.R. 71, 77 (B.A.P. 9th Cir. 1994) (holding reorganization plans which proposed to release non-debtor guarantors violated § 524(e) and were therefore uncomfirmable); *In re American Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989); (noting that § 524(e) limits the court's equitable power under section 105 to order the discharge of the liabilities of nondebtors).

35. Nor does the Disclosure Statement provide any information for creditors to assess the impact of the Insider Release. The Debtor maintains, without support, that it does not believe there is any value to the potential insider claims. This does not provide creditors with the information necessary to assess the "existence, likelihood, and possible success of non-bankruptcy litigation."[33]

36. This lack of information is particularly troubling given that these potential insider claims have been at the forefront of the Debtor's case. After four years of contentious litigation surrounding these claims, LVDF has been raising allegations with this Court regarding improper distributions and other mismanagement of the Debtor by Piazza. Indeed, the Debtor has repeatedly taken the position that such claims are estate causes of action for an estate representative to investigate and pursue. The Court agreed with this assessment. Yet, the Debtor has provided no information in the Disclosure Statement regarding the nature of the claims proposed to be "retained" or the investigation undertaken by the Debtor to determine such claims do not have any value. Nor does the Disclosure Statement provide any information regarding whether and to what extent such claims will be pursued and resolved.

37. The Committee is working to quickly conclude its preliminary investigation into distributions made to Piazza and related insiders in the years preceding the Petition Date. Based upon its investigation to date, the Committee believes the estate possesses viable claims to recover some of the distributions made to such insiders over the course of the past ten years. To the extent the Debtor has conducted its own analysis of these claims, the Debtor should be required to provide creditors with information regarding the transactions it analyzed (including the value of such transactions), the potential claims it reviewed and the reasons why the Debtor has concluded that such claims are not viable.

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[33] *Jeppson*, 66 B.R. at 292.

38. Accordingly, the Disclosure Statement should disclose: (i) the claims proposed to be released under the Amended Plan and their estimated value; (ii) the details of any investigation conducted by the Debtor regarding such claims before capitulating their value under the Amended Plan; and (iii) the potential for enhanced recoveries if such claims are pursued.

B. Inadequate Information Regarding Insider Value Retention

39. If unsecured creditors do not vote in favor of the Amended Plan, the Debtor will be required to satisfy the "cram down" requirements of section 1129(b) of the Bankruptcy Code. Section 1129(b)(1) provides that a plan that satisfies all of the applicable provisions of section 1129(a) may be confirmed despite the rejection of the plan by an impaired class if the plan: (1) does not unfairly discriminate; and (2) is fair and equitable.[34] A plan is fair and equitable with respect to an unsecured creditor class if junior classes of creditors and equity holders do not receive or retain any property under the plan, unless the unsecured creditor class is paid in full.[35]

40. The Amended Plan provides for Piazza and PrairieFire to share any excess value from the $15 million litigation reserve, as well as for Piazza to receive the benefit of a new consulting agreement with the Reorganized Debtor. There is no information, however, regarding the terms of the consulting agreement, including the compensation Piazza is to receive thereunder and for what period of time. Nor is there any information to support the basis by which Piazza is entitled to any value when unsecured creditors will not be paid in full. The Disclosure Statement must provide information to support the basis for Piazza's retention of value under these circumstances.

[34] 11 U.S.C. § 1129(b).

[35] 11 U.S.C. § 1129(b)(2).

C. Inadequate Information Regarding Business Plan

41. To confirm a plan under section 1129(a)(11) of the Bankruptcy Code, the debtor or any successor to the debtor under the plan must not be at risk of liquidation or need further financial reorganization.[36] A plan passes the feasibility test if the debtor presents ample evidence to demonstrate that the plan has a "reasonable probability of success" and that the "provisions of the plan of reorganization can be performed."[37] Where the financial realities do not accord with the debtor's projections or where the projections are unreasonable and not financially sustainable, the plan should not be deemed feasible.[38]

42. The Disclosure Statement fails to attach any financial projections or other information regarding the future viability of the Reorganized Debtor. As it stands, existing members will be awarded a free base membership for a period of two years. There is no information, however, regarding how the Debtor intends to generate operating income during this two-year period or thereafter. There is similarly no information regarding how many members the Reorganized Debtor intends to convert to a "pay to play" membership structure. Given that Piazza was unable to garner sufficient interest to support the Original Plan, it is unclear whether the Reorganized Debtor will be able to subscribe the requisite number of members to support go-forward operations.

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[36] *See generally* 11 U.S.C. § 1129(a)(11); *In re Pizza of Hawaii, Inc.,* 761 F.2d 1374, 1382 (9th Cir. 1985) ("The purpose of section 1129(a)(11) is to prevent confirmation of visionary schemes which promise creditors and equity security holders more under a proposed plan than the debtor can possibly attain after confirmation").

[37] *In re Sagewood Manor Associates*, 233 B.R. 756, 762 (Bankr. D. Nev. 1998).

[38] *Las Vegas Monorail Co.*, 462 B.R. 795, 798 (Bankr. D. Nev. 2011).

43. The Disclosure Statement similarly does not provide any information regarding the Reorganized Debtor's go-forward liquidity needs, but simply proposes to allocate $500,000 on account of go-forward operating expenses. There is no information with which a creditor can assess whether such amount is sufficient for the go-forward needs of this business.

44. Finally, although PrairieFire proposes significant investments in the business, there is no information regarding how it intends to finance such investment. The Debtor's members have previously been promised significant development, which for certain members included substantial payments in exchange for timeshares and one-acre lots. With the Debtor's cancellation of all memberships, these prior promises are also being negated. Given the previous failed development of the Property, unsecured creditors should understand how PrairieFire intends to fund operations and capital expenditures going forward.

45. Without a go-forward business plan, including go-forward financial projections, unsecured creditors who are being asked to support future operations cannot assess whether the Reorganized Debtor will have sufficient liquidity to remain viable in the long term.[39] The Disclosure Statement must be updated to provide this basic information to creditors.

D. Inadequate Information Regarding Unsecured Creditor Claim Value

46. Section 1125 of the Bankruptcy Code mandates the full disclosure of all material information to place a claim or interest holder in a reasonable position to "discern how [the disclosure statement] would affect their interests."[40] As currently drafted, the Disclosure

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[39] *See also In re Las Vegas Monorail Co.*, 462 B.R. 795, 798 (Bankr. D. Nev. 2011) (holding that the debtor failed to satisfy burden of showing "feasibility" of proposed plan because its own projections failed to show sufficient cash flow to fund and maintain both debtor's operations and obligations).

[40] *In re 3dFX Interactive, Inc.*, No. 02-55795, 2006 WL 2010786, at *11 (Bankr. N.D. Ca. 2006) (holding that the disclosure lacked a balance of information which would allow voters to determine how it would affect their interests).

Statement does not contain sufficient information for a creditor to assess the potential value to be realized under the Amended Plan.

47. The Disclosure Statement provides a proposed general unsecured claims pool of between $10 million to $30 million. There is no information, however, regarding the basis for such estimate. As it stands, more than $1.25 billion of claims have been filed against the Debtor, not including the potentially significant claims that may be filed as a result of the Debtor's termination of all existing membership agreements. For creditors to properly asses the amount they are likely to receive under the Amended Plan, the Disclosure Statement must describe the basis for the Debtor's estimated general unsecured claims, including the value of any claims that may arise from the termination of the Debtor's membership agreements.

E. Inadequate Information Regarding Claims Impairment

48. Pursuant to the Amended Plan, Class 3—M2 EPC Mechanics Lien Claim, Class 4—Top Rank Builders/Morales Construction Mechanics Lien Claim and Class 6—General Unsecured Claims, are each designated as impaired classes and entitled to vote to accept or reject the Amended Plan.[41] The Disclosure Statement fails to provide any information regarding the business justification for designating the mechanics lien claims as impaired and whether, in the absence of such impairment, the Debtor would be able to confirm the Amended Plan.

49. Section 1129(a)(10) of the Bankruptcy Code requires that if a class of claims is impaired under the plan, at least one class of claims that is impaired has accepted the plan, determined without including any acceptance of the plan by an insider.[42] A class of claims

[41] Disclosure Statement,§§ IV.C.1, IV.C.3.

[42] 11 U.S.C. § 1129(a)(10).

is impaired unless the plan leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest.[43]

50. Artificial impairment occurs when a plan imposes an insignificant or *de minimis* impairment on a class of claims to qualify those claims as impaired under section 1124.[44] Although artificial impairment is not *per se* impermissible, the Ninth Circuit has recognized that it goes to a determination of whether a plan has been proposed in good faith under section 1129(a)(3).[45] Indeed, artificial impairment is recognized as a "form of gerrymandering and when abusively used is held to be antithetical to the good faith which must be at the center of any reorganization effort."[46]

51. The Debtor has not provided any justification for classifying the mechanics lien claims as impaired and whether such claims are being artificially impaired solely to garner the vote of an impaired class for plan confirmation purposes. The Disclosure Statement must at a minimum set forth the basis for the impairment of the mechanics lien claims.

F. Inadequate Information Regarding Risk Factors

52. The only risk factor identified in the Disclosure Statement is the risk that the Amended Plan is not confirmed on the timeline required by the DIP Order.[47] In light of the

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43 11 U.S.C. § 1124.

44 *In re Hotel Associates of Tucson*, 165 B.R. 470, 474 (B.A.P. 9th Cir. 1994) (discussing the broad concept of impairment and how a plan proponent has used impairment to create a slightly impaired class to vote on the plan in order to enhance its own position).

45 *L & J Anaheim Associates v. Kawasaki Leasing International, Inc. (In re L & J Anaheim Associates),* 995 F.2d 940, 943 n.2 (9th Cir. 1993) (noting the belief that abuses on the part of a plan proponent to artificially impair a class should be addressed by "denying confirmation on the grounds that the plan has not been 'proposed in good faith.'").

46 *In re NNN Parkway 400 26, LLC*, 505 B.R. 277, 285 (Bankr. C.D. Ca. 2014) (noting that artificial impairment is a "form of gerrymandering and when abusively used is held to be antithetical to the good faith which must be at the center of any reorganization effort."); *see also Hotel Associates of Tucson,* 165 B.R. at 476 (remanding the matter to the bankruptcy court to determine whether the act of impairment in an attempt to gerrymander a voting class of creditors is indicative of bad faith).

47 Disclosure Statement, § IV.E.3.

significant Disclosure Statement deficiencies described in this Objection, the factors must be expanded to include, among others, the risks that:

- the Reorganized Debtor will not obtain the requisite membership interest to support ongoing operations;
- $500,000 proposed for ongoing operations is insufficient;
- the termination of existing memberships materially increases the unsecured claims pool, resulting in less value being available for unsecured creditors;
- the Reorganized Debtor is not successful in its claims objections, resulting in an unsecured claims pool that exceeds $30 million;
- the Court finds that the Amended Plan has not been proposed in good faith because the mechanics' lien claims have been artificially impaired;
- the Amended Plan is not confirmable under section 1129(a) of the Bankruptcy Code, because not all impaired classes vote in favor of the Amended Plan; and
- the Amended Plan is not confirmable under the "cramdown" provision of section 1129(b) of the Bankruptcy Code.

II. The Debtor's Members Must Be Solicited to Vote on the Amended Plan

53. Section 1126(a) of the Bankruptcy Code provides that the holder of a claim or interest is generally entitled to vote to accept or reject a proposed plan.[48] The use of the term "claim" is instructive, as the Bankruptcy Code defines it broadly to mean a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, un-matured, disputed, undisputed, legal, equitable, secured, or unsecured."[49] Indeed, the Ninth Circuit has ruled that any creditor who is affected by a proposed plan is entitled to vote.[50] Creditors are considered "affected" by a plan if their interests are "materially and

[48] 11 U.S.C. §1126(a).

[49] 11 U.S.C. § 101(5)(A).

[50] *Matter of Beverly Hills Bancorp*, 752 F.2d 1334, (9th Cir. 1984).

adversely affected thereby."[51]

54. As currently contemplated, the Debtor proposes to solicit only those members who are identified as "creditors" on the Debtor's books and records. The Amended Plan, however, proposes to reject all membership agreements. Rejection of the Debtor's membership agreements may, in some cases, give rise to a claim against the Debtor's estate. Any members holding "claims" will be "affected" by the Amended Plan and should be entitled to vote.[52]

55. The Committee is cognizant of the cost attendant with soliciting votes from tens of thousands of creditors, particularly given the budgetary constraints in this case. To balance the interest of due process with the expense of solicitation, the Committee proposes soliciting these members via email. The Committee understands that that Debtor historically communicated with its members by email. Accordingly, soliciting votes from the Debtor's current members via email is the method most likely to provide creditors with notice regarding the Amended Plan.

III. Other Disclosure Statement Concerns

56. In addition to the concerns raised above, the following additional modifications should be made to the Disclosure Statement:

- Preference Claims: Like the insider claims, the Disclosure Statement provides that the Debtor does not believe "any significant preferences were paid." The Debtor should identify the total preference payments and why such claims are not "significant." The Disclosure Statement must also clarify whether the Debtor intends to pursue any preference claims.[53]

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[51] *Matter of Combined Metals Reduction Co.*, 557 F.2d 179, 199 (9th Cir. 1977).

[52] There is a distinction between the ~80,000 members the Debtor categorized as creditors in their bar date motion and the remaining ~170,000 members. Upon information and belief, the 170,000 remaining members are inactive and have not spent any money with the Debtor in at least ten years. Accordingly, it is unlikely that those members will be materially and adversely affected by the termination of their inactive membership agreements.

[53] The Debtor seems to want it both ways – although the Disclosure Statement provides that "neither the Debtor nor the Reorganized Debtor will pursue any preference litigation based on monetary transfers," it goes on to provide that the Reorganized Debtor "shall have the right to pursue any preference actions."

- Plan Supplement: The Motion should identify the timing for the filing of the Plan Supplement, which shall be not less than ten days prior to the voting deadline.

- Mechanics Lien Ballots: The Motion fails to include ballots for Class 3 and Class 4. Such ballots should be approved.

RESERVATION OF RIGHTS

57. The proposed order approving the Disclosure Statement was not submitted with the Motion. Accordingly, the Committee hereby reserves its rights to supplement this Objection at or prior to the hearing on the Disclosure Statement.

CONCLUSION

WHEREFORE, the Committee respectfully requests that the Court deny the Motion unless modified as set forth herein and provide such further relief as is just and proper.

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