UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

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| IN THE MATTER OF | ) | |
| | ) | |
| ANCONA BROS. CO., | ) | CASE NO. BK91-81684 |
| | ) | |
| DEBTOR | ) | CH. 11 |

MEMORANDUM

Hearing was held on January 24, 1994, on the Creditors' Committee amended disclosure statement and objection thereto. Appearing on behalf of debtor were Jerrold L. Strasheim and Mary L. Swick of Baird, Holm, McEachen, Pedersen, Hamann & Strasheim, Omaha, Nebraska. Appearing on behalf of the Official Creditors' Committee were Clifton Jessup and Angela Layton of Dixon & Dixon, P.C., Omaha, Nebraska. Appearing on behalf FirsTier Bank, N.A., was Robert Yates of Fraser, Stryker, Vaughn, Meusey, Olson, Boyer & Bloch, P.C., Omaha, Nebraska. Appearing on behalf of Josephine Upah was David Crawford of Schmid, Mooney & Frederick, P.C., Omaha, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A) and (L).

Background

On November 2, 1993, the Official Committee of Unsecured Creditors (Committee) filed a Chapter 11 plan and disclosure statement. The debtor, Ancona Bros. Co., objected to the plan and disclosure statement, and a hearing was held on November 8, 1993. After the Court found that the plan and disclosure statement contained false and misleading information, the Committee was ordered to either amend or withdraw the disclosure statement and plan (Filing No. 792).

The Committee complied with the court order by filing an amended Chapter 11 plan (Filing No. 796) and an amended disclosure statement (Filing No. 797) on November 18, 1993. Objections were filed by the debtor (Filing No. 804) and FirsTier Bank, N.A. Omaha (FirsTier) (Filing No. 805). A hearing to approve the amended disclosure statement was held on January 24, 1994.

At the hearing, the Committee conceded that its amended plan and disclosure statement must provide for post-petition financing before this Court may approve the amended disclosure statement or

confirm the amended plan. Because of this concession, this Order will not address the objections regarding financing. If the Committee files an amendment that provides for post-petition financing, the issue of adequate disclosure regarding financing will be addressed at that time. The debtor's current objections to the lack of financing provisions are granted.

## Decision

1. The issue of whether to impose Rule 9011 sanctions against the Committee will be deferred until the confirmation hearing. The debtor must resubmit its objections at that time, or the issue will be moot.

2. The Committee's amended plan is facially defective. Since a facially defective plan is not confirmable, the amended disclosure statement will not be approved until the defects in the amended plan and amended disclosure statement are cured.

3. The Committee's amended disclosure statement does not provide adequate disclosure to the parties who will vote on the plan. The amended disclosure statement must be amended to comply with 11 U.S.C. § 1125.

## Discussion

The debtor's objections to the amended disclosure statement fall into three categories. The first section of the objection asks the Court to impose Fed. Bankr. R. 9011 sanctions on the Committee. This Court will defer consideration of whether to impose Fed. Bankr. R. 9011 sanctions against the Committee until the confirmation hearing. Since the Committee is drafting its plan without the cooperation of the debtor, it is too early to determine whether Fed. Bankr. R. 9011 applies to the Committee's actions or whether the Committee is attempting in good faith to bring this Chapter 11 case to confirmation. It is the burden of the debtor to raise Fed. Bankr. R. 9011 at the confirmation hearing, or the request will be treated as moot.

The second section of the debtor's objection alleges that the facial defects in the Committee's amended plan prevent approval of the disclosure statement and prevent confirmation of the amended plan. The Committee is not required at a hearing on the disclosure statement to show that the plan completely conforms to 11 U.S.C. § 1129, but if it is apparent at this hearing that the plan or the disclosure statement fails to comply with §1129 as a matter of law, the Court may decline to approve the disclosure statement. In re Pecht, 57 B.R. 137, 139 (Bankr. E.D. Va. 1986). A facially nonconfirmable plan accompanying a disclosure statement lacks

adequate information as a matter of law, is misleading to the parties who will vote on the plan, and is a needless expense. Id.

After reviewing the disclosure statement and the plan, this Court finds that the Committee has failed to comply with § 1129 as a matter of law in several different areas of its plan and disclosure statement. The Court has listed and discusses these areas below.

The third section of the debtor's objection alleges that the Committee has failed to adequately disclose certain information in its amended disclosure statement. 11 U.S.C. § 1125(b) requires that ballots may not be solicited for a plan until after the plan or a summary is distributed and a disclosure statement containing adequate information is approved. The Bankruptcy Code provides the following definition:

> "adequate information" means information of a kind, and in sufficient detail, as is reasonably practicable. . ., that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan. . .

11 U.S.C. § 1125(a). This disclosure statement has failed to provide "adequate information" to interested claim holders who will vote on the Committee's amended plan. The Court agrees with some of the debtor's objections to nondisclosure of certain matters of substance and agrees with most of the debtor's objections regarding inconsistencies. Those areas that the Committee must disclose more information and those areas that must be corrected in another amended disclosure statement are addressed below.

FirsTier's objection to the amended disclosure statement alleges that the Committee improperly treated FirsTier's impaired interest as unimpaired. The Court is not convinced by the language in the disclosure statement that FirsTier is unimpaired as the disclosure statement alleges. The objection is addressed below in conjunction with a similar objection made by the debtor.

The following additions, deletions, or changes must be made by the Committee to its disclosure statement and its amended plan or the Committee should withdraw its plan from consideration.

Amendments

**1. Trade Credit Disclosure.** The Committee needs to insert into its amended plan a statement regarding how the Committee intends to attract and maintain trade credit. The Committee is proposing that the reorganized debtor retain a substantial amount of post-petition accounts payable. The Committee has earlier represented through an expert that it would be impossible for the debtor to maintain its past trade credit relationships, and that the debtor's reorganization plan should not rely upon such financing because trade credit would be unavailable.

Since the Committee's position apparently has changed, it should disclose the factual basis for its new position that it will keep present trade credit and attract the new trade credit necessary to meet its projections. This disclosure should be stated with an awareness that current management will not be involved in the reorganized debtor and could possibly compete with the debtor for trade credit.

**2. Management.** The Committee does not need to disclose the specific individuals who will replace the debtor's current management team until the confirmation hearing. 11 U.S.C. § 1129(a)(5). In re River Village Assocs., 161 B.R. 127, 141 (Bankr. E.D. Pa. 1993) (holding that 11 U.S.C. § 1129 did not require the disclosure of the future purchaser or the future manager of the debtor at the time the plan was proposed because that information is "typically unknown" at a disclosure statement hearing); but see In re American Solar King, 90 B.R. 808 (Bankr. W.D. Tex. 1988) (holding that future board members did not have to be specifically identified as required by § 1129(a)(5)(A)(ii) at disclosure hearing because proposed plan did not alter debtor's old system of corporate governance). This omission by the Committee does not cause the Committee's amended plan to be defective on its face. It is reasonable for the Committee to wait until after the disclosure statement is approved before hiring a new management team because it is unlikely that qualified candidates will commit to working for the reorganized debtor at this early of a stage and because it is unfair to require that the tentative candidates commit to the job when it is still early in the confirmation process.

The Committee, however, may not remain silent in the disclosure statement regarding the selection of a new management team. The Committee should disclose the efforts expended in obtaining a new management team, disclose an estimation of the salary and benefit expenses of new management, and break down its expense projections to disclose what portion of its total expenses represents management expenses. The Committee should also be able

to project the size, the structure, and the hierarchy that the new management will adhere to in the reorganized debtor.

The Committee must also address whether old management is subject to an anti-compete agreement and if not, must disclose the possibility that current management will compete with the debtor. To the extent known, the Committee should disclose how it intends to deal with the inevitable defection of current management, the possibility of the reorganized debtor being in competition with current management, and certain risks to the business that such competition may pose. However, the Committee does not have to disclose, as the debtor asserts, that there will a downturn of business, that the debtor will fail if the Anconas' compete with the debtor, etc.

Related to this objection is the disclosure of the board of directors of the debtor. The amended plan sets forth the process to select the officers of the debtor. The interests of the board of directors is sufficiently ascertainable in this disclosure statement by examining the parties electing directors and how many are elected by each party. Actual disclosure of these individuals is not necessary until the confirmation hearing. 11 U.S.C. § 1129(a)(5).

The Committee does not have to disclose any information regarding the importance of current management to the debtor. The debtor argues that the Committee must disclose the importance of Michael Ancona and current management to the success of the debtor, the efforts of Richard Upah to sell the debtor over the past ten months, and the Court's own statement regarding the importance of current management. Filing No. 804, § III, A., p. 20. No such disclosures are required.

The debtor's citation to this Court's Memorandum regarding a temporary restraining order is misleading. That opinion was issued a few weeks into the bankruptcy case, which was over two and one half years ago, and that opinion dealt only with the short term interest of the debtor. The Court's quote regarding the need for current management to stay in place at that time was intended to apply only to the period it took to get a plan confirmed, and at that point in the case, this Court thought that period would be relatively short. This Court's 1992 Memorandum does not necessarily reflect the Court's opinion of what management team is in the long term best interest of the debtor.

**3. Improper Classification.** The Committee does not need to make any changes in its plan with regard to the classification of the Upah claim. The Upah claim is based on a state court judgment.

There may be a bankruptcy issue for litigation regarding whether the Upah claim is in fact an equity interest or a claim for a debt, but this litigation will take place either at the confirmation hearing or in other litigation. Since the status of Upah's claim may not be determined without further litigation, the Committee may classify Upah as a creditor because Upah's status is not relevant to the rights of the other claim holders. However, the Committee should make disclosures regarding the existence of any pending litigation that would effect Upah's status.

The Committee is also not required to change its plan with regard to the Class 7 individual Ancona claims and Class 5B trade creditors. The debtor alleges that these claims are "substantially similar" and of the same "legal nature," and therefore, these claims should be classified in the same class under 11 U.S.C. § 1122(a). The issue of whether these claims are "substantially similar" and of the same "legal nature" will be resolved at a trial on confirmation, not at the disclosure statement hearing. Fed. Bankr. R. 3013 states, "For the purpose of the plan and its acceptance, the court may, on motion after hearing on notice as the court may direct, determine classes of creditors and equity security holders pursuant to §§ 1122. . .of the Code." As the Committee stated in the hearing, there may exist business justifications for this classification scheme, and the Committee is entitled to an evidentiary hearing to present its case.

The same reasoning applies to the debtor's objection to the treatment of the individual Ancona Class 8 claims. The debtor alleges that Class 8 claims should be treated as general unsecured claims. This Court agrees with the Committee that there may be legitimate business reasons for not treating this claim substantially the same as the other general unsecured claim holders, and such an issue must be resolved at a hearing on confirmation of the plan, not a disclosure statement hearing.

**4. Improper Impairment.** The Committee must provide more disclosure regarding the impairment of the FirsTier claim. The Committee purports to treat FirsTier as unimpaired, and the disclosure statement states, "The Class 1 Claim will be paid in full with interest according to its contractual terms. The Class 1 Claimant shall retain the liens securing the Class 1 Claim." Filing No. 797, p. 17. FirsTier has objected to the Committee's plan because it believes that it is impaired under the Committee's plan and disclosure statement.

FirsTier alleges that the Committee's plan will involuntarily subordinate its security interest to that of the Committee's post-petition financier. After reviewing both the disclosure statement

and the plan, this Court is unable to determine whether or not FirsTier's claim is actually impaired. The disclosure statement states that FirsTier will retain its lien, but the statement does not make clear whether FirsTier will retain its priority in its collateral. The Committee must explain whether the post-petition financier is taking a prior lien in FirsTier's collateral and if so, must classify FirsTier as impaired. If the post-petition financier is not subordinating FirsTier's lien, the Committee should disclose what collateral will be used to secure the post-petition debt.

The Committee must also further clarify the status of the individual Ancona brothers' and/or Upah's Class 9 interests. If the plan will alter the legal, equitable or contractual rights of the interests under 11 U.S.C. § 1124, the Committee must treat Class 9 as impaired and provide these claim holders the right to vote on the plan. The information in the disclosure statement is not adequate to enable the Court to determine whether these interests are impaired or not. The Committee must disclose more than its existing statement, "The holders of Allowed Class 9 Interests will retain their Interests." Filing No. 797, p. 20. It must be explained to interested parties how it can be that these interests are unpaired.

**5. Cram Down Provisions.** The debtor's objections to the cram down of Class 5B trade creditors, the Ancona's Class 7 claims, and the Ancona's Class 8 claims as not fair and equitable, as violations of the absolute priority rule, as unfair discrimination, and as not paying as much as a Chapter 7 liquidation are all overruled.

The Court has already ruled that the question of preferential treatment for Upah over other claim holders is a question for the confirmation hearing. The debtor's argument is premised upon its unwavering belief that Upah's claim is an equity interest, which is a legal conclusion. It is not apparent to this Court, as a matter of law, that Upah's interest is junior to other general unsecured creditors, or that Upah's claim is substantially similar to the other claims listed.

It is true that Upah is receiving a $350,000 payment upon confirmation, ahead of all other general unsecured creditors, but if Upah's claim is not substantially the same as the other general unsecured creditors, this payment may be permissible. The Committee has not had the opportunity to submit evidence on this issue, and the Court can not draw a legal conclusion regarding Upah's claim until a hearing is held.

The more significant problem with the debtor's objections to the cram down allegations of improper impairment and improper classification, is that the debtor does not have standing to object on behalf on the individual Ancona brothers, the trade creditors, or other creditors. If the trade creditors or the individual Ancona brothers have objections to the treatment or the status of their claims under the plan at the confirmation hearing, they must make their objections on their own motion with their own attorneys.

For the purposes of the disclosure statement, the debtor's objections on behalf of certain creditors are not detrimental to the estate because objections raised in a disclosure hearing address only the issue of adequate information, and the Court has an overriding interest in seeing that adequate disclosure is accomplished. However, at a confirmation hearing, these same types of objections, if made by the debtor on behalf of the creditors, may cause this Court to seriously question whose interests counsel for the debtor is representing.

**6. Undercapitalization and Equity Subordination.** The debtor alleges that any payments to the Class 6 claim holder Upah before other general unsecured creditors would violate Nebraska law because the debtor, according to the Committee, has a negative net worth. The debtor's entire objection is based upon the legal conclusion that Upah is an equity shareholder. Once again this Court's response to this objection is that it must be determined in other litigation that Upah's interest is equity rather than debt before addressing whether the payments to Upah violate state law.

After reviewing the cases and statutes cited by the debtor, this Court can not find as a matter of law that Upah is an equity shareholder and would be receiving payments as an equity holder from a company with a negative net worth. The Court does note, however, that the case submitted by the debtor to support debtor's position that Nebraska courts have found that "undercapitalization in and of itself is fraud on creditors," actually states the opposite, "inadequate capitalization, by itself, is insufficient to prove fraud." J.L. Brock Builders, Inc. v. Dulbeck, 223 Neb. 493, 500, 391 N.W.2d 110 (1986).

**7. Attorney's Signature Not Sufficient.** The Committee's amended disclosure statement and amended plan should be signed by Committee members. Attorney signatures are not sufficient. The Committee may refer to the case cited by the debtor, In re Haukos Farms, Inc., 68 B.R. 428, 434 (Bankr. D. Minn. 1986), for guidance.

**8. Constitutional Rights Violation.** Although the Committee's plan may violate the constitutional rights of the individual Ancona brothers, it is obvious the Anconas' rights under the statute are

violated by the terms of the plan. The Anconas' Class 8 claim was properly filed, and it is allowed until objected to. The Committee must deal with this claim through the claims allowance/objection process. By disallowing the claim in the plan without following the claims procedures, the Committee is effectively taking away the Anconas' rights to that claim without due process. The Court cannot approve a disclosure statement that concerns a plan which, on its face, violates rights of any claim holder. The plan must properly deal with the claims of all parties and it cannot contemplate procedures which violate the Code.

**9. Administrate Expense Payments.** The debtor objects to the Committee's plan as facially defective because the plan does not pay administrative expenses until after the effective date of the plan. The Court agrees with the debtor that the Committee has established artificial delays in the administrative expense payment process. Any party at any time may request the allowance of an administrative expense, and the Committee may not avoid this right through its plan or pay Upah before these claims are paid in full. The plan violates § 1129(a)(9) and is, therefore, facially defective.

**10. Amount and Sources of Payments Before and After Effective Date.** The Committee must disclose the amount and sources of payments that they are making under this plan and the dates that these payments will be made. This information must be in the plan or the disclosure statement and in plain english. The plan defines the "Effective Date" as thirty days after confirmation. Filing No. 796, ¶ 1.29, p. 5. Neither document informs voters the dollar amount that will be paid or the source of such payments, and as has been addressed above, the Committee has manipulated some payment dates by altering the allowance of the claims schedule.

For certain claims, i.e. Upah or the post-petition financier, an interested party may be able to determine the amount of the claim from the projections, but this information should be in the discussion portion of the disclosure statement and plan as well as the projections. Accompanying this information should be an explanation of the source of funds being used to pay each claim holder in this plan. Starting with the administrative claims and ending with the equity interests, no party can ascertain from this disclosure statement who is getting money, how much money is being paid, and where this money comes from. Therefore, the Committee must amend to provide the date, the amount, and the source for each payment. This will include supporting statements for the payments made in the long term projections that are attached to the disclosure statement.

**11. Description of Class of Claims.** The Committee should amend its disclosure statement to provide an adequate description of claims. Currently, the disclosure statement provides no description of the claims in each class. The Committee should identify each class of claims by a word description and not by reference to other classes as it currently has done in its plan. For example, it is impermissible to state "(c) Class 3 - Class 3 consists of the Secured Claims against the Debtor that are not classified in Class 1, 2, 4, 5A, 6, 7, 8 or 9 of this Plan." Filing No. 796, Art. II, ¶ 2.03, p. 7. The Committee should identify Class 3 and all classes of claims by stating a legal description of the class, the total amount of claims in the class, what parties are in this class, and how much money the claim holders in each class will receive.

**12. Appeal Issues.** The Committee must disclose why its plan permits Upah to keep money paid to her pursuant to the plan, even if she loses the appeal and it is eventually determined that the debtor owes her no money. The reason behind this preferential treatment must be disclosed, or the provision taken out of the plan.

**13. Miscellaneous.** The Committee should amend the disclosure statement to meet all objections raised by the debtor in Filing No. 804, Material Omissions, § III, P.(i) - (xi), pp. 34-35.

In addition, the Committee should amend the disclosure statement to provide the following information as requested by the debtor in Filing No. 804, Inaccuracies and Inconsistencies, § III, Q.(i) -(iv), (vii - ix), pp. 36 - 39. The Committee does not have to address (v) because the accuracy of this statement is an assertion of fact and is in dispute. The Committee may also disregard (vi) because the objection is asserting factual conclusions that are unsupported. In addressing (viii), the Committee must explain the relationship between Boudreau & Associates, Inc., and the retained expert, Pegasus & Company.

Separate journal entry to be entered.

DATED: March 3, 1994.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

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| IN THE MATTER OF | |
| ANCONA BROS. CO., | CASE NO. BK91-81684 A |
| DEBTOR(S) | |
| | CH. 11 |
| | Filing No. |
| Plaintiff(s) | |
| vs. | JOURNAL ENTRY |
| | |
| | DATE: March 3, 1994 |
| Defendant(s) | HEARING DATE: January 24, 1994 |

Before a United States Bankruptcy Judge for the District of Nebraska regarding Chapter 11 plan and disclosure statement and objection thereto.

APPEARANCES

Jerrold L. Strasheim and Mary L. Swick, Attorneys for debtor
Clifton Jessup and Angela Layton, Attorneys for Official Creditors' Committee
Robert Yates, Attorney for FirsTier Bank, N.A.
David Crawford, Attorney for Josephine Upah

IT IS ORDERED:

Disclosure statement filed by the Committee is denied approval. See memorandum entered this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge