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A Horse Divided: Colt's Second Bankruptcy

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A Horse Divided: Colt's Second Bankruptcy¹

Samuel C. Louderback

Preston D. Matthews

Joshua R. Nunnally

¹ See also Thomas Scheffey, *A Horse Divided: The Colt's Bankruptcy Saga*, CONN. LAW TRIB., December 28, 1992.

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PART I: HISTORY OF COLT

Chapter 1: Introduction

In 1836, Sam Colt invented a revolver mechanism that allowed a gun to be fired multiple times without reloading.² Supposedly, his idea for the revolving cylinder came from watching the wheel of the ship during his time as a sailor.³ Soon after he founded the company, Sam Colt began a long-standing relationship with the United States government, which ordered 1,000 Colt revolvers for the Mexican War in 1846.⁴ Building on this early success, Colt set up a new factory in Hartford, Connecticut, and business expanded rapidly.⁵

By the time the Civil War began in 1861, Sam Colt had made the Colt Revolver a world-renowned firearm.⁶ Sam Colt died on January 10, 1862, but left behind a fortune estimated at \$15 million dollars. His wife Elizabeth Root was appointed President of the company.⁷ In 1901, the company was sold by the Colt family to a group of investors based in New York and New England who continued the company's successes.⁸ Under new leadership, Colt expanded the business further, making the Colt .45 the standard firearm used by American troops in both World Wars.⁹ Naturally, government orders drastically decreased following the end of World War II, and by the mid 1950's the

² <http://www.history.com/topics/inventions/samuel-colt>.

³ http://www.netstate.com/states/peop/people/ct_sc.htm.

⁴ <http://www.history.com/topics/inventions/samuel-colt>.

⁵ <http://www.fundinguniverse.com/company-histories/colt-s-manufacturing-company-inc-history/>.

⁶ *Id.*

⁷ <http://www.investors.com/news/management/leaders-and-success/sam-colt-invented-repeating-firearms/>; <http://www.history.com/topics/inventions/samuel-colt>.

⁸ *Id.*

⁹ *Id.*

company was losing money.¹⁰ On the verge of bankruptcy, the company was sold to Penn-Texas Corporation in 1955.¹¹

George A. Strichman became president in 1962 and immediately decided to redefine the company's image.¹² In an attempt to better organize the company, Colt's firearm subsidiary was named Colt's Inc. in 1964, which led to a narrowing of products and markets.¹³ This reorganization, coupled with a business boom during the Vietnam War, led to several acquisitions that resulted in a doubling of the company's earnings per share in just two years.¹⁴ The company continued its trajectory of growth over the next decade, even while the economy slowed between 1973 and 1977. In 1977, a government investigation on Colt's involvement in the black market slowed business for a short while.¹⁵

During the 1970's, Colt found itself involved in the black market for guns, which led to a one-year prison sentence for one Colt employee.¹⁶ The company reportedly sent small shipments to dummy firms in areas like Botswana, Greece, West Germany, and the Canary Islands.¹⁷ These shipments were then redirected to South Africa.¹⁸ Upper management claimed that they had no knowledge of the illegal activity, and attempted to

¹⁰ *Id.*

¹¹ *Id.*

¹² <http://www.encyclopedia.com/doc/1G2-2840500166.html>.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ https://books.google.com/books?id=qgYAAAAAMBAJ&pg=PA16&lpg=PA16&dq=In+1977+Colt++and+%22illegal%22+arms+and+ammunition+sales+to+and+%22South+Africa%22&source=bl&ots=ipOzkdl4HT&sig=Gku_8g7lN_Sf6nq15oYYd1bSM-U&hl=en&sa=X&ved=0ahUKEwjn94Hi_KAhWCKB4KHS1vB7QQ6AEIMDAD#v=onepage&q=colt&f=false.

¹⁷ *Id.*

¹⁸ *Id.*

avoid liability by placing the blame on several employees.¹⁹ Concurrently, the U.S. government ceased all orders of the M16, though there is no “official” connection between the two events.²⁰

The loss of the government contract forced the company to make serious cuts. In 1982, despite having just completed a \$100-million-dollar on-site improvement, the company closed down one of its major divisions, which employed 4,500 workers.²¹ Though the division represented nearly 25% of Colt’s total sales, it experienced a loss of nearly \$62 million from the previous year.²²

Troubles continued for the company in 1986, when 1,100 workers went on strike at plants in Hartford.²³ This strike became the longest of its kind in Connecticut history.²⁴ The dispute arose over wages and benefits, and the National Labor Relations board alleged that Colt engaged in unfair practices, such as threatening workers with the loss of jobs.²⁵ After four years of grueling strikes, the company reached a settlement. The settlement included paying \$13 million in back pay, a 13% wage increase, and stock representing 11.5% of the company to Colt employees.²⁶ The settlement with the union employees came on the heels of a leveraged buyout by private investors, and Colt was renamed Colt’s Manufacturing Company.²⁷ However, just over a year later, the company

¹⁹ <http://www.encyclopedia.com/doc/1G2-2840500166.html>.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ <https://news.google.com/newspapers?nid=2245&dat=19890124&id=kJozAAAIBAJ&sjid=lTIHAAAIBAJ&pg=5213,2749982&hl=en>.

²⁴ *Id.*

²⁵ <http://www.nytimes.com/1986/10/11/nyregion/after-8-months-uaw-sees-shift-in-colt-strike.html>.

²⁶ *Id.*

²⁷ <http://www.nytimes.com/1992/03/20/business/colt-s-in-bankruptcy-court-filing.html>.

requested that workers take a 10% pay-cut as the company hit a new low.²⁸ The company knew it was headed towards bankruptcy the moment the deal was struck to end the strike.²⁹

²⁸ http://articles.courant.com/1992-03-20/news/0000204348_1_connecticut-development-authority-colt-s-colt-industries.

²⁹ *See*. http://articles.courant.com/1994-09-17/news/9409202111_1_colt-connecticut-development-authority-preferred-stock (“The deal, according to the company officials, left [Colt] so deep in debt that the firearms maker stood little chance of survival. Losses mounted quickly, and within two years the company was in bankruptcy”).

Chapter 2: Colt's First Chapter 11 Bankruptcy

In 1992, with commercial sales already in decline, government sales dropped off after the Gulf War suddenly ended. The quick ending to the war left Colt in disarray; the only feasible option was for the company to file for Chapter 11 bankruptcy. Industry experts attributed the bankruptcy to excessive debt, loss of military orders, and outdated revolvers that did not appeal to consumers.³⁰ The company had assets of \$91.5 million, liabilities of \$85.5 million, and employed around 925 people.³¹ During the late 1980's and early 1990's Colt fell behind in creating weapons that fit the needs of modern gun users.³² As a result, even the local Hartford police department looked elsewhere for their firearms, crediting the absence of a product to fit their needs.³³ In order to keep the company running (and refrain from any further loss of jobs) the Connecticut Development Authority and Australian Bank extended a \$10 million line of credit to Colt.³⁴ This gave the state of Connecticut majority ownership of the company while the reorganization was being worked out.³⁵ Only two years prior, the state had invested \$25 million and Australian Bank lent more than \$35 million to a group of investors to help purchase the company.³⁶

While the 1992 bankruptcy was supposed to be a quick process, Colt faced major hurdles over the name of the company and the patents being separated out of the company in the 1990 buyout.³⁷ In 1990, Colt had entered into a complicated buyout that consisted of private investors, union employees, and the Connecticut State Employees'

³⁰ <http://www.nytimes.com/1992/03/20/business/colt-s-in-bankruptcy-court-filing.html>.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ http://articles.courant.com/1993-08-28/business/0000005447_1_colt-connecticut-development-authority-bankruptcy-filing.

Pension fund.³⁸ One part of the private investors consisted of a group that later opposed the 1992 bankruptcy.³⁹ As part of the buyout, Colt entered into a financial agreement with this group where Colt used the rights to its name as leverage to secure the deal.⁴⁰ After Colt entered bankruptcy, the group argued that the Colt name was not part of the security for the financial agreement, but had instead been sold to them, thus Colt should pay them to use the name.⁴¹ In fact, in the years leading up to the 1992 bankruptcy, Colt seemed to indicate that the claims by the investors were correct.⁴² In order to resolve the issue, the state of Connecticut stepped in and purchased the name rights for \$10 million, which they then turned over to the Company in exchange for preferred stock.⁴³

After 31 months in Chapter 11, U.S. Bankruptcy Judge Robert L. Krechevsky confirmed Colt's fifth amended plan of reorganization, ending what he called "the most complicated reorganization effort" he had seen in the 16 years he had been there.⁴⁴ As a result of the plan, Colt was taken over by a partnership led by Zilkha & Co., a New York financial advisory and investment firm (and formerly one of the biggest banking empires in the Middle East) run by Donald Zilkha.⁴⁵ The partnership paid approximately \$27 million for 85 percent of Colt and assumed an additional \$27 million in liabilities.⁴⁶ With

³⁸ Colt Overview

³⁹ http://articles.courant.com/1993-08-28/business/0000005447_1_colt-connecticut-development-authority-bankruptcy-filing.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² http://articles.courant.com/1993-10-31/news/0000002683_1_connecticut-development-authority-sam-colt-unsecured-creditors/3.

⁴³ http://articles.courant.com/1994-09-17/news/9409202111_1_colt-connecticut-development-authority-preferred-stock.

⁴⁴ *Id.*

⁴⁵ *Id.*; <http://www.newsweek.com/unmaking-gunmaker-158053>.

⁴⁶ http://articles.courant.com/1994-09-17/news/9409202111_1_colt-connecticut-development-authority-preferred-stock

the takeover, the majority of the creditors received around \$0.50 for every dollar owed, a rather generous deal for many of the unsecured creditors.⁴⁷ However, the state pension fund, which had previously invested \$25 million in 1990, received only \$4.3 million on account of its claims.⁴⁸

⁴⁷ *Id.*

⁴⁸ *Id.*

PART II: COLT'S SECOND BANKRUPTCY

Chapter 3: The Lead up to the Second Bankruptcy

Twenty years after it came out of its first bankruptcy case, Colt found itself in very familiar territory. On June 14, 2015 Colt announced it had filed for protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.⁴⁹ Colt's Chief Restructuring Officer, Keith A. Maib, filed a concurrent report with the petition explaining Colt's path to bankruptcy.⁵⁰ Maib was brought in ahead of the bankruptcy on March 11, 2015 from Mackinac Partners LLC, an accounting firm.⁵¹ He had a history of serving as a restructuring officer with other companies facing the same fate.⁵² When Maib first came on the job, Colt attempted to shop around a prepackaged Chapter 11 plan of reorganization (which was later amended), but the voting deadline on the plan expired on June 12, 2015 with insufficient acceptances, forcing Colt to file for relief in bankruptcy court without a plan accepted by the classes necessary for confirmation.⁵³ Maib stressed the importance of finding a quick resolution as the company had become increasingly worried about meeting the demands of the U.S. Government, which made up approximately 40% of Colt's revenue.⁵⁴

Maib further explained that if a quick resolution was not reached, the only alternative was a Chapter 7 bankruptcy, which would have a substantial impact on the tax revenue of the city of Hartford, Connecticut, including the loss of about 800 jobs.⁵⁵

⁴⁹ <http://www.colt.com/Media/PressReleases/tabid/252/articleType/ArticleView/articleId/132/Colt-Defense-Announces-Fast-Track-Restructuring.aspx>.

⁵⁰ Maib Report

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

Generally, a company as large and historic as Colt will take every effort to avoid Chapter 7 liquidation, opting instead for the flexibility of Chapter 11.

As with many companies that are forced into Chapter 11 bankruptcy, Colt had a highly over-leveraged capital structure. This made a section 363 sale especially appealing.⁵⁶ According to Maib, the company's capital structure was as follows: a \$72.9 million term loan that was secured by a first lien on intellectual property and a blanket second lien on all other assets, a \$35 million senior loan secured by a second lien on the intellectual property and a blanket first lien on all other assets, and \$250 million in 8.75% Senior Notes due in 2017.⁵⁷ Colt's debt issues, and its inability to pay them, started in 2014 after what Maib described as a sales bubble the year before, caused by fears of increased gun regulation.⁵⁸

While this may have been true, Colt was trending in the opposite direction of almost every other gun manufacturer in America.⁵⁹ Just a few months after Colt filed bankruptcy, two of their competitors, Smith & Wesson and Sturm Ruger, saw soaring profits and overall gain.⁶⁰ Unlike these companies, who were heavily focused on civilian consumers, Colt's ownership (led by Donald Zilkha) focused only on military and private contracts.⁶¹ Zilkha sold a portion of the company to the private equity firm Sciens Capital Management ("Sciens") in 2005—where Zilkha was the managing partner—which

⁵⁶ *Id.* See Chapter 6 for more information about § 363 sales.

⁵⁷ *Id.* Senior notes are priority unsecured loans that must be paid upon a bankruptcy. They have priority over all other unsecured loans. <http://www.investopedia.com/terms/s/seniornote.asp>.

⁵⁸ Maib Report. Anecdotally, this is a pattern that repeats itself in the gun industry. A shooting incident or incidents occur, the media, sections of the public, and politicians cry for gun control, and gun owners and enthusiasts, worried that access to fire arms and ammunition may be curtailed, pull demand forward, buying guns and ammunition widely. Gun control legislation then fails due to political headwinds, and sales slump.

⁵⁹ <http://www.bloomberg.com/news/articles/2015-12-07/smith-wesson-soars-to-highest-in-2007-on-gun-control-talk>.

⁶⁰ *Id.*

⁶¹ <http://www.investopedia.com/articles/markets/071315/why-colt-went-out-business.asp>.

resulted in an additional \$300 million in debt that Colt agreed to take on as part of the deal.⁶² Sciens furthered the goal of focusing on government contracts by creating a separate unit for defense and letting the consumer division slack, which resulted in Colt entering into an agreement to borrow \$150 million in what they classified as a leveraged recapitalization.⁶³ By 2009, Colt was forced to borrow an additional \$250 million.⁶⁴ As a result of its governmental focus, any loss of government contracts would be extremely detrimental to the company.

In fact, that fear is exactly what played out; it was not the burst of a commercial sales bubble in 2013 that led to the 2014 sales drop, but instead was the loss of a \$77 million contract with the U.S. military.⁶⁵ After the loss of the contract, Colt attempted to refinance its secured debt. Colt was able to expand a current loan through a new term loan on November 17, 2014.⁶⁶ This refinancing allowed the company to make an interest payment that was due to its Senior Note holders. Unfortunately, the company's finances did not improve after taking on the additional debt.⁶⁷ In order to combat their ever-growing debt problems, instead of attempting to pay down the debt already owed, Colt entered into a new Credit Agreement on February 9, 2015. This agreement removed the covenants that had previously restricted the amount the company could borrow.

After this agreement, management realized they needed to act quickly to resolve the financial issues that Colt faced.⁶⁸ They attempted to put together a prepackaged Chapter 11 plan for the Senior Noteholders in May, which was firmly rejected.⁶⁹

⁶² *Id.*; <http://www.bloomberg.com/research/stocks/private/person.asp?personId=197777&privcapId=165444>.

⁶³ <http://www.bloomberg.com/news/articles/2014-05-29/colts-curse-gunmakers-owners-have-led-it-to-crisis-after-crisis>.

⁶⁴ <http://www.investopedia.com/articles/markets/071315/why-colt-went-out-business.asp>.

⁶⁵ *Id.*

⁶⁶ Maib Report.

⁶⁷ *Id.*

⁶⁸ *Id.*

After a second amended prepackaged plan was rejected, Colt sought out PWP Weinberg Partners to begin preparation for a section 363 sale by preparing a list of potential buyers.⁷⁰ Maib listed the following reasons that Colt should enter an accelerated section 363 sale:

(i) the fragility of the Company's business and the need for a clear path forward for emergence from chapter 11, (ii) a section 363 sale would open the process to widespread parties bidding from any interested party, including strategic and financial buyers, (iii) a section 363 process would focus the parties' efforts towards determining what is the highest and best offer for the Company's business, and (iv) a section 363 process will offer more potential tenant alternatives and creative solutions to the Landlord as a party to the West Hartford Facility Lease.⁷¹

Maib stated that Colt already had approved a stalking horse bidder⁷² in Sciens, who at the time of the Chapter 11 filing owned 87% of the company.

⁶⁹ The prepackaged plan attempted to restructure the senior notes into approximately \$100 million, 10% "junior-priority" senior loans that would become due in 2023. *See* <http://www.colt.com/Media/Press-Releases/articleType/ArticleView/articleId/125/Colt-Defense-LLC-Launches-Restructuring-Transaction>; Maib Report .

⁷⁰ Maib Report.

⁷¹ *Id.*

⁷² *Id.* *See also* <http://www.investopedia.com/terms/s/stalkinghorsebid.asp> (Describing a stalking horse bidder as an entity that the company chooses to make the first initial bid on the company's assets). The goal is to avoid low bids on the company by setting a high (but still realistic) bar for all subsequent bids, ensuring the company will get a competitive offer.

Chapter 4: The Players in the Second Bankruptcy

The Debtor

Colt Defense, LLC is a Delaware limited liability company with its principle place of business in West Hartford, Connecticut.⁷³ On June 14, 2015, each of the ten debtors below filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code.⁷⁴ The cases (collectively, the “Bankruptcy Cases”) were jointly administered under Case No. 15-11296.

Debtor Name	Debtor Case Number
Colt Defense LLC	15-11287
Colt Defense Technical Services LLC	15-11288
Colt Finance Corp.	15-11289
New Colt Holding Corp.	15-11290
Colt International Cooperatief U.A.	15-11291
Colt's Manufacturing Company LLC	15-11292
Colt Security LLC	15-11293
Colt Canada Corporation	15-11294
CDH II Holdco Inc.	15-11295
Colt Holding Company LLC	15-11296

Court and Administrators

The Honorable Laurie Selber Silverstein oversaw the Bankruptcy Cases in the United States Bankruptcy Court for the District of Delaware.⁷⁵ Judge Silverstein received her B.S. from the University of Delaware in 1982 and her J.D. from The National Law Center of The George Washington University in 1985.⁷⁶ Prior to being appointed to the bench in 2015, Judge Silverstein was a partner at the Delaware law offices of Potter

⁷³ <http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=9898968>. Last visited April 25, 2016.

⁷⁴ <http://www.kccllc.net/coltdefense>. Last visited April 25, 2016.

⁷⁵ *Id.*

⁷⁶ <http://www.americancollegeofbankruptcy.com/directory/laurie-selber-silverstein-863>. Last visited April 25, 2016.

Anderson & Corroon LLP, where she led the bankruptcy and corporate restructuring practice.⁷⁷

Andrew R. Vara was the United States Trustee appointed to the case. Mr. Vara received his law degree from the Ohio State University Moritz College of Law and his undergraduate degree from Duke University.⁷⁸ Before joining the U.S. Trustee Program, Mr. Vara clerked for the Honorable Laurence Howard, Chief Judge of the U.S. Bankruptcy Court in the Western District of Michigan.⁷⁹ The U.S. Trustee was represented by Tiiara N. A. Patton of the U.S. Department of Justice.

Attorneys and Firms

Colt was represented by John J. Rapisardi, Peter Friedman, and Joseph Zujkowski of O'Melveny & Myers LLP (primary counsel), and Mark D. Collins and Jason M. Madron of Richards, Layton & Finger PA (local counsel).

The IRS was represented by Charles M. Oberly III and Ellen W. Slight of the U.S. Department of Justice.

Kurtzman Carson Consultants LLC served as the Claims Agent, represented by Albert Kass. Perella Weinberg Partners L.P. acted as Colt's financial advisor and Mackinac Partners LLC acted as its restructuring advisor.⁸⁰ The list of other attorneys and professionals involved in the case is too large to mention.

Unions

The International Union, United Automobile, Aerospace and Agricultural Implement Workers of America and its Local 376 (together, the "UAW") represented

⁷⁷ <http://blogs.wsj.com/bankruptcy/2014/10/20/meet-the-newest-pick-for-the-delaware-bankruptcy-bench/>. Last visited April 25, 2016.

⁷⁸ <https://www.justice.gov/ust/press-releases/andrew-r-vara-appointed-acting-us-trustee-delaware-new-jersey-and-pennsylvania>. Last visited April 25, 2016.

⁷⁹ *Id.*

⁸⁰ <https://www.bloomberglaw.com/document/O47BH0AIH8N5> Shooting Indus: Colt emerges from Chapter 11 bankruptcy. (INDUSTRY NEWS) NS1 — Feb 01 2016 15:55:48. Last visited April 25, 2016.

Colt employees in the dispute over retiree health benefits. The UAW was represented by Susan E. Kaufman of Cooch and Taylor PA and Michael Nicholson of Nicholson Feldman LLP.

Colt Management and Investors

Managers

The following is a list of the management of Colt Defense, LLC.⁸¹

Name	Title
Dennis Veilleux	President/CEO
Scott B. Flaherty	Senior VP/CFO
John Coghlin	Senior VP/Gen Counsel/Secretary
J. Michael Magouirk	Senior VP: Operations/COO
Paul Spitale	Senior VP: Commercial Programs
Kenneth Juergens	Senior VP: Gov & Military Programs
Kevin G Green	Controller

Board Members

The following is a list of the board members of Colt Defense, LLC.⁸²

Name	Primary Company
Daniel Standen	Sciens Capital Management, LLC
Philip Wheeler	Colt Defense LLC
Ioannis Rigas	Sciens International Investments & Holdings S.A.
Charles Guthrie	Lightbridge Corp.
Michael Holmes	Colt Defense LLC
George Casey Jr.	StreetShares, Inc.

Investors

The following is a list of the equity security holders identified by Colt in the bankruptcy petition.⁸³

⁸¹ <https://www.bloomberglaw.com/company/mgmt/533839Z%20US%20Equity>. Last visited April 25, 2016.

⁸² <http://www.bloomberg.com/research/stocks/private/board.asp?privcapId=9898968>. Last visited April 25, 2016.

Name of Holder	Percent of Equity Interest Held
Colt Defense Holding LLC*	62.43%
CDH III LLC*	7.95%
William M. Keys	5.82%
James R. Battaglini	0.38%
Jeffrey J. Grody	1.02%
New Colt Holding Corp. Employee Stock Ownership Plan & Trust	1.19%
Orpheus Holdings LLC	0.81%
Joyce M. Rubino	0.73%
Archer Diversified Investments, LLC	0.58%
Richard Nadeau	0.53%
Donald W. Young	0.33%
Michael P. Reissig	0.42%
Kevin J. Brown	0.26%
John M. Magourik	0.23%
John B. Ibbotson	0.23%
Carlton S. Chen	0.13%
Thomas C. Moore	0.07%
Cirque Investments LLC	0.04%
Colt Defense Holding III LP*	16.76%
Sciens Voting Trust*	0.09%

*Indicates association with Sciens Capital Management

Creditor Committees

The Official Committee of Unsecured Creditors was represented by Todd C. Meyers, Jonathan Polonsky, David M. Posner, and Shane G. Ramsey of Kilpatrick Townsend & Stockton LLP (primary counsel), and Richard M. Beck and Domenic E. Pacitti of Klehr Harrison Harvey Branzburg LLP (local counsel).

Major Creditors

The creditors below represent the thirty largest unsecured claims in the bankruptcy case.⁸⁴

⁸³ See Voluntary Petition.

⁸⁴ See *id.*

Name of Creditor	Nature of Claim	Amount of Claim
Wilmington Trust Company	Bond Debt	\$260,937,500.00
Magpul Industries Corp/	Trade Debt	\$981,537.75
Microbest, Inc.	Trade Debt	\$755,172.85
The Wilson Arms Company	Trade Debt	\$628,530.60
Pricewaterhouse Coopers LLP	Services	\$551,653.00
Schmid Tool & Engineering Inc.	Trade Debt	\$478,066.63
Superior Plating Company	Trade Debt	\$404,200.96
Deloitte Tax LLP	Services	\$398,573.00
ESS Solutions	Trade Debt	\$395,671.52
Light Metals Coloring Co., Inc.	Trade Debt	\$360,967.01
Pioneer Tool Supply Co., Inc.	Trade Debt	\$350,967.77
B.M.L. Tool & Mfg. Corp.	Trade Debt	\$264,472.38
Toth Inc.	Trade Debt	\$233,333.32
Cambridge Valley Machining Inc.	Trade Debt	\$228,555.92
Duz Manufacturing, Inc.	Trade Debt	\$217,845.75
Willis of New York, Inc.	Services	\$203,581.50
Accro-Met, Inc.	Trade Debt	\$193,935.47
Creed Monarch, Inc.	Trade Debt	\$185,161.95
Cantor Colburn LLP	Services	\$165,478.52
Rathbone Precision Mfg.	Trade Debt	\$149,277.91
L-3 Communications EOTech, Inc.	Trade Debt	\$143,356.26
Northern Precision Mfg.	Trade Debt	\$142,078.61
Alphacasting, Inc.	Trade Debt	\$140,102.60
Fidus Systems Inc.	Services	\$139,985.24
Skadden, Arps, Slate, Meagher & Flom LLP	Services	\$130,000.00
Aerial Industries Inc.	Trade Debt	\$129,572.70
U.S. Armament Corp	Trade Debt	\$127,773.56
Bourdon Forge Company, Inc.	Trade Debt	\$127,083.18
Novak Designs Inc.	Trade Debt	\$120,624.14
L.W. Schneider Inc.	Trade Debt	\$119,026.64

Competitors and Potential Buyers

Colt has a variety of competitors in the gun manufacturing space, including names like Heckler & Koch, Smith & Wesson, Springfield Armory, Remington, Winchester, Sig Sauer, and Beretta. However, none of these competitors were ever publicly interested when Colt was looking to sell. Sciens Capital Management, who was the majority owner

of Colt prior to its bankruptcy filing, was initially proposed as a stalking horse bidder, and ultimately hoped to buy Colt in bankruptcy free of its bond debt.

Other Important Characters in and around the Second Bankruptcy Case

NPA Hartford LLC is Colt's landlord at its West Hartford facility. There was a dispute as to the extent of ownership and involvement in NPA Hartford LLC by Sciens Capital Management.

Lewis Machine & Tool and KRL Holding both objected to the Second Amended Plan, and were represented by Michael Busenkell and Brya M. Keilson of Gellert Scali Busenkell & Brown LLC.

Chapter 5: The Start of the Second Bankruptcy and First Day Motions

The Voluntary Petition – Filed June 14, 2015

Colt Holding Company LLC (“Colt”) filed a voluntary petition for Chapter 11 bankruptcy in the Bankruptcy Court for the District of Delaware (the “Delaware Court”) on June 14, 2015.⁸⁵ This filing was done by filling out Official Form 1 of the Delaware Court.⁸⁶ The form itself is a straightforward three pages.⁸⁷ Included with their early filings was a report by Colt’s Chief Restructuring Officer, Keith Maib.⁸⁸ Maib argued that a protracted Chapter 11 could only result in the termination of Colt as a going concern.⁸⁹ His belief was that a quick section 363 sale was the proper way to handle the bankruptcy, and Colt did indeed consider a 363 sale early in the Chapter 11 process.⁹⁰ The 363 sale will be addressed in a later section.

Included with the petition was a consolidated list of creditors holding the 30 largest unsecured claims.⁹¹ The largest unsecured creditor, by a vast majority, was Wilmington Trust Company, with a \$260,937,500 claim.⁹² For comparison’s sake, the next largest claim was just under \$1,000,000, held by Magpul Industries Corp.⁹³ Wilmington’s claim was based upon unsecured bonds with a face amount of \$250 million for which Wilmington was the indenture trustee. These bonds were actually owned by a series of individuals who held the 8.75% senior notes due in 2017. These bondholders

⁸⁵ Voluntary Petition

⁸⁶ *Id.*

⁸⁷ *Id.*, Colt estimated on the form that they had less than \$50,000 in assets and liabilities, would have assets to distribute to unsecured creditors, and had less than fifty creditors.

⁸⁸ Maib Report.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

were organized as an Ad Hoc Consortium (the “Consortium”). When one creditor has such a dominating share of the unsecured debt, they can attempt to use their position to leverage the other unsecured creditors and the debtor into providing them with favorable treatment.

The United States Trustee appointed an official committee of unsecured creditors on June 25, 2015.⁹⁴ Unsurprisingly, Wilmington Trust was on the committee, along with MagPul Industries Corporation, Stephen Nyhan and Jeana Walker-Nyhan, the International Union of United Auto Workers, and the Pension Benefit Guaranty Corporation.⁹⁵

First Day Motions

Colt filed several first day motions with their bankruptcy petition or shortly thereafter. A “first day motion” is a motion filed at the beginning of the bankruptcy proceeding, often on the same day as the petition. Almost every Chapter 11 bankruptcy will have first day motions. Many first day motions are basic formalities that help set up the initial structure of the bankruptcy and establish who the players in the bankruptcy will be.⁹⁶ Others can create battles where the parties fight to establish their initial territory, and such motions can have long-term effects on the outcome of the bankruptcy. A prudent debtor might use first day motions to establish a favorable position from the beginning of the bankruptcy.⁹⁷

The overarching goal of first day motions is to allow the debtors to continue operating effectively from the initiation of the bankruptcy, as well as lessening the

⁹⁴ Appointment of Creditors Committee.

⁹⁵ *Id.*

⁹⁶ For example, a Motion for *Pro Hac Vice* Admission to bring in out-of-state attorneys, or a motion to consolidate several subsidiary bankruptcies into the bankruptcy of the parent entity.

⁹⁷ For more detailed information on first day motions, see Landress, Sanford R., *First Day Motions: Perils and Possible Pitfalls, An Overview of First-day Motions*, available at <http://trace.lib.utk.edu/assets/Kuney/Borders/note153.pdf>.

administrative burden of Chapter 11. Often this means allowing the debtor to make payments on prepetition debts or seek financing arrangements for their post-petition business. The motions may also allow the debtor to maintain their cash flow, utilities, supply chain, vendors, financing, payments, and other administrative details included in ordinary business operations. These are especially important if the business wants to continue as a going concern.

The structure of the Bankruptcy Code itself leads to the filing of first day motions. Colt is a “debtor in possession” or “DIP,” that is, they are a debtor that has retained control of their own operations. Upon filing for bankruptcy, Bankruptcy Code § 362 automatically applies to “freeze” all of the debtor’s assets in the bankruptcy estate. This is known as the “automatic stay.” With some exceptions, the stay stops all actions to collect upon claims against the debtor that accrued before the bankruptcy was filed.⁹⁸ Thus, prepetition claimants may only seek relief within the bankruptcy, and the debtor is prohibited from paying prepetition claims except with court approval.

Based on these restrictions, it makes sense that the DIP would need to move the court to enable it to pay necessary claims for the continuation of its business. If the restrictions were applied absolutely, no DIP could reasonably run their business. The DIP would not be able to pay employee wages, utilities, or other business expenses. Thus, the first day motions allow the DIP to engage in the necessary transactions to maintain the value of the business. However, under Federal Rule of Bankruptcy Procedure 6003, the bankruptcy court does not consider motions filed within twenty days after the filing of a Chapter 11 petition “except to the extent necessary to avoid immediate and irreparable harm.” Thus, in order to receive immediate relief, the DIP must show why it would suffer irreparable harm if relief were delayed in order to be successful on their first day motions. Below, we analyze the major first day motions filed by Colt, their purpose, and their effects.

⁹⁸ Bankr. Code § 362.

Motion to Act as Foreign Representative

Colt filed several first day motions with their bankruptcy petition. Included was a motion for Colt to act as the foreign representative “on behalf of any of the Debtors’ estates in any judicial or other proceeding in any foreign country, including Canada.”⁹⁹ Importantly, this would grant Colt the ability to control the bankruptcy fate of Canadian corporation and Colt subsidiary Colt Canada Corporation. This request was approved by order on June 16, 2016.¹⁰⁰

Motion Requesting Joint Administration

Colt also filed a motion requesting joint administration of the Chapter 11 cases of all of Colt’s affiliated debtors and debtors in possession (collectively, the “Debtors”) under Colt’s case number.¹⁰¹ Colt and its affiliated Debtors continued to manage and operate their business as debtors in possession pursuant to Bankruptcy Code §§ 1107(a) and 1108.¹⁰² United States Bankruptcy Judge Laurie Selber Silverstein granted Colt’s motion requesting joint administration on June 16, 2015.

This order was critical due to the structure of Colt. Colt is actually split into many smaller subsidiary entities held by a parent entity, Colt Holding Company LLC.¹⁰³ In order to ensure an effective bankruptcy, Colt needed to be able to bring their entire umbrella of entities into the bankruptcy estate. Generally this type of motion will be granted because it is in the interest of the debtor and the creditors. The debtor is able to

⁹⁹ Motion to Act as Foreign Representative.

¹⁰⁰ Order.

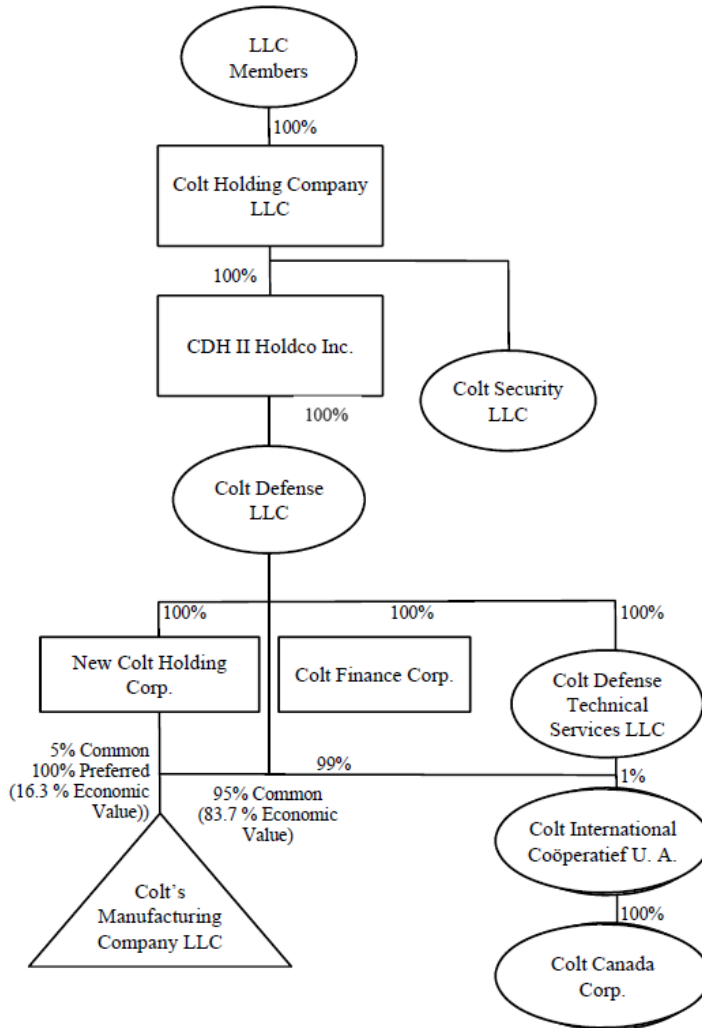
¹⁰¹ Motion for Joint Administration: “Colt Holding Company LLC directly or indirectly owns 100% of the stock or membership interest in the other nine Debtors.” Affiliated entities include Colt Security LLC, Colt Defense LLC, Colt Finance Corp., New Colt Holding Corp., Colt’s Manufacturing Company LLC, Colt Defense Technical Services LLC, Colt Canada Corporation, Colt International Cooperatief U.A., and CDH II Holdco Inc.

¹⁰² *Id.*

¹⁰³ *See generally* Colt Organizational Structure as of June 14, 2015, *infra*.

more efficiently administer their bankruptcy, rather than having to make separate filings for each and every corporation. For the creditors, savings in terms of reduced administrative expenses means there will be more value to fulfill their claims. The following chart illustrates the Colt subsidiary structure.¹⁰⁴

COLT ORGANIZATIONAL STRUCTURE AS OF JUNE 14, 2015



Motions to Maintain Colt as a Going Concern

Many of Colt's first day motions were aimed at allowing Colt to maintain payment of ordinary course of business prepetition claims. These included a motion to maintain bank accounts,¹⁰⁵ a motion to pay critical trade vendor claims,¹⁰⁶ a motion to

¹⁰⁴ <http://chapter11dallas.com/colt-bankruptcy/>. Last visited April 18, 2016.

¹⁰⁵ Motion to Maintain Bank Accounts.

pay sales and use taxes,¹⁰⁷ a motion prohibiting utilities from discontinuing services,¹⁰⁸ a motion to pay employee wages,¹⁰⁹ and several motions to appear *pro hac vice*¹¹⁰ by attorneys seeking to work on the case who are not licensed in Delaware. Each of these motions were filed the day after the petition was filed.¹¹¹ Many of these motions are fairly common for a DIP to file. They are discussed in more detail below.

Motion to Maintain Bank Accounts

Colt's motion to maintain bank accounts sought to allow Colt to continue using their own "centralized Cash Management System" and bank accounts, while waiving "certain bank account and related requirements of the Office of the United States Trustee," to continue their deposit practices under the Cash Management System, to extend their time to comply with section 345(b) of the Bankruptcy Code, and to authorize the DIP to continue Intercompany Transactions.¹¹² This motion was granted by order the day after its filing. This order gave Colt the authority to make changes to maintain, use, change, open or close bank accounts, and to maintain, use, and alter their Cash Management Plan. Importantly, the order also gave banks explicit permission to work with the DIP. Colt was further excused from the U.S. Trustee requirement that they close all existing bank accounts and open new DIP accounts. However, Colt had to notify the U.S. Trustee and other parties if they wished to open another account. This order also

¹⁰⁶ Motion to Pay Critical Vendor Claims.

¹⁰⁷ Motion to Pay Sales and Use Taxes.

¹⁰⁸ Motion Prohibiting Utilities from Discontinuing Services.

¹⁰⁹ Motion to Pay Employee Wages.

¹¹⁰ For example, Motion to Appear Pro Hac Vice.

¹¹¹ Each of these first day motions is supported by the contemporaneously filed Maib Report. The goal of the Maib Report, in this respect, is to show why these motions are necessary to prevent immediate and irreparable harm.

¹¹² Motion to Continue Use of Cash Management System and Bank Accounts.

waived the notice requirement upon the sale, use, or lease of property under Bankruptcy Code § 6004(a). Finally, Colt was given a 60-day extension to comply with § 345(b) of the Bankruptcy Code.¹¹³

Motion Authorizing the Debtors to Pay Prepetition Claims of Critical Vendors

One of the most important motions for a DIP like Colt is the motion authorizing the debtors to pay prepetition claims of critical vendors. Without vendor parts, Colt's entire supply chain could fall apart, causing massive damage to their ability to operate as a business while in bankruptcy, and eliminating the company's value. Indeed, in their motion Colt argued that failure to pay vendor claims might lead critical vendors to "cease providing goods and services to the Debtors or otherwise take action to impede the Debtors' restructuring."¹¹⁴ They further argued that paying critical vendors was "necessary to operate and restructure their business as a going concern and to maximize value for all creditors."¹¹⁵ This is especially concerning for Colt because many of their customers are national militaries. These entities require prompt and timely satisfaction of their purchase contracts, or else the contracts will be lost. Without a successful supply chain, Colt would be doomed. Anticipating these difficulties, the court granted Colt's motion the day after its filing.¹¹⁶ Included in the order was a \$6.8 million cap on Colt's payment to critical vendors.¹¹⁷ The order also allowed Colt to condition payment of critical vendor claims on the execution of a trade agreement, in order to ensure a critical

¹¹³ Bankruptcy Code section 345(b) requires that any estate funds invested by the United States Trustee in an entity must be secured by a bond from that entity in favor of the United States, secured by the undertaking of a corporate surety approved by the United States trustee for the district in which the case is pending; and conditioned on— (i) a proper accounting for all money so deposited or invested and for any return on such money; (ii) prompt repayment of such money and return; and (iii) faithful performance of duties as a depository; or the deposit of securities of the kind specified in section 9303.

¹¹⁴ Motion to pay critical vendors.

¹¹⁵ *Id.*

¹¹⁶ Order on Motion to Pay Critical Vendors.

¹¹⁷ *Id.*

vendor's continued performance, or in their business judgment to forgo a trade agreement where they believe it is unnecessary to ensure a critical vendor's continued performance. With this order in place, Colt's supply chain was able to remain stable, allowing their continued generation of value.

Motion to Pay Employee Wages

Not surprisingly, one of the necessary prepetition obligations the DIP needs to pay is employee wages. Colt motioned to be able to pay both their employees and independent contractors.¹¹⁸ This motion often includes (and in this case does include) the ability to pay all employment, unemployment, Social Security, employment insurance (Colt Canada), and federal, state, provincial, and local taxes, and to make payroll deductions including to employee benefit plans, garnishments, and other voluntary deductions.¹¹⁹ At the time of filing, Colt employed approximately 729 employees. Over 400 of those workers were represented by United Automobile, Aerospace and Agricultural Implement Works of America, more commonly known as UAW. Clearly, it was critical for Colt as a going concern to be able to continue to pay their employees.

Motion to File Consolidated List of Creditors

Colt also motioned for the court to allow Colt to file a consolidated list of creditors for all of the affiliated entities in the Colt bankruptcy.¹²⁰ In Delaware, Local Rule 2002-1(f)(v) "requires each debtor, or its duly retained agent, in jointly administered cases to maintain a separate creditor mailing matrix."¹²¹ Colt successfully argued that separating the creditors into separate matrixes per each debtor was overly burdensome.¹²²

¹¹⁸ Motion Authorizing the Debtors to Pay Employee Wages.

¹¹⁹ *Id.*

¹²⁰ Motion to File Consolidated List of Creditors.

¹²¹ *Id.*

¹²² Order; Order granted June 16, 2015.

The Order required Colt to keep the consolidated debtor list available in readable electronic form.

Motion to Maintain and Renew Prepetition Insurance

Colt motioned for an order authorizing the Debtors to maintain and renew their prepetition insurance policies and to pay prepetition insurance policies.¹²³ The court granted this motion by order dated July 10, 2015.¹²⁴ The amount of prepetition insurance obligation payments was limited to \$205,000.¹²⁵

Motion to Allow the Debtors to Obtain Post-Petition Financing

Perhaps the most complex first day motion was Colt's motion to allow the debtors to obtain post-petition financing.¹²⁶ Colt sought to obtain post-petition financing in the amount of \$20 million. Colt claimed in the motion that the \$20 million in new liquidity was necessary to ensure their continued business while they pursued a section 363 sale.¹²⁷ According to the Maib Report, Colt's "available and projected Cash Collateral [was] insufficient to fund their operations, the credit to be provided under the DIP Facilities [was] necessary to preserve the value of the Debtors' estates for the benefit of all stakeholders."¹²⁸ The new secured debt Colt sought was actually from Colt's prepetition secured lenders. Colt argued the transaction was arms-length and that they sought third-

¹²³ Order. In the Motion, Colt requested to be able to maintain, supplement, amend, extend, renew or replace their prepetition insurance policies as needed in their business judgment. The business judgment rule limits the liability on corporate boards of directors for making rational but risky business decisions. For more on the business judgment rule in Delaware, see <http://global.blogs.delaware.gov/2015/04/09/delawares-business-judgment-rule-international-variations/>.

¹²⁴ Order.

¹²⁵ *Id.*

¹²⁶ Motion Authorizing Debtors to Obtain Post-petition Financing.

¹²⁷ Colt's attempted section 363 sale will be discussed in a later section.

¹²⁸ Maib Report.

party creditors to potentially find their needed loans.¹²⁹ The proposed loan structure was split between a “Senior DIP Facility” in the amount of \$6.66 million and a “Term DIP Facility” in the amount of \$13.33 million.¹³⁰

Unlike the other first day motions, Colt met harsh opposition to its financing motion. Colt’s largest unsecured creditor, the Ad Hoc Consortium of bondholders, submitted an objection to Colt’s proposed post-petition financing plan.¹³¹ In the objection, the bondholders argued they had proposed a financing plan that was more suited to Colt’s needs.¹³² The terms of their proposal included \$55 million in DIP financing funded by the bondholders themselves in a superpriority secured loan, which would prime the Secured Creditors that were willing to lend the \$20 million in post-petition financing sought by the debtors.¹³³ The bondholders argued their proposal afforded Colt much more flexibility and the ability to navigate Chapter 11 while keeping their business as a going concern.¹³⁴

At this point, it is important to highlight the battle between the Consortium and major Colt stakeholder Sciens Capital Management LLC (“Sciens Capital”). The bondholders argued that the \$20 million arrangement would lead to a “speedy sale” to Sciens Capital.¹³⁵ This led to the bondholders putting forward the financing package referenced in the objection. The bondholders alleged Sciens Capital was a large

¹²⁹ Motion Authorizing Debtors to Obtain Post-petition Financing.

¹³⁰ *Id.* The motion includes the entirety of the terms of the loan, and is an interesting example of a complex business loan proposal.

¹³¹ Objection to the DIP Motion and Response to the Debtors’ Allegations Regarding the Ad Hoc Consortium.

¹³² The proposal is supported by the Declaration of Steven P. Levine in Regards to Alternative Debtor in Possession Financing Proposal (the “Levine Declaration”).

¹³³ Objection to the DIP Motion and Response to the Debtors’ Allegations Regarding the Ad Hoc Consortium.

¹³⁴ *Id.*

¹³⁵ Randles, Jonathan, *Colt Bondholders Object to Speedy Sale of Gun maker*, June 22, 2015, Law 360.

contributing factor to Colt declaring bankruptcy by claiming Colt's tax and cash benefits for itself instead of reinvesting those assets into Colt.¹³⁶ These dueling parties eventually came to a consensual financing deal.

The battle and resulting agreement between the DIP and the Consortium was addressed by the court on July 24, 2016.¹³⁷ Ultimately, the DIP was authorized to acquire an increased amount of \$75 million in post-petition financing, with the Senior DIP Facility in the amount of \$41.67 million and the Term DIP Facility in the amount of \$33.33 million.¹³⁸ The court agreed with both Colt and the Consortium that Colt needed more working capital to maintain their business as a going concern.¹³⁹ The court concluded that the DIP proposed financing was a fair and reasonable course of financing and that no credit was available on more favorable terms.¹⁴⁰ The Consortium was not successful in their objection. As a practical matter, both the Senior and Term DIP Facility were granted both senior secured liens and superpriority claims.¹⁴¹ The superpriority claims were positioned at the top tier of administrative expenses. Essentially, these claims were above all of the unsecured creditors, sitting just below the secured creditors in order of priority. As far as the secured liens, the DIP Facilities were placed at the top of the totem pole as far as priority in the bankruptcy estate.

Finally, the order authorized Colt to use their cash collateral. However, any credit under the DIP Facilities and cash collateral must be used in accordance with the DIP Facility documents and an agreed to budget between Colt and the Senior and Term DIP.

¹³⁶ *Id.*

¹³⁷ Order Allowing Post-petition Financing.

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

Chapter 6: The Proposed § 363 Sale

An Overview

As mentioned previously, Keith Maib, Colt's Chief Restructuring Officer, believed the only sensible path forward for Colt was a § 363 sale.¹⁴² Maib reached this conclusion after Colt undertook a series of failed refinancing efforts compounded by an inability to convince the senior noteholders to restructure their bonds.¹⁴³ Colt wanted to push through a pre-packaged Chapter 11 plan that would restructure the Senior Notes and delay millions of dollars of payments in bond maturities.¹⁴⁴ After their first attempt at restructuring failed, Colt finalized a restructuring support agreement to propose to the bondholders. This plan offered the bondholders new debt in return for a delay in the maturity of the bonds.¹⁴⁵ The bondholders did not accept the restructuring agreement and the parties remained in stasis.¹⁴⁶

In the face of this deadlock, Colt directed PWP Weinberg Partners¹⁴⁷ to prepare a list of potential buyers for the company's assets.¹⁴⁸ As noted in the introduction, Colt had a ready-made "stalking horse bidder" in Sciens Capital Management LLC, a company that already owned 87% of the outstanding Colt shares.¹⁴⁹ Sciens wanted a quick, pre-packaged bankruptcy with a § 363 sale in which they acted as a stalking horse bidder,

¹⁴² Maib Report.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ PWP Weinberg Partners is an advisory and asset management firm.

¹⁴⁸ Maib Report.

¹⁴⁹ *Id.*

with their floor offer being the assumption of certain senior Colt debt.¹⁵⁰ The bondholders vehemently opposed Sciens' plan, even alleging that there was "an awful lot of bad stuff going on" with Colt and Sciens' relationship.¹⁵¹ The bondholders believed that Sciens was essentially draining Colt of its financial viability, enabled by a lack of responsible corporate governance.¹⁵² In the end, the parties could not come to an agreement and the proposed § 363 sale never materialized.

What is a § 363 Sale?

At this point, it is necessary to explore a general overview of a § 363 sale under the Bankruptcy Code. A § 363 sale authorizes the trustee or DIP to "use, sell, or lease" property of the estate.¹⁵³ Generally speaking, the DIP may continue to operate their business normally, including sales of assets (the bondholder's original plan), without notice or a hearing, in the ordinary course of business.¹⁵⁴ If the trustee or DIP decides to "use, sell, or lease" property other than in the ordinary course of business, there must be notice and a hearing, meaning simply notice plus the opportunity to be heard.¹⁵⁵

Where substantially all of the company's assets are being sold, courts prefer a public sale.¹⁵⁶ This helps fulfill the goal of finding the true, bona fide highest bidder for the estate assets. Typically, the court issues an order to confirm the validity of the sale.

¹⁵⁰ <https://advance.lexis.com/document/index?crd=ff739251-7144-477d-abac-d5835600b70a&pdpermalink=c5b25bfc-6206-4862-9f72-ddc78a732dc4&pdmfid=1000516&pdisurlapi=true>.

¹⁵¹ *Id.* This statement was made by the bondholder's attorney, Robert J. Stark, of Brown Rudnick LLP, in court.

¹⁵² *Id.*

¹⁵³ Bernstein, Michael L. and Kuney, George W., *Bankruptcy in Practice*, American Bankruptcy Institute (5th Ed. 2015).

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

Though the Bankruptcy Code does not have an express procedure for § 363 sales, there is a procedure that has developed as a matter of practice.¹⁵⁷ Generally, the debtor will shop its assets to a buyer, who will enter into a purchase contract subject to higher bidders.¹⁵⁸ Bidding procedures are usually established by the debtor’s motion. This motion protects the initial bidder, known as the “stalking horse,” from the risk of higher bidders.¹⁵⁹ Without these protections, there would be little incentive for a bidder to become the “stalking horse.”¹⁶⁰

These § 363 plans can be subject to scrutiny, but as long as there is stakeholder protection, adequate disclosure, reasonable opportunity for creditor investigation, open opportunity for the highest bidding, and reasonable marketing, the court will uphold the § 363 sale as a bona fide sale.¹⁶¹ Entities are often motivated to seek this avenue because it can be much quicker and cheaper than a bankruptcy.

Why the § 363 Plan Failed

The failure of the pre-packaged bankruptcy and proposed § 363 plan can be traced to the central conflict between Sciens Capital and the senior noteholders. The senior noteholders vehemently opposed the idea of Sciens Capital taking control of Colt after the bankruptcy.¹⁶² Crucially, they did not believe they would be adequately protected if Sciens were to take control of Colt.¹⁶³ The bondholders claimed Sciens had veto power

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* Typically the stalking horse will get a “breakup fee” if their purchase contract falls through, ordinarily 3 percent of the purchase price.

¹⁶¹ *Id.*

¹⁶² <https://advance.lexis.com/document/index?crd=ff739251-7144-477d-abac-d5835600b70a&pdpermalink=c5b25bfc-6206-4862-9f72-ddc78a732dc4&pdmfid=1000516&pdisurlapi=true>.

¹⁶³ *Id.*

over any meaningful decision made by the Colt board and officers.¹⁶⁴ This bad blood between Sciens and the senior noteholders began with the inability to reach an agreement on a pre-packaged Chapter 11 plan. Essentially, by this point the senior noteholders had their heels dug in, refusing to acknowledge any plan that placed Sciens in a position of greater power.

With the senior noteholders holding to their position, Colt had no choice but to enter into a typical Chapter 11 bankruptcy. As the coming sections will illustrate, the battle between Sciens and the senior noteholders was not limited to the pre-packaged plan and § 363 sale. As the senior noteholders and Sciens each tried to reach the most favorable outcome for their constituencies, this battle helped shape the bankruptcy throughout the Chapter 11 process.

¹⁶⁴ *Id.*

Chapter 7: Lease Issues

On July 22, 2015, the Official Committee of Unsecured Creditors (the “Committee”),¹⁶⁵ the Ad Hoc Consortium of Holders of 8.75% Senior Note due 2017 (the “Consortium”),¹⁶⁶ and Colt¹⁶⁷ all filed emergency motions for entry of orders pursuant to Rule 2004,¹⁶⁸ directing Sciens Capital Management (“Sciens”) and Colt’s landlord, NPA Hartford LLC (“Landlord”), to produce documents and appear for oral depositions.

The Consortium’s motion alleged that the Landlord was “affiliated with and controlled by” Sciens, and that the Landlord “agreed to extend the lease contingent on Sciens remaining in control of” Colt.¹⁶⁹ The Committee’s motion alleged that Sciens, through the Landlord, threatened to evict Colt from its West Hartford, Connecticut plant after bondholders rejected prepackaged bankruptcy proposals that required them to trade in senior bonds at a 55 to 70 percent discount, “while equity (approximately 87% of which [wa]s controlled by Sciens) was left unimpaired.”¹⁷⁰ The Committee further alleged that failure to resolve the lease issues “may result in considerable, unnecessary value destruction and, potentially, the loss of hundreds of jobs.” Colt’s Rule 2004 Motion was primarily concerned with resolving the concerns of the Committee and the Consortium prior to the lease’s expiration on October 25, 2015, likely so that Colt could be better prepared for a section 363 sale or plan of reorganization.

¹⁶⁵ Committee’s Rule 2004 Motion.

¹⁶⁶ Consortium’s Rule 2004 Motion.

¹⁶⁷ Colt’s Rule 2004 Motion.

¹⁶⁸ “Bankruptcy Rule 2004 permits any party with an interest in the bankruptcy estate to conduct an examination of any matter affecting the administration of the estate or the formulation of a plan.” Doc 230 (citing Fed. R. Bankr. P. 2004(b); *In re Teleglobe Commc’ns Corp.*, 493 F.3d 345, 354 n.6 (3d Cir. 2007)).

¹⁶⁹ Consortium’s Rule 2004 Motion.

¹⁷⁰ Committee’s Rule 2004 Motion.

On July 28, 2015, both the Landlord¹⁷¹ and Sciens¹⁷² filed objections to the motions filed by the Committee and the Consortium. The Landlord's objection stated that it had never refused to extend the lease, and had not yet made a decision regarding an extension "because it ha[d] not received basic information about to whom it would be leasing and what the financial condition of the lessee would be."¹⁷³ The Landlord's objection also stated that it was independent from Sciens, though it admitted that Sciens (or, more accurately, its principals) owned 30.16% of the Landlord, while the remaining 69.84% of the Landlord's membership interests were held by third party investors that were unaffiliated with Sciens.¹⁷⁴ Sciens' objection claimed that the Rule 2004 Motions were filed in bad faith and should be denied.¹⁷⁵ Sciens proposed to voluntarily submit to discovery regarding the narrow issue of its ties to the Landlord.¹⁷⁶

On August 28, 2015, the Committee filed a motion for an order granting the committee derivative standing on behalf of Colt to assert, prosecute, and settle claims arising out of Colt's lease of the West Hartford facility, and authorization to hold, assert and, if necessary, waive Colt's attorney-client privilege, its work product privilege, and any other applicable privileges.¹⁷⁷ Colt filed its objection to the Committee's motion on September 10, 2015, where it alleged that the "Committee r[an] the risk of undermining the fragile progress made in ongoing settlement discussions involving the Landlord."¹⁷⁸ Colt requested that the Committee's motion be denied to allow the negotiation process between Colt and the Landlord to continue.

¹⁷¹ Landlord's Objection to Rule 2004 Motions.

¹⁷² Sciens' Objections to Rule 2004 Motions.

¹⁷³ Landlord's Objection to Rule 2004 Motions.

¹⁷⁴ *Id.*

¹⁷⁵ Sciens' Objections to Rule 2004 Motions.

¹⁷⁶ *Id.*

¹⁷⁷ Committee's Motion for Derivative Standing.

¹⁷⁸ Colt's Opposition to Committee's Motion for Derivative Standing.

The Committee replied to Colt's objection on September 17, 2015, and stressed the importance of the lease issue in question.¹⁷⁹ The Committee claimed, "the resolution of the lease will form the cornerstone of any plan of reorganization or proposed sale."¹⁸⁰ While the Committee reaffirmed its desire for derivative standing, it appears they would have been happy to simply have a seat at the table during the lease negotiation process.¹⁸¹

During a hearing on October 7, 2015, Judge Silverstein denied the Committee's motion without prejudice.¹⁸² The ruling essentially halted any plans by the Committee to pursue separate litigation against the Landlord, and paved the way for Colt to conclude negotiations on its lease.

¹⁷⁹ Committee's Reply in Support of Motion for Derivative Standing.

¹⁸⁰ *Id.*

¹⁸¹ *See id.* ("[N]either the Debtors, Sciens nor the Landlord have invited the Committee to the negotiating table. Not even once.")

¹⁸² Minute Entry re: Hearing Held on October 7, 2015.

Chapter 8: Retiree Benefits and the UAW

Colt's Motion to Modify Retiree Health Benefits¹⁸³

As part of Colt's Restructuring Support Agreement ("RSA") dated October 9, 2015, Colt negotiated with the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America and its Local 376 (together, the "Union") on the terms of certain modifications to their collective bargaining agreement, as well as modifications to retiree benefits for individuals who were represented by the Union.¹⁸⁴ Essentially, Colt was concerned that the costs of the post-retirement health benefit program were too high and could only increase as time passed. Thus, Colt sought to rein in these costs through negotiation with the Union.

Colt proposed that the retiree health program be converted into a health reimbursement account ("HRA") model, which would allow Colt to control their costs for the program while giving program participants greater flexibility with respect to their Medicare supplemental insurance.¹⁸⁵ On November 22, 2015, Colt sent its final proposal to the Union, which the Union rejected the following day. Thus, Colt sought relief under section 1114 of the Bankruptcy Code by filing this motion.¹⁸⁶

To determine whether modification of retiree benefits is appropriate under 11 U.S.C. § 1114, courts generally apply a nine-part test substantially similar to the test for determining whether a collective bargaining agreement should be rejected or terminated under § 1113:

- (a) the debtor in possession must have made a proposal to the retirees;
- (b) the proposal must be based on the most complete and reliable information available at the time of the proposal;
- (c) the modification must be necessary to permit reorganization;
- (d) the modification must provide that all affected parties are treated fairly and equitably;
- (e) the debtor must provide the retirees with such relevant information as is necessary to evaluate the proposal;

¹⁸³ Colt's Motion for Order to Modify Retiree Benefits.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

- (f) the debtor must have met with the retiree representative at reasonable times subsequent to making the proposal;
- (g) the debtor must have negotiated with the retirees concerning the proposal in good faith;
- (h) the retirees must have refused to accept the proposal without good cause; and
- (i) the balance of the equities must clearly favor modification of the retiree benefits.

Colt offered proof of a number of the factors, including its assertion that there was a substantial risk that the costs of the current Retiree Health Program may balloon and exceed Colt's ability to meet their post-reorganization cash obligations. In support of that concern, Colt estimated that it would spend approximately \$1.4 million on post retirement health benefits for 2015 alone, and expected these expenses to increase over time.¹⁸⁷ The average five year cost to Colt per participant was roughly \$1,150, though the approximately 55 participants that made up the bulk of the claims averaged over \$2,700 or more per participant.¹⁸⁸

The main contention of Colt's proposal was the amount it offered to fund each participant's HRA account, which was \$1,350 per year (which Colt promised not to amend for ten years). Since Colt estimated its per participant cost at about \$1,150, Colt presumably believed that \$1,350 per year was generous to the average participant. The problem, however, arose with the approximately 25% of participants whose average cost was \$2,700 or more, who likely did not think \$1,350 was nearly enough to cover their expenses.

UAW's Response and Memorandum of Understanding¹⁸⁹

In response to Colt's motion for relief under section 1114 and request for an order to force the Union into accepting Colt's proposal, the Union filed a motion on December 15, 2015, which included a Memorandum of Understanding ("MOU"). The MOU's purpose was to document the mutual agreement reached between Colt and the Union on

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ UAW's Response.

the retiree benefits issue.¹⁹⁰ The MOU provided for assumption of the collective bargaining agreement by Colt and for the modification of the retiree benefits under 11 U.S.C. 1114(e)(1)(B).

The MOU provided some objectives that were aimed towards establishing a better relationship between Colt, its employees, and the Union.¹⁹¹ However, the main provision of the MOU was in Attachment A, which provided that Colt would reimburse each retiree for any Medicare Part B premiums paid up to \$1,500 per person. This was \$150 more per person than the amount Colt offered in its proposal. Thus, the Union was successful in helping its members realize greater benefits from Colt than they otherwise would have received.

¹⁹⁰ *Id.*

¹⁹¹ Memorandum of Understanding.

Chapter 9: The Reorganization Plan(s)

The First Joint Plan of Reorganization

The first plan of reorganization (the “Plan”) was filed by Colt on October 9, 2015.¹⁹² The Plan classified claims into nine separate classes as well as a group of unclassified claims and subordinate claims pursuant to § 1123 of the Bankruptcy Code.¹⁹³ The nine classes of claims were: Priority Non-Tax Claims, Term Loan Claims, Other Secured Claims, Senior Note Claims, Qualified Unsecured Trade Claims, General Unsecured Claims, Intercompany Claims, Equity Interests in Debtor Subsidiaries, and Equity Interests in Parent. The following claims were listed as classified: Administrative Expense Claims, Priority Tax Claims, Professional Fees, and DIP Facility Claims.¹⁹⁴

Each of the Unclassified Claims were claims that generally would be paid in full if certain qualifications were met.¹⁹⁵ Holders of Administrative Expense Claims were required to serve a request for payment of their claim to Colt. Failure to do so by the Effective Date (the business day specified by Colt upon confirmation of the Plan) would lead to a loss of the ability to receive funds for a claim.¹⁹⁶ If no objections were filed then the Administrative Expense Claim became an Allowed Expense Claim and the holder of the claim would be entitled to full payment of the claim.¹⁹⁷ Holders of Priority Tax Claims were entitled to full payment over a period of up to five years after June 14, 2015 (the “Petition Date”).¹⁹⁸ Every professional who required compensation for their work on the Chapter 11 case needed to serve Colt with an application for allowance of final

¹⁹² First Reorganization Plan

¹⁹³ *Id.*; 11 U.S. Code § 1129

¹⁹⁴ *Id.*

¹⁹⁵ 11 U.S. Code § 1129 (a)(9)

¹⁹⁶ First Reorganization Plan

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

compensation and reimbursement of expenses by the 45th day after the Effective Date.¹⁹⁹ After this application is served on Colt, all professionals would be paid in full as allowed by the Bankruptcy Court.²⁰⁰ Post-Effective Date fees were to be paid to the professionals in the ordinary course of business.²⁰¹

The DIP Facility Claims were separated out into DIP Senior Loan Claims and DIP Term Loan Claims.²⁰² The DIP Senior Loan Claims were allowed in the amount of \$41,666,666.67 plus accrued post-petition interest. These Claims were to be paid in cash through the proceeds of a new \$40,000,000 senior secured loan (the Senior Exit Facility), as well as from an offering (described *infra*), which includes third lien secured debt and the sale of New Class A LLC Units.²⁰³ The DIP Term Loan Claims were to be allowed in the amount of \$33,333,333.33 plus accrued post-petition interest.²⁰⁴

The nine classes of claims were separated out into Impaired and Unimpaired claims based on the following chart:²⁰⁵

<u>Class</u>	<u>Designation</u>	<u>Impairment</u>	<u>Entitled to Vote</u>
1	Priority Non-Tax Claims	Unimpaired	No (Presumed to Accept)
2	Term Loan Claims	Impaired	Yes
3	Other Secured Claims	Unimpaired	No (Presumed to Accept)
4	Senior Notes Claims	Impaired	Yes
5	Qualified Unsecured Trade Claims	Impaired	Yes
6	General Unsecured Claims	Impaired	Yes
7	Intercompany Claims	Unimpaired	No (Presumed to Accept)
8	Equity Interest in Debtor Subsidiaries	Unimpaired	No (Presumed to Accept)
9	Equity Interest in Parent	Impaired	No (Presumed to Accept)

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² These are the claims that were forwarded as part of Colt's post-petition financing.

²⁰³ First Reorganization Plan; Offering Term Sheet.

²⁰⁴ *Id.*

²⁰⁵ *Id.*

Under the Bankruptcy Code, a class of claims is impaired unless certain conditions are met.²⁰⁶ In order for a class of claims to be unimpaired, the “legal, equitable, and contractual rights to which such claim or interest entitles the holder” must be “unaltered.”²⁰⁷ Essentially, that class of claims must be left in the same position as when they entered the Plan. Alternatively, there are five other conditions which may cause a class of claims to be unimpaired: the cure of any default on the claim, reinstatement of the maturity of the claim, compensation to the holder of the claim for any damages “incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law,” compensation for any pecuniary loss on the claim from a failure to perform a nonmonetary obligation, or the legal, equitable, or contractual rights of the claim are not otherwise altered.²⁰⁸ This distinction is critically important. Claims that are “impaired” are entitled to vote on the reorganization plan, while those that are “unimpaired” do not get to vote and are deemed to have accepted the plan.

Priority Non-Tax Claims

Priority Non-Tax Claims were unimpaired and entitled to receive cash equal to the amount of the claim either by the Effective Date, the date it becomes an Allowed Priority Non-Tax Claim, when it becomes due in the ordinary course of business, or another mutually agreed upon date.²⁰⁹ As this class was unimpaired, holders of these claims were presumed to accept the plan under § 1126(f) of the Bankruptcy Code and thus not entitled to vote on the plan.²¹⁰

²⁰⁶ 11 U.S. Code § 1124

²⁰⁷ *Id.*

²⁰⁸ *Id.*

²⁰⁹ First Reorganization Plan

²¹⁰ First Reorganization Plan; 11 U.S. Code § 1126(f)

Term Loan Claims

Holders of the Term Loan Claims were impaired and were entitled to receive an unspecified amount plus reasonable fees and expenses and accrued pre and post-petition interest through the Effective Date.²¹¹ After these fees were paid, the Term Loan Claims would be fully satisfied.²¹² Holders of the Term Loan Claims were impaired and entitled to vote to accept or reject the plan.²¹³

Other Secured Claims

Holders of Other Secured Claims would be satisfied either with cash paid in full along with interest, proceeds from the sale of collateral securing the claim, the collateral itself along with interest, or other distributions that are equal to the total claim.²¹⁴ These amounts were to be paid on the latest of the Effective Date, the date the claim becomes allowed, when the claim becomes due in the ordinary course of business, or another mutually agreed upon date.²¹⁵ As this class is to be paid in full, they were unimpaired and not entitled to vote on the Plan.²¹⁶

Senior Notes Claims

Each Holder of a Senior Note Claim would be entitled to receive a Pro Rata Share of the New Class B LLC Units.²¹⁷ New Class B holders have one vote per share, but have no dividends.²¹⁸ These shares were to be issued on the Effective Date or as soon as they

²¹¹ First Reorganization Plan

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *Id.*

²¹⁵ *Id.*

²¹⁶ *Id.*

²¹⁷ *Id.*

²¹⁸ Offering Term Sheet

became available for distribution.²¹⁹ This class was impaired and holders of Senior Notes Claims were entitled to vote to accept or reject the Plan accordingly.²²⁰

Qualified Unsecured Trade Claims

All Allowed Qualified Unsecured Trade Claims were to receive payment of cash on the later of the Effective Date, the date they become due in the ordinary course of business, the date which is customary practice between the Debtor and the Holder, or the date the claim becomes allowed.²²¹ However, this class was only entitled to payment on a claim without the addition of post-petition interest, and each holder is required to waive any late fees or penalties.²²² As a result, this class was impaired and entitled to vote on the Plan.²²³

General Unsecured Claims

Holders of General Unsecured Claims would receive a note or other consideration reasonably agreed upon by the Debtors in the amount reasonably equivalent to the percentage of recovery realized by the Senior Notes Claims.²²⁴ These claims were to be paid on the later of the Effective date, the date they become allowed, or as soon as practical afterwards and would not include any interest or penalties associated with the claims.²²⁵ As a result holders of General Unsecured Claims were impaired and entitled to vote on the Plan.²²⁶

²¹⁹ First Reorganization Plan

²²⁰ *Id.*

²²¹ *Id.*

²²² *Id.*

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Id.*

Intercompany Claims

All Intercompany Claims that became Allowed would either be reinstated or canceled and discharged on the Effective date.²²⁷ However, discharge would only be available to the extent a non-Debtor holder received no less favorable treatment than the other General Unsecured claims and if they did not receive or retain any property connected with such discharge.²²⁸ This class was unimpaired and not entitled to vote on the Plan.²²⁹

Equity Interests in Debtor Subsidiaries

These interests would be unaffected by the Plan with the exception of being reinstated on the Effective Date.²³⁰ Therefore this class was unimpaired and not entitled to vote on the Plan.²³¹

Equity Interests in Parent

All Equity Interests in the Parent were to be canceled on the Effective Date without notice. This class was presumed to reject the plan and was not entitled to vote.²³²

Financing the Exit from Bankruptcy

In order to finance the Plan, the Debtors were to raise \$50 million in new capital from the following sources: a third lien secured debt and New Class A LLC Units.²³³

²²⁶ *Id.*

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.*

²³³ Disclosure Statement

Sciens was intended to contribute \$15 million of the Offering Consideration, Fidelity/Newport was to contribute \$15 million, and each holder of Senior Notes other than Fidelity/Newport, who owned \$100,000 or more in Senior Notes (the “Eligible Holders”), or another amount agreed to by the Creditor parties, were entitled to a pro rata portion of the remaining \$20 million.²³⁴ The total amount of capital contributed had an option to be increased by up to \$5 million if Sciens, Fidelity/Newport, and the Consortium agreed. Such amount would be allocated to each party on a pro-rata basis of 30% to Sciens, 30% to Fidelity/Newport and 40% to the Eligible Holders.²³⁵

The third lien secured debt had a third priority lien on all assets of the Debtors at an interest rate of 8% per year payable in kind semi-annually by adding it to the balance during the first two years, with a 5-year minimum liquidity covenant and other minimum financial covenants and including \$25 million of junior debt.²³⁶ These terms were not all-inclusive and were subject to the agreement of the Creditors.²³⁷

The New Class A LLC (“Class A”) units voted together with the New Class B LLC (“Class B”) units as a single class, however holders of Class A were entitled to 100 votes for each unit held.²³⁸ Class A holders were also entitled to receive 100% of all distributions made by the Reorganized Parent until the holders have been paid in full.²³⁹ After all holders of Class A were paid, distributions were to be made in the following ratio, 75% to holders of Class A and 25% to holders of Class B.²⁴⁰ Each Class A unit had a conversion clause which converted all Class A units into Class B units upon the occurrence of one of the following: a liquidity event (such as a public offering), a sale,

²³⁴ Disclosure Statement

²³⁵ Disclosure Statement

²³⁶ First Reorganization Plan; Disclosure Statement

²³⁷ First Reorganization Plan

²³⁸ *Id.*

²³⁹ *Id.*

²⁴⁰ *Id.*

merger or business combination transaction, an asset sale, or if the total amount owed to Class A is reduced to zero.²⁴¹

Exit Intercreditor Agreement

On the Effective Date all parties were to enter into an Exit Intercreditor Agreement that would include provisions on lien priorities, the enforcement of remedies, application of proceeds, and other rights and which would provide for the subordination of the Third Lien from the other arrangements.²⁴²

Cancellations

Except as otherwise provided, all liens securing any Secured Claim were deemed released on the Effective Date. Any notes, bonds, indentures, certificates, or other instruments or documents which evidenced the claims of the Impaired Creditors to the plan were to be cancelled and discharged with the exception of the agreements relating to the Term Loan, Senior Notes, and the DIP Senior Loan Agreement.²⁴³

New Board of Directors

The new board of directors for the reorganized parent would consist of: the CEO of the reorganized Colt, two directors designated by Fidelity/Newport, two independent directors, and two directors designated by Sciens.²⁴⁴ The Consortium, Fidelity/Newport, and Sciens would each appoint one independent director.²⁴⁵ However, each independent director nominated must be reasonably acceptable to Fidelity/Newport, Sciens, and the Consortium.²⁴⁶

²⁴¹ *Id.*

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ *Id.*

²⁴⁶ *Id.*

If there is no Liquidity Event by the fifth anniversary of the Effective Date, then the number of Board of Directors would be increased by one and the holders of Class B may designate one additional member.²⁴⁷

Other Arrangements Under the Reorganization Plan

There are several other sections of the Reorganization Plan that are worth noting, but unnecessary to discuss in detail. They include sections on Distributions, Procedures for Resolving Disputed Claims and Equity Interests, Executory Contracts and Unexpired Leases, Condition Precedent to Confirmation and the Effective Date, Effect of Confirmation, Retention of Jurisdiction, and Miscellaneous Provisions.²⁴⁸

The Distribution Section designated dates of distribution and authorized a Disbursement agent for general claims, Senior Notes, Term Loans, and DIP agents who is in charge of disbursing the distribution to the appropriate parties.²⁴⁹ The Procedures for Resolving Disputed Claims set up a policy for objecting to claims and estimating the amount of claims by the Bankruptcy Court.²⁵⁰ Under Executory Contracts and Unexpired Leases, the Plan called for the assumption of all executory contracts and unexpired leases that were not mentioned in the Plan. Additionally, the Plan included any modifications agreed to by the parties in the assumption, provided for an indemnification of Directors, Officers, and Employees, and included an important clause in connection with the West Hartford Facility (which was discussed in Chapter 7, *supra*).²⁵¹

The Condition Precedent listed the following conditions that must be satisfied before Confirmation: approval of the extended lease or purchase of the West Hartford facility, approval by the Bankruptcy Court of the Disclosure Statement, followed by entry

²⁴⁷ *Id.*

²⁴⁸ *Id.*

²⁴⁹ *Id.*

²⁵⁰ *Id.*

²⁵¹ *Id.*

of the Disclosure Statement in Canada and a Confirmation Order.²⁵² It also provided that the Effective Date could not occur until there was entry of a Confirmation Order and a Confirmation Recognition Order, execution and delivery of all documents related to the Plan, the Financing was confirmed, the New Management Incentive plan was executed, the West Hartford Facility was either leased or purchased, a Collective Bargaining Agreement was reached, the Board of Directors was designated and appointed, and a few other conditions typically associated with a Chapter 11 reorganization were met.²⁵³

The Effect of Confirmation section had two important sections that covered releases by the Debtors, Holders of Claims, and Holders of Equity Interests to the maximum extent permitted by Law, as well as a section on Exculpation and Limitation of Liability for the Debtors and Reorganized Debtors.²⁵⁴

The Retention of Jurisdiction reserved jurisdiction for the Bankruptcy Court for all matters arising out of the Plan to the fullest extent the law allows.²⁵⁵

Finally, under Miscellaneous provisions, there were sections regarding governing law, the service of documents, the exemption of the Plan from Securities Law, and the exemption of the Plan from transfer taxes.²⁵⁶ All together the Plan consisted of 12 sections and 68 pages with the addition of several exhibits ranging from 65 to 125 pages.

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ *Id.*

²⁵⁵ *Id.*

²⁵⁶ *Id.*

The Second Joint Plan of Reorganization

On November 10th, 2015 Colt filed their second joint plan of reorganization (the “Second Plan”), which was ultimately accepted by the parties.²⁵⁷ While the majority of the Second Plan was similar to the original Plan, there were a few differences, including the separation of Senior Notes into participating and non-participating holders (with different effects for both) and the change of Qualified Unsecured Trade Claims to Trade Claims.²⁵⁸ Below is a chart representing the breakdown of claims in the Second Plan:

<u>Class</u>	<u>Designation</u>	<u>Impairment</u>	<u>Entitled to Vote</u>
1	Priority Non-Tax Claims	Unimpaired	No (Presumed to Accept)
2	Term Loan Claims	Impaired	Yes
3	Other Secured Claims	Unimpaired	No (Presumed to Accept)
4-A	Senior Notes Claims of Participating Holders	Impaired	Yes
4-B	Senior Notes Claims of Non-Participating Holders	Impaired	Yes
5	Trade Claims	Unimpaired	No (Presumed to Accept)
6	General Unsecured Claims	Impaired	Yes
7	Intercompany Claims	Unimpaired	No (Presumed to Accept)
8	Equity Interest in Debtor Subsidiaries	Unimpaired	No (Presumed to Accept)
9	Equity Interest in Parent	Impaired	No (Presumed to Accept)

Term Loan Claims

In the Second Plan, the Term Loan Claims were deemed allowed—in the amount of \$67.9 million dollars—after being unspecified in the original Plan.²⁵⁹ This amount was to be satisfied in cash by Colt upon acceptance of the plan.²⁶⁰ These claims were impaired and were thus entitled to vote on the plan.²⁶¹

²⁵⁷ The Second Plan

²⁵⁸ The Second Plan; First Reorganization Plan

²⁵⁹ The Second Plan; First Reorganization Plan

²⁶⁰ Bloomberg Modified Second Amended Plan

²⁶¹ The Second Plan

Senior Note Claims

In the first Plan, the senior notes were compiled together into one group of claims; however, in the Second Plan, the Senior Note Claims were separated into Claims of Participating Holders and Claims of Non-Participating Holders.²⁶² Participating Holders included groups that vote for the plan, including Fidelity/Newport, the Consortium Noteholders and the Eligible Noteholders.²⁶³ In order to be an Eligible Noteholder the holder had to have held a claim equal to \$100,000 or more.²⁶⁴ Any holder of a Senior Note Claim in this group who voted for the plan was to receive a pro rata share of the New Class B LLC Units.²⁶⁵

The other Senior Note Claims were the Non-Participating holders, which was any holder who voted against the plan or had less than \$100,000 in notes.²⁶⁶ This group is separated by result.²⁶⁷ If a Non-Participating holder vetoed the Plan, but the Plan was accepted and the holder filed their claim in a timely manner, they were to receive their pro rata share of the New Class B LLC Units.²⁶⁸ If they did not file their claim they were to receive a fourth lien equal to the lesser of 10% of their claim or their pro rata share of \$7,000,000.²⁶⁹ If they voted for the plan and filed their claim in a timely manner, they were entitled to receive cash in an amount equal to 7% of the value of their claims from a Cash Reserve that totaled \$3,000,000.²⁷⁰ Once the Cash Reserve was depleted, they would choose one of the following: a fourth lien equal to 10% of their claim with interest

²⁶² The Second Plan; First Reorganization Plan

²⁶³ The Second Plan

²⁶⁴ *Id.*

²⁶⁵ *Id.*

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ *Id.*

²⁶⁹ *Id.*

²⁷⁰ *Id.*

of 8% per year, or their pro rata share of \$7,000,000. Both sets of Senior Note Claims were impaired and thus were entitled to vote for the plan.

Trade Claims

In the first Plan, Trade Claims were classified as General Unsecured Trade Claims and were impaired. Trade Claims were only entitled to receive payment on the claim without any post-petition interest and were also required to waive any late fees or penalties.²⁷¹ However, in the Second Plan, Colt agreed to pay the full amount of the Claim in cash, which allowed the Trade Claims to become unimpaired and be presumed to accept the plan.²⁷²

General Unsecured Claims

In the original Plan, the General Unsecured Claims were entitled to an amount reasonably equivalent to the percentage of recovery realized by the Senior Note Claims.²⁷³ The Second Plan specified the amount they were to receive.²⁷⁴ If the holder of a General Unsecured Claim voted for the plan, they would get cash equal to 7% of their claim, a fourth lien note with 8% interest equal to 10% of their claim, or their pro rata share of \$7,000,000.²⁷⁵ If the holder of a General Unsecured Claim voted against the plan, they would receive a fourth lien note equal to 10% of their claim or their pro rata share of \$7,000,000, whichever is less.²⁷⁶ This group was impaired and entitled to vote on the plan.

Settlement of Claims

²⁷¹ First Reorganization Plan

²⁷² First Reorganization Plan

²⁷³ First Reorganization Plan

²⁷⁴ The Second Plan

²⁷⁵ *Id.*

²⁷⁶ *Id.*

One important item to note is a section of the plan that acted as a settlement of claims against Sciens.²⁷⁷ In consideration for the \$15,000,000 that Sciens was to put forward for financing the Second Plan, this section effectively settled all claims by any debtor or related party against Sciens.²⁷⁸ This appears to have been put in to allow Sciens to walk away from the Chapter 11 plan with a clean slate, just like Colt. It was an effective move by Sciens to protect themselves against any further court actions, but was contingent on their investment in the Offering, as mentioned in the first Plan.

²⁷⁷ *Id.*

²⁷⁸ *Id.*

Objections to the Second Joint Plan

Objection By the Internal Revenue Service²⁷⁹

The Internal Revenue Service (“IRS”), a creditor and party in interest, asserted an unsecured priority and general unsecured, pre-petition claim against Colt Security, LLC in the amount of \$11,259.24. The IRS objected to the third party non-debtor limitation of liability, exculpation, injunction and release provisions set forth in Section 10 of the Second Amended Joint Plan (the “Plan”). The IRS felt that precedent from the third-circuit and from the bankruptcy court held that the non-consensual release of a non-debtor required certain factors to be met, which Colt failed to do.²⁸⁰ Thus, the IRS believed that the release of non-debtors with respect to their potential liability to the IRS was unjustified.

Furthermore, the IRS objected to the Plan to the extent it failed to preserve the setoff and recoupment rights of the IRS.²⁸¹ The IRS argued that it had the right to setoff mutual prepetition debts and claims, as well as post-petition debts and claims, but that the Plan made no provision for such rights.²⁸² The IRS claimed there was no compelling reason to forego its setoff rights, and that the Plan should thus preserve the government’s setoff rights.²⁸³

The IRS objected to parts of the plan that failed to provide for payment of an adequate interest rate on its priority tax claims that were not paid on time and in full, and also objected to provisions of the Plan to the extent it discharged debts described in 11

²⁷⁹ See Objection by the IRS.

²⁸⁰ *Id.*

²⁸¹ *Id.*

²⁸² *Id.*

²⁸³ *Id.*

U.S.C. 1141(d)(6).²⁸⁴ The IRS also objected to Section 11 of the Plan on jurisdictional grounds, claiming that the court lacked subject matter jurisdiction.²⁸⁵

Objection by Lewis Machine & Tool Co. and KRL Holding Company LLC²⁸⁶

Lewis Machine & Tool Co. (“Lewis”) and KRL Holding Company LLC (“KRL”) argued in their December 9th objection that the Chapter 11 plan needed to exclude releases for intellectual property infringement claims — KRL said Colt owed \$1 million for patent infringement — and that the plan did not create a monetary reserve for disputed claims, among other objections.²⁸⁷ According to their Objection, “Lewis Provides its customers with high quality weapons, components and modular weapon systems,” and “certain of the Debtors are customers of Lewis,” while “KRL is the owner of certain related patents.”²⁸⁸ Additionally, KRL “asserted claims in excess of \$1,000,000.00 against the Debtors due to, among other things, the Debtors’ continued infringement of certain patents.”²⁸⁹ Lewis and KRL also objected to the Plan on similar grounds as the IRS and the U.S. Trustee, relating to certain Third Party Releases.²⁹⁰ Colt ultimately settled with KRL after the Second Plan was confirmed, which is further explained in Chapter 10.

²⁸⁴ *Id.*

²⁸⁵ *Id.*

²⁸⁶ *See* Objection by Lewis and KRL.

²⁸⁷ <http://www.law360.com/articles/736800/us-trustee-opposes-colt-s-ch-11-plan-as-too-broad>. Last visited April 25, 2016.

²⁸⁸ *See* Objection by Lewis and KRL.

²⁸⁹ *Id.*

²⁹⁰ *See id.*

Objection by the U.S. Trustee

The U.S. Trustee objected to Colt's reorganization plan, alleging that it was not in compliance with 11 U.S.C. § 1129(a).²⁹¹ In its objection, the U.S. Trustee asked the bankruptcy judge not to confirm the plan. The U.S. Trustee described the plan as overly broad, specifically arguing that it improperly alleviated third parties from liability to those claims holders who neither voted on the plan nor opted out.²⁹²

The U.S. Trustee argued that third-party liability releases are supposed to be limited to claims holders who actually vote in favor of the plan or vote no, but do not opt out from the releases.²⁹³ However, the objection argued that the reorganization plan improperly went much further, extending releases to creditors who do not vote or are only presumed to have not opted out. "Releases given by non-debtors to other non-debtors in a plan are permissible only in rare and exceptional circumstances in which certain key factors are present," the objection argued, citing to Delaware bankruptcy case law.²⁹⁴ "Absent actual, affirmative consent or a real opportunity to opt-out," the U.S. Trustee argued that the Third-Party releases are non-consensual and should not be approved.²⁹⁵ Citing *In re Continental Airlines, Inc.* 203 F.3d 203, 214 (3d Cir. 2000), the U.S. Trustee claimed that if the Court were to consider approving the Third-Party Releases, "they must be reviewed under the rigorous standards of *Continental Airlines* and well-established case law within this Court: the 'hallmarks of permissible non-consensual releases' are 'fairness, necessity to the reorganization, and special factual findings to support the conclusions.'"²⁹⁶

²⁹¹ See Objection by the U.S. Trustee.

²⁹² See <http://www.law360.com/articles/736800/us-trustee-opposes-colt-s-ch-11-plan-as-too-broad>. Last visited April 25, 2016.

²⁹³ See *id.*

²⁹⁴ See Objection by the U.S. Trustee.

²⁹⁵ *Id.*

²⁹⁶ *Id.*

In its Order approving Colt's Second Amended Reorganization plan, Judge Silberstein found "[t]he Third-Party Releases are fair to Holders of Claims and Equity Interests and are necessary to the proposed restructuring, thereby satisfying the requirements of *In re Continental Airlines, Inc.* 203 F.3d 203, 214 (3d Cir. 2000)."²⁹⁷ Thus, the objection by the U.S. Trustee was overruled.

²⁹⁷ *Id.*

Chapter 10: Chapter 11 Exit and Subsequent Issues

Chapter 11 Exit and Sciens Default

Shortly after the confirmation hearing confirming Colt's Second Amended Plan, Sciens indicated that it would not be able to fund its \$15 million commitment under the Offering by the funding deadline of December 28, 2015.²⁹⁸ Despite the default, all parties involved deemed it in Colt's best interests to maintain the settlements agreed upon under the Confirmed Plan.²⁹⁹ Additionally, Colt's DIP Lenders agreed to extend the maturity date of the DIP Facilities from December 29, 2015, to January 31, 2016, in exchange for fees paid by Colt.³⁰⁰ Colt's landlord also agreed to extend its lease for its West Hartford facility upon consummation of the Confirmed Plan after it was modified.³⁰¹ Thus, On January 5, 2016, Colt filed a motion for approval of modifications to their Second Amended Plan.³⁰²

The modifications proposed by Colt included reducing the total amount raised through the Offering from \$50 million to "between \$45 million and \$50 million."³⁰³ Colt also proposed limits to the involvement of Sciens, including: limiting the number of Offering Units that Sciens was able to purchase, limiting Sciens' corporate governance rights,³⁰⁴ and limiting its rights to receive management fees "to reflect the significantly reduced amount it may contribute."³⁰⁵

²⁹⁸ Motion for Modifications to Plan,

²⁹⁹ *See id.*

³⁰⁰ *See id.*

³⁰¹ *See id.*

³⁰² *See id.* Keith Maib (Chief Restructuring Officer of Colt Defense LLC) and Daniel Standen (principal of Sciens and Chairman of the Governing Board of Colt Holding Company, LLC) both submitted declarations in support of Colt's Motion for Modifications to the Plan. *See* Maib Declaration and Standen Declaration.

³⁰³ *Id.*

³⁰⁴ If Sciens funded their initial funding amount of at least \$2.6 million before January 8, 2016, they would be allowed to designate one director to serve on Colt's board of directors; if Sciens funded their subsequent funding amount of at least \$7.6 million in the

The modifications also included an agreement by the Landlord to deliver an executed five-year lease extension with a purchase option, effective upon consummation of the confirmed Plan.³⁰⁶ Colt submitted in their motion that “resolicitation of the Confirmed Plan, which would be costly and time consuming, is unnecessary because the Modifications do not materially and adversely affect the consideration provided to creditors . . . or [Colt’s] ability to make distributions under the Confirmed Plan.”³⁰⁷ Therefore, in the shadow of default by Sciens, Colt was able to negotiate with all parties involved to ensure their exit from Chapter 11.

It is interesting to note how pragmatic the parties were in negotiating a just resolution when Sciens (who was in default under the Plan) did not have as much bargaining power or, at times, was not even involved. Negotiations appeared more contentious and protracted whenever there was a disputed matter involving Sciens.

A hearing on Colt’s motion was set for January 11, 2016. Judge Silverstein subsequently granted Colt’s motion on January 12, 2016 (the “Modification Order”).³⁰⁸ The Modification Order included the stipulation that, in the event Sciens did not fund \$5 million in the aggregate by February 8, 2016, each holder of an Allowed Claim in Class 4-A, Class 4-B, or Class 6 would not be deemed to grant releases in favor of Sciens.³⁰⁹ The notice³¹⁰ provided to all such Allowed Claim holders indicated that Sciens did not exercise the right to fund a total of \$15 million in the aggregate by February 8, 2016.

aggregate, then Sciens would be allowed to designate one additional director; if, however, Sciens failed to meet the initial funding amount, Sciens would not be entitled to designate any director to serve on the board. *See* Exhibit B to Colt’s Motion for Modifications to the Plan.

³⁰⁵ *See* Motion for Modifications to Plan,

³⁰⁶ *See id.*

³⁰⁷ *Id.*

³⁰⁸ Order Granting Motion for Modifications to the Plan.

³⁰⁹ *See id.*

³¹⁰ *See* Notice of Limitation of Releases.

Thus, the Allowed Claim holders of the specified classes were not deemed to have granted individual releases in favor of Sciens.³¹¹

Settlement with KRL

On April 13, 2016, the reorganized Colt filed a motion for an order approving its settlement with KRL Holding Company, Inc. (“KRL”) regarding KRL’s patent infringement claim filed with the court in November of 2015.³¹² KRL also objected to the confirmation of the Second Amended Plan.³¹³ As part of this settlement, Colt agreed to allow KRL a Class 6 General Unsecured Claim in the amount of \$714,295.71, which will be payable in cash in the amount of \$50,000.³¹⁴ Additionally, Colt agreed to allow KRL an Administrative Expense Claim in the amount of \$50,000, payable in cash.³¹⁵

Wrapping up the Bankruptcy

As of April 18, 2016 there has not been a final decree in Colt’s bankruptcy. Motions continue to flood in for non-substantive issues like payment of fees due. With the Confirmed Plan in place and Colt’s acceptance of Sciens’ default, the final decree should be forthcoming, barring any extenuating circumstances.

What’s Next for Colt?

Though Colt managed to navigate a second bankruptcy, the future of the company is still unclear. Will Colt fall into the same cycle of errors that caused them to enter bankruptcy twice in the span of twenty-five years? Will Colt tap into the large consumer market for firearms? Will they rely on government contracts, again, to their detriment? Will they manage their debt more effectively? Will the sway of Sciens Capital be

³¹¹ *See id.*

³¹² Settlement with KRL.

³¹³ *Id.*

³¹⁴ *Id.*

³¹⁵ *Id.*

minimized by their diminished position on the board? All of these questions are crucial to Colt's future.

According to Paul Spitale, Colt's Senior Vice President of commercial business, Colt is becoming "a much more balanced company."³¹⁶ He foresees "the commercial business becoming a much larger part of [Colt's] portfolio."³¹⁷ Colt is putting this customer-centric focus at the forefront, attending trade shows like the Shooting, Hunting and Outdoor Trade Show in Las Vegas in January 2016, and announcing several new weapon models for 2016.³¹⁸ Fortunately for Colt, consumer demand for firearms is at an "all-time high," with 23.1 million background checks for firearm purchases in 2015 alone.³¹⁹ Colt estimates the consumer sales market to exceed \$11 billion in 2016.³²⁰

Colt may be forced to rely on this new consumer-first mindset. While Colt was in bankruptcy, the United States Government approved a Colt bid to produce M4's for the Army.³²¹ This should have been a huge victory for Colt coming out of bankruptcy. Unfortunately for Colt, Remington, a competing gun manufacturer, filed a complaint in the U.S. Court of Federal Claims against the government.³²² Remington cited the fact that Colt was at a high risk of liquidation or complete financial failure at the time the contract was rewarded.³²³ The Court held that the "facts did not support the contracting officer's

³¹⁶ <http://www.foxbusiness.com/features/2016/01/21/post-bankruptcy-colt-wants-bigger-piece-gun-sales.html>. Last visited April 18, 2016.

³¹⁷ *Id.*

³¹⁸ *Id.*

³¹⁹ *Id.*

³²⁰ *Id.*

³²¹ http://www.al.com/news/huntsville/index.ssf/2016/04/federal_court_grants_remington.html. Last visited April 18, 2016.

³²² *Id.*

³²³ *Id.* Based on a review completed by the Defense Contract Management Agency (DCMA).

opinion that Colt could produce the rifles and had no justifiable reason to ignore the DCMA evaluation of Colt as high risk.”³²⁴ The Court’s ruling prevents the government from moving forward with Colt for 30 days and orders it to do a new study of Colt’s financial situation.³²⁵ This study and subsequent report, due April 25, 2016, could have a huge effect on Colt’s initial viability after bankruptcy.

³²⁴ *Id.*

³²⁵ *Id.*

Chapter 11: Conclusion

Colt was a divided company going into bankruptcy; majority shareholder Sciens Capital and Colt's Senior Noteholders were in a constant state of struggle. The parties could not agree on a path into bankruptcy. Sciens wanted to enter bankruptcy and quickly pursue a § 363 sale, while the Senior Noteholders wanted a complete restructuring. These two opposing views would flood the bankruptcy with objections and battles throughout the entire process. In the end, with the help of Judge Silverstein, the parties slowly moved towards a mutual plan. The Senior Noteholders were able to get the restructuring they so badly wanted, with Sciens having a lesser position on the board post-bankruptcy. Sciens was able to maintain some of their clout while restructuring the Senior Noteholders' bonds. Ultimately, the Senior Noteholders seemed to come the closest to achieving their pre-bankruptcy goals—they were able to preserve their interests while reducing Sciens' influence over Colt. The reorganized Colt is now better situated than it was pre-bankruptcy, and is now at a crossroads in its business. Hopefully, Colt will use its new position to change its trajectory and avoid having to fall back on the bankruptcy process again in another twenty years.