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Schwab Industries: Competing and Shifting Interests in Chapter 11 Bankruptcy

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Schwab Industries: Competing and Shifting Interests in Chapter 11 Bankruptcy

Workouts and Reorganizations – Professor Kuney

Spring 2016

Trey Buckley, Hannah Kay Hunt, and Hunter Threet

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Cast of Characters

Schwab Industries, Inc. – The parent company in the Debtors' conglomerate structure. Schwab Industries, Inc. was incorporated in Ohio and doing business in northeastern Ohio and southwestern Florida. Schwab Industries had eight subsidiaries.[1]

David A. Schwab – David Schwab was the president, a director, and a shareholder of Schwab Industries. David Schwab was the son and grandson of the founders of Schwab Industries.[2]

Jerry Schwab – Jerry Schwab was the chairman of Schwab Industries' board of directors. Jerry Schwab helped found Schwab Industries as an industrial-supply corporation in 1955.[3]

David Moreland – David Moreland was the executive vice president of Schwab Industries. David Moreland supplied testimony in connection with several contested matters throughout the case. In particular, his testimony became relevant during the first dispute regarding post-petition financing.[4]

David Exley – David Exley was the vice president of administration of Schwab Industries. David Exley testified extensively about the company's financial practices during the first dispute regarding post-petition financing.[5]

Bank of America – Bank of America is an American multinational banking and financial services corporation headquartered in Charlotte, North Carolina. Bank of America was involved in Schwab Industries' secured financing arrangement.[6]

Huntington National Bank – Huntington National Bank ("Huntington") became Huntington Bancshares, Inc. after a recent merger. Huntington is headquarted in Columbus, Ohio and

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[1] Bloomberg, http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=4293172 (last visited Apr. 25, 2016).

[2] Corporation Wiki, https://www.corporationwiki.com/Florida/Cape-Coral/david-a-schwab-P4842879.aspx (last visited Apr. 25, 2016).

[3] Corporation Wiki, https://www.corporationwiki.com/Ohio/Dover/jerry-a-schwab/47891644.aspx (last visited Apr. 25, 2016).

[4] Zoominfo, http://www.zoominfo.com/p/David-Moreland/2069409748 (last visited Apr. 25, 2016).

[5] Corporation Wiki, https://www.corporationwiki.com/Florida/Fort-Myers/david-r-exley/66113616.aspx (last visited Apr. 25, 2016).

[6] Bank of America, http://about.bankofamerica.com/en-us/global-impact/csr-report.html#fbid=iu8ByQOn8MV (last visited Apr. 25, 2016).

provides full-service banking and commercial financing in the Midwest. Huntington was involved in Schwab Industries' secured financing arrangement. The Schwab family also had a split-dollar life insurance policy that was held in trust with Huntington.[7]

KeyBank – KeyBank is a subsidiary of the Cleveland-based KeyCorp, which provides retail, commercial, and investment banking throughout the United States. KeyBank served as the agent on Schwab Industries' secured financing. Therefore, KeyBank was the pre-petition lender predominantly involved in Schwab Industries' bankruptcy case.[8]

Judge Russ Kendig – Judge Russ Kendig is a bankruptcy judge in the Northern District of Ohio. Judge Kendig received his undergraduate degree from Northwestern University and his J.D. from the Ohio State University. Judge Kendig presided over the Schwab Industries bankruptcy case.[9]

EFO Financial Group – EFO Financial Group ("EFO Financial") specialized in underwriting debtor-in-possession loans and other alternative financing arrangements to U.S.-based companies. EFO Financial served as a third-party DIP lender to Schwab Industries.[10]

Naples Lending Group – Naples Lending Group ("Naples") was a subsidiary of ITG Holdings, a sophisticated investment firm in Naples, Florida. EFO Financial assigned its interest in the Debtors' post-petition financing facility to Naples.[11]

Hahn, Loeser & Parks – Hahn, Loeser & Parks ("Hahn Loeser") is a full-service law firm that was founded in Cleveland in 1920. The firm has seven offices throughout Ohio, southwest Florida, California, and Illinois. Hahn Loeser served as Schwab Industries' main bankruptcy counsel throughout the case.[12]

Brouse McDowell – Brouse McDowell is a full-service business law firm located in Cleveland, Ohio. Brouse McDowell served as special counsel for Schwab because Hahn Loeser had conflicts of interest with the Schwab family.[13]

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[7] Huntington, https://www.huntington.com/About-Us (last visited Apr. 25, 2016).

[8] KeyBank, https://www.key.com/about/index.jsp (last visited Apr. 25, 2016).

[9] United States Bankruptcy Court Northern District of Ohio, https://www.ohnb.uscourts.gov/content/chief-judge-russ-kendig (last visited Apr. 25, 2016).

[10] EFO Financial, http://efofinancial.com (last visited Apr. 25, 2016).

[11] Bloomberg, http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=142203146 (last visited Apr. 25, 2016).

[12] Hahn Loeser, http://www.hahnlaw.com (last visited Apr. 25, 2016).

[13] Brouse McDowell, http://www.brouse.com (last visited Apr. 25, 2016).

Thompson Hine – Thompson Hine served as the pre-petition secured lender's counsel throughout the bankruptcy case. Alan Lepene, a partner of Thompson Hine, successfully defended the pre-petition lender's position that Schwab Industries should not receive $18 million worth of post-petition financing.[14]

Western Reserve Partners – Western Reserve Partners ("Western Reserve") provides acquisition, capital-raising, and financial advisory services to middle-market companies. Western Reserve acted as the financial advisor to the bankruptcy estate of Schwab Industries. As such, Western Reserve helped structure and conduct the auction process. Western Reserve earned approximately $950,000 in fees from the case.[15]

Euclid Chemical Company – Euclid Chemical Company ("Euclid Chemical") is a global supplier of admixtures, concrete fibers, curing and sealing compounds, structural grouts, epoxy adhesives, floor hardeners and toppings, joint fillers, industrial and architectural coatings, decorative color/stains/stamps, and a comprehensive selection of restoration materials. It was founded in Cleveland, Ohio, in 1910 and operated as a family business until it was purchased in 1984. Euclid Chemical supplied chemicals to Schwab Industries that were necessary for the production of concrete. Euclid Chemical objected to the Debtors' post-petition financing arrangement.[16]

St. Mary's Cement – St. Mary's Cement ("St. Mary's") is a cement producer based in Ontario, Canada. It is one of the oldest cement producers in North America and primarily services the Great Lakes region. St. Mary's is currently a wholly owned subsidiary of Vorantim Cimentos. St. Mary's was a pre-petition supplier of Schwab Industries that objected throughout the bankruptcy case.[17]

Port Manatee's Port Authority – Port Manatee's Port Authority operates a deep-water port located in the eastern Gulf of Mexico at the entrance of Tampa Bay. Schwab Industries leased a deep-water port from Port Manatee's Port Authority. Port Manatee's Port Authority interjected in the case to ensure Schwab Industries cured any deficiencies prior to assuming and assigning the lease.[18]

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[14] Thompson Hine, http://www.thompsonhine.com (last visited Apr. 25, 2016).

[15] Western Reserve, http://wesrespartners.com (last visited Apr. 25, 2016).

[16] Euclid Chemical, http://www.euclidchemical.com (last visited Apr. 25, 2016).

[17] St. Mary's, http://www.stmaryscement.com (last visited Apr. 25, 2016).

[18] Port Manatee's Port Authority, http://www.portmanatee.com (last visited Apr. 25, 2016).

Holcim, Inc. – Holcim, Inc. ("Holcim") is a wholly owned subsidiary of Holcim, Limited, a Swiss company that is one of the largest cement suppliers in the world. Holcim was a supplier of Schwab Industries that objected to stated cure amounts prior to Schwab Industries' § 363 sale.[19]

Allen Concrete Company – Allen Concrete Company ("Allen Concrete") serves residential contractors and builders in southwest Florida. Allen Concrete specializes in the placement and finishing of structural concrete. Allen Concrete owned fifty percent of a partnership with Schwab Industries. Allen Concrete objected to the assignment of Schwab Industries' partnership interest in the sale process.[20]

National Lime & Stone – National Lime & Stone ("National Lime") was an Ohio corporation that produced and distributed concrete, aggregates, and minerals. National Lime leased property and purchased supplies from Schwab Industries. National Lime attempted to raise sufficient equity to invest in Schwab Industries prior to the bankruptcy case. National Lime was an active unsecured creditor throughout the case.[21]

Pension Benefit Guaranty Corporation – Pension Benefit Guaranty Corporation ("PBGC") is a federal agency created by ERISA (1974) to protect pension benefits in the private sector. The PBGC objected to preserve Schwab Industries' liability for $3.2 million in underfunded pension liability.[22]

Cement Resources – Cement Resources was a shell corporation formed by Atlas Holdings and Garmark Partners. Cement Resources served as the stalking horse bidder in the auction and sale process.[23]

Atlas Holdings – Atlas Holdings was an investment firm located in Greenwich, Connecticut. Atlas Holdings had investments throughout the world in, *inter alia*, building materials. Atlas Holdings helped form Cement Resources to serve as the stalking horse bidder.[24]

Garmark Partners – Garmark Partners was an investment firm that provided mezzanine debt and structured equity capital to middle-market companies. Along with Atlas Holdings, Garmark Partners formed Cement Resources to serve as the stalking horse bidder.[25]

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[19] Holcim, http://www.holcim.us (last visited Apr. 25, 2016).

[20] Allen Concrete, http://allenconcreteinc.com/main.html?src=%2F (last visited Apr. 25, 2016).

[21] National Lime, http://www.natlime.com (last visited Apr. 25, 2016).

[22] PBGC, http://pbgc.gov (last visited Apr. 25, 2016).

[23] Cement Resources, http://garmark.com (last visited Apr. 25, 2016).

[24] Atlas Holdings, http://www.atlasholdingsllc.com (last visited Apr. 25, 2016).

[25] Garmark Partners, http://garmark.com (last visited Apr. 25, 2016).

OldCastle Materials – OldCastle Materials (“OldCastle”) is the leading vertically integrated supplier of aggregates and ready-mix concrete in the United States. OldCastle was the successful purchaser of Schwab Industries’ ready-mix cement and concrete operations at the § 363 sale and auction.[26]

Resource Land Holdings – Resource Land Holdings was formed in 1998 to invest in agricultural, timber, and mining properties. Resource Land Holdings purchased a 2,100-acre plot that contained limestone deposits from Schwab Industries at the § 363 auction.[27]

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[26] OldCastle, http://www.oldcastlematerials.com (last visited Apr. 25, 2016).

[27] Resource Land Holdings, http://www.rlholdings.com/home1.html (last visited Apr. 25, 2016).

I. <u>The Debtors' Businesses</u>

Schwab Industries, Inc. ("Schwab Industries") was a closely held corporation operating in Dover, Ohio.[28] Schwab Industries served as the parent company to eight other corporations that were operating across Florida and Ohio.[29] Four members of the Schwab family owned directly or indirectly all of the equity in Schwab Industries and its eight subsidiaries, which allowed Jerry Schwab and his son, David, to control the direction of the company.[30] Schwab Industries was engaged in producing, supplying, and distributing ready-mix concrete, concrete block, cement, and related supplies to commercial, residential, and governmental contractors throughout northeast Ohio and southwest Florida.[31]

Northeast Ohio includes the metropolitan areas for Cleveland, Akron, and Youngstown, and contained a population of approximately 4.5 million people in the first decade of the twenty-

[28] *See* Equity Security Holders, Doc. No. 3, at p. 1; Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 9. The archetypal definition for a closely held corporation comes from the Massachusetts case *Donahue v. Rodd Electrotype*, 328 N.E.2d 505 (Mass. 1975). *Donahue* defines a closely held corporation as "typified by: (a) a small number of stockholders; (b) no ready market for corporate stock; and (c) substantial majority stockholder participation in management, direction, and operation of the corporation." *Donahue*, 328 N.E.2d at 512.

[29] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 9–11.

[30] Equity Security Holders, Doc. No. 3, at p. 1; Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 9–10. The equity of Schwab Industries was owned as follows: Jerry Schwab owned 824 shares; David Schwab owned 505 shares; Marry Lynn Schwab owned 379 shares; and Donna Schwab owned 123 shares. Equity Security Holders, Doc. No. 3, at p. 1 .

[31] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 8–9.

first century.[32] By contrast, southwest Florida encompassed a population of approximately 1.2 million people as of 2010.[33] A majority of the relevant area in southwest Florida is rural swampland, which was not exactly ideal for development.[34] The area's three coastal counties, Lee, Collier, and Charlotte, however, experienced a residential and commercial development boom between 2002 and 2006.[35] In particular, Lee County, which includes the Cape Coral–Fort Meyers area, issued 5,200 single-family building permits between 2002 and 2006 and experienced a population growth of approximately 200,000 people.[36] Collier and Charlotte counties experienced similar growth – but to a lesser extent – during that same period.[37]

The Schwab family started their family business in 1955.[38] The original business was named Ohio Industrial Supply Corporation and was engaged in buying and selling industrial equipment.[39] The incorporators were A.L. Schwab, Jerry Schwab, Ruth Schwab, and Donna

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[32] Ne. Ohio Int'l Bus. Network, *Northeast Ohio: A Powerhouse in Middle America*, 2006, at 1–2 *available at* http://www.neoisgreat.com/NE_OHIO.pdf.

[33] Sw. Fla. Econ. Dev. Alliance, *Demographics*, Post to *Research & Data*, SW. FLA. ECON. DEV. ALLIANCE, https://swfleda.com/demographics/ (last visited Apr. 12, 2016).

[34] *See* Reg'l Econ. Research Inst., *Southwest Florida Economic Indicators*, Feb. 2011, at 21–22 *available at* http://floridasinnovationcoast.com/files/documents/Regional_EIR_Feb2011.pdf; Sw. Fla. Econ. Dev. Alliance, *Local County Map*, SW. FLA. ECON. DEV. ALLIANCE, https://swfleda.com/interactive-map-county/#.Vw0IgUu-1g0 (last visited Apr. 12, 2016).

[35] *See* Reg'l Econ. Research Inst., *Southwest Florida Economic Indicators*, Feb. 2011, at 10–15 *available at* http://floridasinnovationcoast.com/files/documents/Regional_EIR_Feb2011.pdf.

[36] *Id.* at 11, 21.

[37] *Id.* at 11–12, 21.

[38] OHIO SEC. OF STATE, http://www5.sos.state.oh.us/ords/f?p=100:7:0::NO:7:P7_CHARTER_NUM:246471 (last visited Apr. 12, 2016).

Schwab, who all started the company with just $500 in capital.[40] In 1986, Jerry and Donna Schwab changed the name of the company to Schwab Industries, Inc. and changed the purpose of the company to producing and selling ready-mix concrete and cement.[41] The Schwabs hoped to take advantage of government initiatives around the Cleveland area by entering the cement and concrete business.[42] In fact, shortly after the change, projects from state, federal, and municipal agencies represented a major portion of Schwab Industries' work in Ohio.[43] Schwab Industries also had a competitive industry advantage via the company's strategic positioning near major interstates and high traffic areas, which allowed the company to expediently deliver materials to building sites.[44] As a result, the Schwab family's small business quickly grew after entering the concrete and cement industry and, by 2010, employed around 350 people.[45]

Five of Schwab Industries' subsidiaries were incorporated and doing business in Ohio.[46] Specifically, Medina Cartage Company ("MCC"), Medina Supply Company ("MSC"), Quality

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[39] Ohio Supply Corporation's Articles of Incorporation *available at* http://www2.sos.state.oh.us/reports/rwservlet?imgc12g&Din=D026_1898.

[40] *Id.*

[41] Amendment to Ohio Industrial Supply's Articles of Incorporation *available at* http://www2.sos.state.oh.us/reports/rwservlet?imgc12g&Din=F899_1595.

[42] *See* Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 8–9.

[43] *Id.*

[44] *Id.*

[45] *Id.* at p. 9.

[46] *Id.* at p. 10.

Block & Supply Company ("QBS"), O.I.S. Tire, Inc. ("OIS"), and Twin Cities Concrete Company ("TCC") all were incorporated in Ohio and operated throughout northeast Ohio.[47]

Each of these subsidiaries had a place in Schwab Industries' supply chain. MCC operated transportation systems, including hauling trucks.[48] MSC, QBS, and TCC together operated twelve ready-mix plants, two concrete block plants, and one aggregate distribution terminal.[49] OIS was a tire repair shop in Midvale, Ohio, and its relationship to Schwab Industries' overall business model is unclear today.[50]

Additionally, three of Schwab Industries' subsidiaries were incorporated and doing business in Florida.[51] In particular, Schwab Ready-Mix, Inc. ("SRM"), Schwab Materials, Inc. ("SMI"), and Eastern Cement Corporation ("ECC") were all operating in southwest Florida.[52]

SRM operated all seven of Schwab Industries' ready-mix plants in the Fort Meyers area.[53] SMI was a holding company for ECC and was located on a 2,100-acre plot of real estate in Fort Meyers.[54] The 2,100-acre tract of real estate was an attractive asset, as it contained an

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[47] *Id.*

[48] *Id.*

[49] *Id.*

[50] At the time of the debtors' bankruptcy filings in February 2010, OIS had already dissolved and wound down its business operations and liquidated its assets. *See* O.I.S's Articles of Dissolution. Therefore whether OIS rebuilt tires for MCC or other subsidiaries is unclear, as the subsidiary did not play a major role in the bankruptcy case.

[51] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 10–11.

[52] *Id.*

[53] *Id.*

[54] *Id.*

operating orange grove and a quarry with aggregate deposits.[55] ECC operated a 40,000 metric ton import/export terminal in Port Manatee, which was allegedly the largest deep-water port near the Panama Canal.[56] ECC's port access allowed Schwab Industries to import and export concrete materials to and from foreign markets.[57] ECC sold forty percent of its imported product directly to SRM for use at its plants, and the other sixty percent was sold to independent companies that were not competitive with Schwab Industries.[58]

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[55] *Id.* The aggregate deposits included sand, limestone, and other minerals that are the basic ingredients for making concrete. *Id.* Schwab Industries used the aggregate deposits to supply its ready-mix plants in Florida, which presumably would have integrated its supply chain and reduced the cost of doing business in two different states. *Id.* at p. 11. Notably, Schwab Industries had not obtained permits to mine the aggregate deposits on the property prior to filing for bankruptcy. Transcript of March 15, 2010 Hearing, Doc. No. 120, at p. 70–71.

[56] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 11.

[57] *Id.*

[58] *Id.*

II. Events Leading to Filing for Chapter 11

In 2001, Schwab Industries saw an opportunity for it to expand in Fort Meyers's real estate market, and its executives decided to take a risk. Between 2002 and 2006, that risk appeared to pay off as the area experienced a construction boom.[59] In 2007, however, the housing market across the United States, and especially in Florida, collapsed.[60] In the Fort Meyers area specifically, residential building permits declined from around 1,000 being issued in 2006 to less than 100 in 2007, with that number range staying consistent through January 2011.[61]

The real estate decline in Florida caused Schwab Industries to experience a significant drop in sales. In the 2006 fiscal year, Schwab Industries collected around $208 million in sales revenue.[62] By 2009, the company's sales had dropped by around 50% to $103 million, which resulted in an operating loss of approximately $5 million.[63] In 2010, Schwab Industries projected to collect between $70 to $75 million in revenues.[64] This sustained drop in sales over a

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[59] Reg'l Econ. Research Inst., *supra* note 7, at 11–12.

[60] *Id.* at 10–12; Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 11.

[61] *See* Reg'l Econ. Research Inst., *supra* note 7, at 11. Put differently, the number of residential building permits dropped by 90% in one year. *Id.*

[62] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 11 n.4.

[63] *Id.*; Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 6.

[64] Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 94.

four-year period caused a serious cash flow problem for a company that had recently expanded and possibly over-leveraged itself.[65]

As a result of its cash flow problems, Schwab Industries filed a chapter 11 petition on February 28, 2010.[66] The company's capital structure revealed why Schwab Industries suffered cash flow problems. In short, with sales revenue dropping, Schwab Industries did not have enough working capital and cash to meet the payment obligations on its secured and unsecured debt. Schwab Industries estimated its capital structure as follows:

- Estimated Total Value: $118,272,698[67]
  - Cash: $672,698[68]
  - Working Capital: $8,500,000[69]
  - Equipment: $16,100,000
  - Real Estate: $31,400,000[70]

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[65] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 11–12.

[66] *Id.* at p. 8.

[67] Debtors' Outline of Closing Arg., Doc. No. 174, at p. 3. The value of the business became a hotly debated issue during the debtors' attempt to obtain post-petition financing. These numbers reflect the debtors' preferred valuation during those debates. *Id.* The pre-petition secured lenders valued the business between $57 and $77 million. *See* Transcript of March 2, 2010, Doc. No. 120, at p. 182–184; KeyBank Supp. Obj. to Post-Petition Financing, Doc. No. 134, at p. 4–5. The court ultimately agreed with the pre-petition secured lenders. *See* Order Denying Post-Petition Financing, Doc. No. 192, at p. 1. Therefore, the debtors' preferred valuation was probably inflated. The two most highly fluctuating items in the debate were the Port lease and Corkscrew mining property. *See* Debtors' Outline of Closing Arg., Doc. No. 174, at p. 3-4. Thus, the values that the debtors ascribed to those property interests were most likely the source of their valuation's inflation.

[68] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 11. The cash portion was estimated as of December 2009. *Id.*

[69] Schwab Industries defined "working capital" as cash, accounts receivable, inventory, and prepaid expenses. Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 11 n.5.

- Port Manatee Lease: $28,000,000
- Corkscrew Road Property: $ 33,600,000

- Total Secured Debt: $59,703,781[71]
  - Revolving Line of Credit: $ 8,582,950
  - Term A Loan: $19,125,245
  - Term B Loan: 31,995,586
- Total Unsecured Debt: $16,590,149[72]
  - Trade Payables: $13,390,149[73]
  - Pension Plan: $3,200,000[74]

Schwab Industries' primary secured creditors were Bank of America, N.A., Huntington National Bank Association ("Huntington"), and KeyBank, N.A ("KeyBank") (collectively, "Secured Lenders").[75] KeyBank served as the administrative agent on all of the loans.[76] In return for each term loan, Schwab Industries granted the lender a security or mortgage interest on substantially all of Schwab Industries' personal and real property.[77] In return for the revolving line of credit, Schwab Industries granted the lender a floating security interest that rotated between accounts receivable and inventory.[78]

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[70] *See* Debtors' Outline of Closing Arg., Doc. No. 174, at p. 3. The "Real Estate" item was exclusive of the port lease and the Corkscrew property. *Id.*

[71] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 12.

[72] *Id.* at p. 12.

[73] *Id.*

[74] PGBC's Obj. to Sale Procedure, Doc. No. 268, at p. 1.

[75] KeyBank's Obj. to Post-Petition Financing, Doc. No. 36, at p. 1.

[76] *Id.*

[77] *Id.* at p. 2.

In the winter of 2010, Schwab Industries' cash needs were at a seasonal peak due to the industry-wide inability to create concrete at cold temperatures, causing a seasonal drop in sales for concrete producers.[79] Already hemorrhaging cash, Schwab Industries did not have enough money to pay the principal and interest payments due under the Amended and Restated Credit Agreement with the Secured Lenders.[80] As such, the Secured Lenders notified Schwab Industries on January 13, 2010, that it was in default on its secured debt.[81]

Schwab Industries originally sought to refinance with the Secured Lenders and began negotiations soon after it received the notice of default.[82] The Secured Lenders sent Schwab Industries a term sheet in early February.[83] The Secured Lenders' terms allegedly envisioned Schwab Industries filing for bankruptcy and liquidating its assets within ninety (90) days of the petition date.[84] The Secured Lenders also agreed to provide post-petition financing to fund Schwab Industries' day-to-day operations until the business was sold.[85]

The Schwab family naturally did not support the idea of quickly selling the company – and family legacy – in a bankruptcy proceeding.[86] The Schwabs believed that the construction

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[78] *See* Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 75; Debtor's Motion to Use Cash Collateral, Doc. No. 224, at p. 11.

[79] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 12.

[80] KeyBank's Obj. to Post-Petition Financing, Doc. No. 36, at p. 2.

[81] *Id.*

[82] *Id.* at p. 3.

[83] *Id.*

[84] Transcript of March 2, 2010 Hearing, Doc. 120, at p. 53–54.

[85] *Id.* at p. 47–48; KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 3.

industry had bottomed out and that the market had nowhere to go except up.[87] Further, because their business relied heavily on government projects, they believed that Schwab Industries was in a good position to receive federal stimulus monies.[88] Therefore, if they could file a chapter 11 petition and stall collection efforts, their business could successfully reorganize and continue to operate under their control. With these ideas in mind, the Schwabs began discussions with third parties for post-petition financing.[89]

On February 27, 2010, the Schwabs notified the Secured Lenders that they were pursuing financing from a third-party lender,[90] and that night, the Secured Lenders received a copy of Schwab Industries' motion for post-petition financing.[91] The following day, Schwab Industries and its eight subsidiaries filed voluntary chapter 11 petitions in the Bankruptcy Court for the Northern District of Ohio, Canton Division, where the case was docketed in Judge Russ Kendig's courtroom.[92]

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[86] Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 53–54.

[87] Debtors' Outline of Closing Arg., Doc. No. 174, at p. 6.

[88] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 9.

[89] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 12–13.

[90] KeyBank Objection to Post-Petition Financing, Doc. No. 36, at p. 3.

[91] *Id.*

[92] Debtors' Voluntary Petition, Doc. No. 1, at p. 1 ; Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 8.

III. Section 364(c)–(d) Financing

Along with the petition, Schwab Industries and its subsidiaries (collectively, "Debtors") filed several first-day motions. All of these motions were either intended to facilitate the administration of the estate or to smooth day-to-day operations that were necessary to continue the Debtors' businesses.[93] For example, the Debtors filed a motion to pay sales, franchise, and real estate property taxes, which had accrued in the amount of $821,193.[94] The Debtors also filed motions to pay pre-petition wages, salaries, and benefits of employees and retain certain bankruptcy professionals.[95] Additionally, the Debtors moved to jointly administer the cases of the parent corporation, Schwab Industries, and its eight subsidiaries for administrative

[93] GEORGE W. KUNEY ET AL. & MICHAEL L. BERNSTEIN, BANKRUPTCY IN PRACTICE 273–74 (Charles J. Tabb eds., 5th ed. 2015).

[94] Debtors' Motion to Pay Taxes, Doc. No. 14, at p. 8–10.

[95] Debtor's Motion to Pay Employees, Doc. No. 20, at p. 8–12; Debtors' App. to Employ Hahn, Loeser & Parks, Doc. No. 7, at p. 8. In its application for employment, Hahn, Loeser & Parks disclosed that it had represented two of the Secured Lenders in previous matters. Debtors' App to Employ Hahn, Loeser & Parks, Doc. No. 7, at p. 15. Although Hahn, Loeser & Parks worked for a subsidiary of Bank of America in an unrelated matter, it represented Huntington when the bank set up an irrevocable insurance trust for the Schwab family. Id. Hahn, Loeser & Parks argued that the prior representation did not affect their "disinterestedness" or present a material conflict of interest. 11 U.S.C. § 327(a) ("The trustee, with the court's approval, may employ one or more attorneys...that do not hold or represent an interest adverse to the estate, and that are disinterested persons...."); Id. The Court granted Hahn, Loeser & Parks's motion for employment, which set the stage for a malpractice suit later in the case. Order Granting App. to Employ Hahn, Loeser & Parks, Doc. No. 200, at p. 4.

convenience.[96] The court granted all of these motions without much debate on either side, as the Debtors needed to pay employees, maintain their bank accounts, continue to use their utilities, and pay taxes to operate their businesses and generate value for the estate.[97]

Moreover, the Debtors filed a motion for post-petition financing on the same day as the other first-day motions.[98] This motion became the first meaningfully contested matter in the case because the Debtors sought such financing pursuant to Section 364(c) or (d) of the Bankruptcy Code.

To receive post-petition financing, both Sections 364(c) and (d) first require the debtor-in-possession to show that alternative financing terms were unavailable on less onerous terms.[99] The major difference between Sections 364(c) and (d) is the amount of court involvement and the priority of the security interest granted under each section.[100] Under Section 364(c), the debtor can ask the court to grant the post-petition lender an administrative expense with priority over other administrative expenses, additional liens on property that is not already subject to an existing lien, or a junior lien.[101] The court must provide pre-petition lenders with notice and hearing prior to granting such relief.[102] Under Section 364(d), the debtor is permitted to ask the

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[96] Debtors' Motion for Joint Admin., Doc. No. 6, at p. 6; *see* 11 U.S.C. § 1015(b) (allowing joint administration if a joint petition of two or more petitions are pending in the same court).

[97] *See* Order Granting Joint Admin., Doc. No. 41, at p. 2-3; Order Allowing Payment of Shipper's Liens, Doc. No. 42, at p. 4-5; Order Granting Payment of Employees, Doc. No. 43, at p. 5-6; Order Allowing Use of Bank Accounts, Doc. No. 57, at p. 4-6; Order Allowing Use of Utilities, Doc. No. 58, at p. 4-7; Order Allowing Payment of Taxes, Doc. No. 59, at p. 4.

[98] *See* Debtors' Motion for Post-Petition Financing, Doc. No. 10.

[99] 11 U.S.C. § 364(c)–(d); KUNEY & BERNSTEIN, *supra* note 66, at 261.

[100] KUNEY & BERNSTEIN, *supra* note 65, at 261.

[101] 11 U.S.C. § 364(c)(1)-(3); *id.*

Court to grant the post-petition lender a senior or equal lien on property of the estate that is already subject to a lien – that is, a priming lien.[103] The Court must provide pre-petition lenders with notice, a hearing, and adequate protection prior to granting relief under Section 364(d).[104] Further, the debtor-in-possession bears the burden of proof on the issue of adequate protection.[105]

The Debtors claimed that they attempted to obtain alternative debt financing on an administrative expense or junior lien basis and equity financing.[106] Potential lenders rejected both of the debt proposals, however, because both situations would leave those lenders second in line to the Secured Lenders.[107] The Debtors also loosely discussed with a few investors a possible equity investment in their businesses; but because the housing market had crashed, investors probably did not see any feasible return on the Debtors' businesses in the near future.[108] The Debtors alleged that these attempts to obtain alternative financing were sufficient to meet Section 364(c) and (d)'s background conditions.[109]

Further, the Debtors asked the court to grant the potential debtor-in-possession lender ("DIP lender") super-priority administrative expense claims, first priority liens on any

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[102] 11 U.S.C. § 364(c); KUNEY & BERNSTEIN, *supra* note 66, at 261.

[103] 11 U.S.C. § 364(d); KUNEY & BERNSTEIN, *supra* note 66, at 261.

[104] KUNEY & BERNSTEIN, *supra* note 66, at 261–62.

[105] 11 U.S.C. § 364(d)(2).

[106] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 12–13, 18.

[107] *See* Transcript for March 2, 2010 Hearing, Doc. No. 120, at p. 90–93.

[108] *See id.*

[109] *See* 11 U.S.C. § 364(c)–(d); Transcript for March 2, 2010 Hearing, Doc. No. 120, at p. 93.

unencumbered assets, and priming liens on any previously encumbered assets.[110] Since the Secured Lenders already had security interests in substantially all of the Debtors' assets, the Debtors proposed that the court grant the Secured Lenders adequate protection in the form of replacement liens.[111] To grant replacement liens under Section 364(d)(1)(B), the court had to determine whether the Debtors could show (1) that sufficient equity would remain in their businesses to prevent a diminution in value of the Secured Lenders' collateral or (2) that the proceeds of the loan would help increase the value of the Secured Lenders' collateral.[112]

After the Debtors filed their motion, the primary issue became whether Schwab Industries had a sufficient "equity cushion" to prevent diminution in the value of the Secured Lenders' collateral.[113] While courts differ in the amount of such equity that is necessary, they generally agree that the equity cushion must be at least twenty (20) percent of the total value of the business to afford adequate protection.[114] Therefore, the court had to determine whether Schwab Industries had an equity cushion of at least twenty (2) percent after incurring the post-petition debt.

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[110] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 7.

[111] *Id.*

[112] *Swedeland Dev. Group, Inc. v. Resolution Trust Corp.*, 16 F.3d 552, 557 (3d Cir. 1994); KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 5; Committee Objection to Post-Petition Financing, Doc. No. 117, at p. 10.

[113] *See* Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 21; KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 5–7.

[114] *See, e.g.*, *Pistole v. Mellor*, 734 F.2d 1396, 1401 (9th Cir. 1984).

A. Terms of the Loan

After their failed attempts to obtain credit elsewhere, the Debtors began negotiations with EFO Financial Group ("EFO Financial") for post-petition financing.[115] EFO Financial specialized in underwriting debtor-in-possession loans and other alternative financing arrangements to U.S.-based real estate projects and corporations.[116] As an underwriter, EFO Financial probably sold most of its loans to other distressed investors in the market. EFO Financial maintained its principal place of business in Naples, Florida.[117]

EFO Financial agreed to serve as the proposed DIP lender prior to the commencement of Schwab Industries' bankruptcy case.[118] The Debtors and EFO Financial memorialized the terms of the proposed debtor-in-possession loan ("DIP loan") in a commitment letter that was attached to the Debtors' post-petition financing motion.[119] The commitment letter provided that the Debtors would receive a maximum principal amount of $18,308,655, which would be advanced in three separate stages.[120] The Debtors promised to spend the funds in accordance with a 13-week budget that the Debtors and the DIP lender agreed upon.[121]

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[115] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 14; Debtors' Brief in Support of Post-Petition Financing, Doc. No. 114, at p. 2.

[116] EFO Financial, http://efofinancial.com/financing_solutions.htm (last visited Apr. 12, 2016).

[117] EFO Financial, http://efofinancial.com/index.htm (last visited Apr. 12, 2016).

[118] *See* KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 3.

[119] Commitment Letter, Doc. No. 10-2.

[120] Commitment Letter, Doc. No. 10-2, at p. 2.

[121] *Id.* at p. 3.

In the first stage, the DIP lender would advance $3.5 million upon the court's entry of an interim order.[122] In the second stage, the DIP lender would advance another $3.5 million upon the entry of another interim order and the Debtors' satisfaction of certain conditions, including: (1) purchasing title insurance, from a company satisfactory to the DIP lender, on all real property in which the DIP lender retained a priming lien and naming the DIP lender as lost payee and additional insured; (2) executing any mortgage interests and security interests to give the DIP lender rights in certain collateral; and (3) a finding that the order of the court could not be appealed, stayed, or modified.[123] Finally, the DIP lender would advance the remaining $11,308,655 under an order authorizing such an advance and the completion of due diligence review.[124] The Debtors agreed to use the proceeds of the final advance to satisfy the outstanding principal, unpaid interest, and expenses for the first two advances.[125]

The DIP loan contained several terms, which, although unfavorable to the Debtors, were fairly consistent with market rates at the time. First, the interest rate was twelve (12) percent and increased to twenty (20) percent if the Debtors defaulted.[126] The first interest payment on the emergency advance would total $42,000 as a result. Further, the DIP lender was entitled to a two percent (2) commitment fee on each advance that would total approximately $360,000 if every

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[122] *Id.* at p. 2.

[123] *Id.* at p. 2, 10–14; Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 5.

[124] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 5; Commitment Letter, Doc. No. 10-2, at p. 2–3.

[125] Commitment Letter, Doc. No. 10-2, at p. 3.

[126] *Id.* at p. 4.

advance were made.[127] The DIP lender was also entitled to a two (2) percent exit fee of the entire principal amount at the loan's maturity.[128] The DIP lender would receive a one and a tenth (1.1) percent loan-servicing fee on each advance, which would total $198,000 if every advance were made.[129] Lastly, the DIP lender was entitled to an unused-line fee that amounted to thirty five hundredths (0.35) of a percent per month of the principal that had not been advanced after thirty (30) days from the entry of a final order.[130] Therefore, assuming all advances were disbursed on schedule, the Debtors would pay $960,000 in fees to the DIP lender.

The terms of the proposed DIP loan were common in the 2010 marketplace. Beginning in 2008, DIP lenders were experiencing returns in the mid to upper teens from the combination of high interest rates and fees.[131] Between 2008 and 2009, the average interest rate on a DIP loan was around twelve (12) percent, which is exactly what the proposed DIP lender charged the Debtors.[132] Further, the average upfront and exit fee was around two (2) to four (4) percent, which was commensurate to the proposed commitment and exit fees that EFO Financial charged the Debtors.[133] Underwriters, such as EFO Financial, also demanded fees for arranging,

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[127] *Id.* at p. 14.

[128] *Id.* at p. 14.

[129] *Id.* at p. 5.

[130] *Id.* at p. 5.

[131] Kenneth Steinberg & Christopher Robertson, *Key Developments and Trends in DIP Financing,* WEST PRACTICAL LAW (Feb. 19, 2010) at p. 1 *available at http://www.davispolk.com/sites/default/files/kenstein.chrobert.practical.law_.finance.article.03.24.15.PDF*.

[132] *Id.*; Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 4.

underwriting, and syndicating DIP loans during this period, which explains why EFO Financial charged the loan-service fee and an unused line-fee.[134] Therefore, the Debtors at least received market rates on the proposed financing arrangements, although the terms of the proposed DIP loan appear facially unfavorable today.

The DIP loan also contained several conditions precedent that the Debtors were required to satisfy prior to any advance of funds. Most importantly, the Debtors had to grant to the DIP lender a first priority lien on any of the Debtors' post-petition assets, excluding avoidance actions, and a first-priority priming lien on any other assets.[135] The obligations of the Debtors under the loan were also ranked as super-priority administrative expenses, subject only to a "carve-out" for the Debtors' professionals in the amount of $250,000.[136]

Additionally, the DIP loan contained fairly standard events of default, including: (1) the failure to pay principal and interest payments on time, (2) any covenant defaults, (3) entry of an order converting or dismissing the Debtors' chapter 11 case, and (4) entry of an order granting a lien or security interest in any collateral in favor of any other party that is senior to the DIP lender's priming lien.[137] Upon the occurrence of a default event, the Debtors, the U.S. Trustee, and the unsecured creditors' committee's counsel were all entitled to written notice specifying the default.[138] Any party entitled to notice had five (5) days to cure a default, and if that five-day

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[133] Steinberg & Robertson, *supra* note 104, at p. 1; Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 4.

[134] *See* Steinberg & Robertson, *supra* note 104, at p. 1.

[135] Commitment Letter, Doc. No. 10-2, at p. 5–6.

[136] *Id.* at p. 6–7; *see infra* note 497.

[137] Debtors' Motion for Post-Petition Financing, Doc. No. 10, at p. 8.

period expired, the DIP lender had the right to file an emergency motion with the court for relief from the automatic stay.[139] At that point, the Debtors only had the right to contest the declaration of a default, which implies that they could not assert any other defenses relating to the automatic stay.[140]

B. The Lack of Adequate Protection

In their motion, the Debtors sought financing under Section 364(d) of the Code.[141] Section 364(d) required the Debtors to show that the Secured Lenders were adequately protected from any decline in the value of their collateral if the court granted priming liens.[142] Section 361 of the Code defines adequate protection to include periodic cash payments, replacement or additional liens, or any other basis of relief that will provide a creditor with the "indubitable equivalent" of his or her interest in the debtor's property.[143] The focus of the requirement is to protect the secured lender's property interest from any diminution of value, which is required because imposition of a priming lien via a court order could be an uncompensated "taking" of property under the Fifth Amendment of the U.S. Constitution, unless there is adequate protection, in which case no taking would occur because there would be no loss in value.[144]

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[138] Commitment Letter, Doc. No. 10-2, at p. 9.

[139] *Id.*

[140] *Id.*

[141] Debtors' Post-Petition Financing Motion, Doc. No. 10, at p. 7.

[142] 11 U.S.C. § 364(d); KUNEY & BERNSTEIN, *supra* note 66, at 261-62.

[143] 11 U.S.C. § 361(1)-(3).

[144] *See* U.S. Const. amend. V; KUNEY & BERNSTEIN, *supra* note 66, at 262.

The Debtors argued that if the businesses were valued as a going concern, then a sufficient equity cushion existed to grant the Secured Lenders additional or replacement liens to an extent that would adequately protect the Secured Lenders' interest in their pre-petition collateral.[145] The Debtors believed that the proposed debtor-in-possession financing ("DIP financing") would enhance the value of the estate because it would preserve the operations of the businesses.[146] By contrast, a quick liquidation would actually be worse for the Secured Lenders, according to the Debtors, as the estate would lose the value of any goodwill and marketplace advantage that the businesses had accrued.[147] In short, the Debtors' ready-mix operations were simply worth more as an operating unit. As a result, the Debtors concluded that the post-petition financing actually benefited all of the parties in interest because it allowed the Debtors to preserve going-concern value.[148]

Prior to the first hearing, the Secured Lenders, through their agent, KeyBank, quickly filed an objection to the Debtors' motion.[149] The Secured Lenders took issue with the Debtors' actions on the eve of the bankruptcy. Specifically, the Secured Lenders contended that they were given less than twenty-four (24) hours' notice of the Debtors' intent to seek such drastic relief in the bankruptcy court.[150] The Secured Lenders argued that the bankruptcy court would violate the

[145] Debtors' Brief in Support of Post-Petition Financing, Doc. 114, at p. 3–4.

[146] *Id.* at p. 4.

[147] *Id.* at p. 4–11.

[148] *Id.*

[149] KeyBank Obj. to Post-Petition Financing, Doc. No. 36.

[150] *Id.* at p. 4–5.

Secured Lenders' due process rights if it granted priming liens on such short notice.[151] This part of the Secured Lenders' argument was essentially a plea for the court to hear more than the Debtors' side of the story prior to priming the Secured Lenders' liens on the Debtors' collateral.

Next, the Secured Lenders claimed the Debtors could not provide adequate protection.[152] To satisfy Section 364(d), the Debtors had to provide the Secured Lenders with the same protection that the Secured Lenders would have received absent any priming lien.[153] The Secured Lenders argued the Debtors' businesses did not have a large enough "equity cushion" to grant replacement or additional liens that approximated the value of the Secured Lenders' interests subordinated by the proposed priming liens.[154]

Further, the Secured Lenders argued that the court could not grant the DIP lender irrevocable priming liens through an interim order.[155] The Secured Lenders believed that the Debtors' proposed interim relief was not truly interim, as the Debtors had asked the court to

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[151] *Id.* at p. 4–5; *see* U.S. Const. amend. V.

[152] KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 5–7.

[153] *See In re Swedeland Dev. Group, Inc.*, 16 F.3d at 564 ("The [proposed adequate protection] should provide the pre-petition creditor with the same level of protection it would have had if there had not been post-petition super[-]priority.").

[154] KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 6–7.

[155] *See* KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 8–9. The Secured Lenders' argument contains references to Section 364(e) because the Debtor said Section 364(e) allowed the court to grant priming liens in an interim order. *Id.* Section 364(e) renders moot any appeal to reverse or modify a final order that authorizes the extension of credit or accrual of debt if a court issues a final order finding that the credit was extended or the debt was incurred in good faith. 11 U.S.C. § 364(e). Thus, the Secured Lenders said that Section 364(e) only applies to *final orders* by the plain language of the statute. KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 8. Nevertheless, the gravamen of the Secured Lenders' objection was that the court was granting final relief in an interim order, which is not authorized by any section of the Code. *Id.*

grant irrevocable priming liens that would permanently "reshuffle" the priority ladder by making the Secured Lenders junior to the proposed DIP lender.[156] If the court granted an irrevocable priming lien through an interim order, the Secured Lenders would lose the opportunity to convince the court to reverse that order at the final hearing.[157] As such, the Secured Lenders believed that the requested interim order truly granted final relief on an expedited basis, which limited the amount of time the Secured Lenders had to collect evidence and challenge the proposed post-petition financing.[158]

Lastly, the Secured Lenders argued that the EFO Financial's commitment was an illusory contract.[159] The commitment letter gave EFO Financial the right to terminate the contract in its "absolute and sole discretion" and "for any reason whatsoever."[160] The Secured Lenders said EFO Financial had not really given anything of value if its promise to advance funds was subject to capricious termination.[161] As such, EFO Financial's commitment was illusory.[162]

On March 2, 2010, the court held a hearing to consider, *inter alia*, whether to grant an interim order authorizing the Debtors to obtain the first advance of the DIP loan.[163] At the

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[156] KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 8–9.

[157] *Id. See also* Fed. R. Bankr. P. 4001(c) (permitting interim relief prior to a final hearing on a motion to obtain financing only to the extent necessary to avoid immediate and irreparable harm).

[158] KeyBank Obj. to Post-Petition Financing, Doc. No. 36, at p. 8–9.

[159] *Id.* at p. 9–10.

[160] *Id.* at p. 9.

[161] *See id.* at p. 10.

[162] *Id.*

hearing, Larry Oscar of Hahn, Loeser & Parks ("Hahn Loseser") and Marc Merklin of Brouse McDowell appeared as main and special counsel for the Debtors, while Alan Lepene of Thompson Hine appeared as main counsel for KeyBank.[164]

The Debtors and Secured Lenders primarily debated the proper method for valuing the Debtors' businesses at the hearing.[165] The chosen valuation method was related to whether there was a sufficient equity cushion to provide adequate protection to the Secured Lenders.[166] The Debtors contended that a going-concern value of the businesses was appropriate because the Debtors had a viable business plan that created a reasonable prospect of successful reorganization.[167]

The Debtors presented testimony from David Moreland, the executive vice president of Schwab Industries, and David Exley, vice president of administration of Schwab Industries.[168] Both of the executives highlighted the most important assets of the business and trends in the construction industry.[169] Specifically, David Moreland testified about the unique nature of the deep-water port in Manatee, Florida and the potential for mining on the "Corkscrew" quarry

[163] Transcript of March 2, 2010 Hearing, Doc. 120, at p. 1, 34–35.

[164] *See id.* at p. 2, 34–35.

[165] *Id.* at p. 48–50.

[166] *Id.* at p. 38.

[167] Debtors' Brief in Support of Post-Petition Financing, Doc. No. 114; *see In re Beker Industries Corp.*, 58 B.R. 725, 738 (Bankr. S.D.N.Y. 1986) (finding that the debts were likely to remain a going concern with time to reorganize based on credible evidence of continued cash flow improvements).

[168] Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 59–69, 72–78.

[169] *Id.*

property, which contained limestone deposits.[170] David Moreland estimated that the lease on the deep-water port was worth $35 to $40 million alone.[171] David Exley added that the slow collection of accounts receivable in the construction industry deflated the Debtors' borrowing base and cash flow projections, which tended to artificially degrade the Debtors' financial condition.[172]

In response, Alan Lepene claimed a liquidation value of the businesses' assets was the most appropriate valuation because the Debtors had no reasonable chance of successful reorganization.[173] Because the Debtors had touted the deep-water port as a valuable asset, Alan Lepene effectively presented the port's uselessness through cross-examination of David Moreland and David Exley. David Moreland admitted that the port was currently shut down, and David Exley admitted that collection of accounts receivable for the port was considerably slower than for the Debtors' ready-mix operations.[174] Further, Alan Lepene proffered evidence that showed that thirty (30) to forty (40) percent of the Debtors' clients were involved in the residential construction market, which was severely depressed in the spring of 2010.[175]

That being said, Alan Lepene only presented one appraisal of the Debtors' businesses after the Debtors presented hours of testimony.[176] Even if the court doubted some of the

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[170] *Id.* at p. 66–69.

[171] *Id.* at p. 67.

[172] *Id.* at p. 74–77.

[173] *Id.* at p. 48–50.

[174] *See id.* at p. 69–70, 86.

[175] *See id.* at p. 79.

Debtors' claims, the court simply had more information to consider from the Debtors' point of view. Furthermore, the Debtors' position was fairly sympathetic—the Debtors were a local family business that employed hundreds of people. The court accordingly granted the Debtors' proposed relief and allowed the first draw of $3.5 million.[177] The Court set a final hearing for March 17, 2010, to determine whether the Debtors should receive the final two advances on the loan.[178]

The court's decision relied upon the Debtors' valuation methods, which indicated that only a value of $72 million was necessary to provide a twenty (20) percent equity cushion.[179] Based upon the limited testimony offered, the court found that the Debtors had demonstrated a value approximating that figure.[180]

The court gave some indication, however, that the post-petition financing did not quite live up to the Debtors' expectations. For example, the court took note of the fact that the Debtors had not presented any viable plan for reorganization.[181] Further, the DIP loan contained terms that the Court believed might hinder the Debtors' ability to repay the loan.[182] Judge Kendig described his attitude about the hearing in the following manner:

I feel like it's a scene in a bad movie where we're insisting on driving over the

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[176] *See id.* at p. 110. The Debtors' witnesses testified – including on cross-examination – from 2:18 p.m. until 11:42 p.m. *See id.* at p. 62, 142.

[177] *See id.* at p. 189.

[178] *See id.* at p. 196.

[179] *See id.* at p. 178–79, 189.

[180] *Id.* at p. 189.

[181] *See id.* at p. 190.

[182] *See Id.* at p. 191.

> cliff together. And if we have to do that, we'll do that and then we'll issue a decision when we come back. And we'll either be three and a half million more dollars down in terms of money that's been put into a, what is currently a cash losing operation, or perhaps more, depending on . . . what the proof is when we return.[183]

The court issued a written order the following day in accordance with its oral decision at the March 2, 2010, hearing.[184] Under that order, the Debtors received a $3.5 million emergency advance of funds in accordance with the commitment letter between the Debtors and EFO Financial.[185] At this point, EFO Financial – the originator of the loan – had assigned its interest to Naples Lending Group ("Naples")[186], which is a subsidiary of a sophisticated hedge fund that specializes in distressed investing.[187] The court granted Naples a priming lien on all of the Debtors' assets, including assets acquired after the petition date, and a super-priority administrative expense claim for any deficiency.[188] The court also granted to the Secured Lenders replacement liens equal to the aggregate diminution of value caused by Naples's priming liens.[189] The Secured Lenders' liens, however – and all other claims below those

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[183] *Id.*

[184] Interim Order Authorizing Post-Petition Financing, Doc. No. 44.

[185] *Id.* at p. 9.

[186] Naples Lending Group, LC is a subsidiary of ITG Holdings, LLC. ITG Holdings, http://www.itgholdings.com/index.html (last visited Apr. 13, 2016). ITG Holdings is a financial company that specializes in distressed debt securities and DIP lending. *Id.* ITG Holdings was founded in 2008 and currently has its principal offices in Naples, Florida. *Id.* Naples Lending serves as the DIP lending and service arm of ITG Holdings and has primarily been involved in chapter 11 cases originating in southwest Florida. *Id.*

[187] Interim Order Authorizing Post-Petition Financing, Doc. No. 44, at p. 2.

[188] *Id.* at p. 11–12.

[189] *Id.* at p. 13.

lenders – were subordinated to Naples's lien interest, which obviously heightened the intensity of the case for the creditors.[190]

By March 12, 2010, specific unsecured creditors started filing objections to the proposed post-petition financing. For example, St. Mary's Cement Company ("St. Mary's) asserted a claim of reclamation under Section 546(c) of the Code and Section 1302.76 of the Ohio Revised Code.[191] Section 546(c) provides that a seller may reclaim goods sold to a debtor so long as the debtor received the goods, while insolvent, within forty-five (45) days of the commencement of the bankruptcy case.[192] To perfect a claim of reclamation, the seller must send a written demand to the debtor within forty-five (45) days of the debtor's receipt of the goods or within twenty (20) days of the commencement of the bankruptcy case.[193] St. Mary's had shipped goods to the Debtors, while they were insolvent, within forty-five (45) days of the petition date, thereby satisfying the requirements under Section 546(c).[194] Further, St. Mary's had made demand on the Debtors to perfect their reclamation claim.[195]

Ohio Revised Code's Section 1302.76 is Ohio's version of UCC 2-702. St. Mary's alleged that the Sixth Circuit had interpreted that provision to prevent a secured creditor from defeating a seller's right to reclamation.[196] St. Mary's further argued that the proposed DIP loan

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[190] *Id.* at p. 14.

[191] St. Mary's Obj. to Post-Petition Financing, Doc. No. 104, at p. 1.

[192] *See* 11 U.S. 546(c).

[193] *Id.*

[194] St. Mary's Obj. to Post-Petition Financing, Doc. No. 104, at p. 1. 195 *Id.* at p. 1–2.

would defeat its right to reclaim those goods because the goods would become subject to the DIP's priming liens.[197] As such, St. Mary's asked the court to include its reclamation claim in the administrative "carve out" that the Debtors' motion created.[198]

Euclid Chemical Company ("Euclid Chemical") also filed a comment in response to the Debtors' motion for post-petition financing.[199] Euclid Chemical claimed that it had installed "dispenser equipment" at one of the Debtors' ready-mix plants.[200] The equipment consisted of a chemical admixture dispenser, a tank, assembly, a shed, and a trailer.[201] Euclid Chemical claimed that it had not transferred any ownership in its equipment to the Debtors.[202] Therefore, Euclid Chemical argued that the equipment was not "property of the estate" within the meaning of Section 541(a) because the Debtors did not have an interest in the equipment.[203] Euclid Chemical accordingly asked the court to exclude the property from any priming lien and require the Debtors to return the property as soon as possible.[204]

On March 15, 2010, the Unsecured Creditors' Committee (the "Committee") filed a

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[196] *Id.*; *see Phar-Mor, Inc. v. McKesson Corp.*, 534 F.3d 502, 508 (6th Cir. 2008).

[197] St. Mary's Obj. to Post-Petition Financing, Doc. No. 104, at p. 2.

[198] *Id.*

[199] Euclid Chemical's Cmt. in Response to Post-Petition Financing, Doc. No. 101.

[200] *Id.* at p. 2.

[201] *Id.*

[202] *Id.* at p. 3.

[203] *Id.* at p. 3; *see* 11 U.S.C. § 541(a) (defining property of the estate to include "all legal and equitable interests of the debtor in property as of the commencement of the case").

[204] Euclid Chemical's Cmt. in Response to Post-Petition Financing, Doc. No. 101, at p. 3–4.

detailed objection to the proposed post-petition financing deal.[205] The Committee believed that the Debtors had provided insufficient information on the issues of "alternative financing" and "adequate protection" under Section 364(d).[206] The Committee alleged that the Debtors had only offered "conclusory explanations" of its attempts to obtain alternative financing.[207] Further, the Committee believed that the debtor-in-possession facility protected the Secured Lenders' interests in a "superficial manner."[208] The Committee pointed out that the Secured Lenders' appraisal showed a $4.8 million deficiency claim for the Secured Lenders if the court authorized the entire debtor-in-possession facility.[209] The Committee contended such a large deficiency claim would greatly impair the position of the unsecured creditors.[210]

Furthermore, the Committee argued that the commitment letter contained several commercially unreasonable terms.[211] For example, the Committee highlighted that the final advance on the loan required the Debtors to pay hefty "service" and "commitment" fees, even though the advance was intended to pay off the previous two advances.[212] The Committee argued that the loan agreement was drafted overly broadly, as it contained several "materially adverse change" clauses and allowed the DIP lender to terminate the agreement in its sole

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[205] Committee Obj. to Post-Petition Financing, Doc. No. 117.

[206] *Id*. at p. 2.

[207] *Id*. at p. 7.

[208] *Id*. at p. 9.

[209] *Id*. at p. 12.

[210] *Id*. at p. 12–13.

[211] *Id*. at p. 15.

[212] *Id*. at p. 16.

discretion.[213] The Committee also alleged that the $250,000 "carve out" for professional fees was insufficient to meet the Debtors' likely expenses.[214]

Overall, the Committee and the Secured Lenders had developed two points of attack on the proposed financing deal that ultimately proved successful. Viewed together, the Committee and the Secured Lenders argued (1) that the Debtors had chosen the wrong method to value their businesses, which inflated their prospects of reorganization, and (2) that the Debtors had not obtained a commercially reasonable loan commitment—instead, the DIP loan would actually hurt the Debtors' prospects of reorganization.[215]

On their part, the Debtors continued to contend that an equity cushion was available if the court applied a going-concern value to its businesses.[216] The Debtors claimed that their businesses were projected to generate positive EBITDA[217] and net positive cash flows.[218] A key link in the Debtors' valuation was the Corkscrew mining property, a 2,100-acre plot of real estate near Fort Meyers, Florida.[219] The Debtors estimated that the property would generate significant revenue in the future because it contained limestone deposits, despite the Debtors' failure to

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[213] *Id.* at p. 14, 19.

[214] *Id.* at p. 19.

[215] *See* KeyBank Supp. Obj. to Post-Petition Financing, Doc. No. 134, at p. 6–9; Committee Obj. to Post-Petition Financing, Doc. No. 117, at p. 15–20.

[216] Debtor's Outline of Closing Arg., Doc. No. 174, at p. 1.

[217] EBITDA is an acronym for "earnings before interest, taxes, depreciation and amortization."

[218] Debtors' Outline of Closing Arg., Doc. No. 174, at p. 1.

[219] *Id.* at p. 1-2; *see supra*, note 70.

obtain the proper mining permits for the property.[220] The Debtors presented testimony from another cement company executive, Neal Montgomery, who claimed that obtaining a permit on the property was possible.[221] The Debtors also offered testimony to show that the construction industry was on the rebound. Ergo, the Debtors claimed that the DIP loan was being used to fund the costs of bankruptcy so that the Debtors could successfully organize and increase the value of the estate.

By contrast, the Secured Lenders continued arguing that "orderly liquidation value" was appropriate.[222] This valuation method assumed that the Debtors' assets would be sold without the normal market exposure. The method essentially asks what a debtor could obtain for each asset or the entire business through a quick sale, as opposed to how much money the Debtors' businesses could generate if they continued to operate.[223]

The Secured Lenders advocated that "orderly liquidation value" was appropriate because the Debtors had not submitted a reasonable plan for reorganization.[224] The construction markets in Fort Meyers, Florida, and Cleveland, Ohio, showed no signs of recovering from their sharp

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[220] *See id.*; Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 70–71. In fact, David Moreland testified that the Debtors had applied for a permit to mine the Corkscrew property, but that the permit was denied. Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 70–71.

[221] Debtors' Outline of Closing Arg., Doc. No. 174, at p. 2.

[222] KeyBank Supp. Obj. to Post-Petition Financing, Doc. No. 134, at p. 6–9.

[223] The Secured Lenders' motive for proposing orderly liquidation value was that it supplies a much lower valuation, at least in most cases. For example, the Debtors' proposed going-concern value estimated the Debtors' value around $ 117 million. Debtors' Outline of Closing Arg., Doc. No. 174, at p. 3. On the other hand, the Secured Lenders' orderly liquidation value estimated the Debtors' value at approximately $52.8 million. Debtors' Outline of Closing Arg., Doc. No. 174, at p. 4.

[224] KeyBank Supp. Obj. to Post-Petition Financing, Doc. No. 134, at p. 6–9.

declines, and the Debtors were still projected to experience negative cash flows.[225] Any equity investor, therefore, was unlikely to infuse a large amount of capital into the businesses.[226] The Secured Lenders' appraisals accordingly showed the Debtors' businesses as valued between $47.5 and $60 million.[227] Because the Debtors would have $75 million in total debt after the DIP loan, the Secured Lenders reasoned that the court could not provide adequate protection in any form because the available equity cushion would be far below twenty (20) percent.[228]

The court ultimately agreed with the Secured Lenders and, in a short, one-paragraph order, denied the Debtors' motion for post-petition financing.[229] It appears that the court made the correct decision because the Secured Lenders' valuation of the Debtors businesses was the most reasonable. The Debtors relied heavily on the future production of a mining property that lacked permits.[230] With the Debtors already bleeding cash and lacking a viable plan to reorganize, liquidation appeared inevitable, and allowing the Debtors to incur further indebtedness would only harm the interests of creditors without supplying a corresponding benefit to the businesses.[231]

Judge Kendig had already hinted at the first hearing that he was skeptical of the loan's

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[225] *Id.*

[226] *Id.*

[227] Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 160–61.

[228] KeyBank Supp. Obj. to Post-Petition Financing, Doc. No. 134, at p. 6–9; Debtors' Outline of Closing Arg., Doc. No. 174, at p. 4.

[229] Order Denying Post-Petition Financing, Doc. No. 192, at p. 1.

[230] *See* Debtors' Outline of Closing Arg., Doc. No. 174, at p. 1–2; Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 70–71.

[231] *See* KeyBank Supp. Obj. to Post-Petition Financing, Doc. No. 134, at p. 6–9.

terms and the Debtors' chances of successful reorganization.[232] Because the Secured Lenders had two weeks – rather than four days – to prepare their arguments, they were able to take a solid stance against the Debtors' proposed valuation. After hearing both sides of the case, the judge could presumably see that the Debtors were essentially asking the court to allow equity to bet against the odds with the creditors' money, which would irreparably harm the interests of the creditors. As such, it appears that Judge Kendig correctly denied the Debtors' motion to obtain post-petition financing.

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[232] *See* Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 190–91.

IV. The Sales Process – Part I

After the court denied the Debtors' motion to authorize post-petition financing, the Debtors were forced to make a deal with the Secured Lenders to use their cash collateral to fund ongoing operations. Cash collateral is defined in Section 363(a) to include "property in which the estate and an entity other than the estate have an interest."[233] The property covered under Section 363 includes "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents."[234] To use cash collateral, a debtor-in-possession must receive the consent of "each entity that has an interest in such collateral" or receive court approval after a notice and a hearing.[235] Because the Debtors had a revolving line of credit secured by a floating lien on receivables and inventory, most of their cash constituted of cash collateral.[236] As such, the Debtors were forced to request the Secured Lenders' permission to use cash collateral to continue to fund business operations.

The Secured Lenders would only allow the use of their cash collateral if the Debtors agreed to certain terms. Therefore, the Secured Lenders had considerable leverage over the Debtors. The Secured Lenders could use that leverage to ensure that the Schwabs quickly sold

[233] 11 U.S.C. § 363(a); KUNEY & BERNSTEIN, *supra* note 66, at 248.

[234] 11 U.S.C. § 363(a); KUNEY & BERNSTEIN, *supra* note 66, at 248.

[235] 11 U.S.C. § 363(c)(2).

[236] *See* Transcript of March 2, 2010 Hearing, Doc. No. 120, at p. 75–77.

their businesses and agreed to statements of fact and conclusions of law that were favorable to the Secured Lenders. Accordingly, the Secured Lenders were in a good negotiating position at this point in the case.

The Debtors and the Secured Lenders filed the first agreed cash collateral order on March 24, 2010.[237] The Secured Lenders drafted the order to cover a short period of three days: March 24 through 26.[238] The terms of the order foreshadowed the eventual terms of the first agreed order to use cash collateral that would cover a more substantial period.[239] Most significantly, the Debtors acknowledged in paragraph "J" of the order that the Secured Lenders had valid and perfected security interests in all of the Debtors' cash collateral generated prior to the petition date.[240] This acknowledgment foreclosed the Debtors' ability to challenge the enforceability of the loan documents or otherwise exercise their avoiding powers later in the case.[241]

Moreover, on April 5, 2010, the Secured Lenders and the Debtors agreed to amend the cash collateral order.[242] Under the amended order, the Debtors were required to remit all of their bank accounts to the Secured Lenders, excepting a small portion to fund the Debtors' payroll.[243] The Debtors could continue to operate and draw from the accounts only in accordance with a

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[237] First Cash Collateral Order, Doc. No. 202.

[238] *Id.* at p. 7.

[239] *See generally* Final Cash Collateral Order, Doc. No. 280.

[240] First Cash Collateral Order, Doc. No. 202, at p. 4–5, ¶ J.

[241] *See* 11 U.S.C. § 544(a)-(b).

[242] *See* Amended Cash Collateral Order, Doc. No. 239, at p. 1–2. 243 *Id.* at p. 7.

pre-approved budget.[244] If the Debtors wanted to spend outside of the budget, then they had to obtain the written consent of the Secured Lenders.[245] The budget lasted from March 31, 2010, to June 21 of that same year and set a spending limit of $1,000,000 prior to the sale of certain non-core assets.[246] After the sale of non-core assets, the Debtors' were authorized to use the proceeds along with a $3,000,000 refund of life insurance premiums from a life insurance policy held by the Schwab Family Trust.[247]

The Debtors also agreed to several terms that ensured that the Secured Lenders remained adequately protected from any diminution in value.[248] First, the Debtors agreed to grant the Secured Lenders replacement liens and super-priority administrative expense claims, junior only

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[244] *Id.* at p. 8.

[245] *Id.* at p. 7–8.

[246] *Id.* at p. 8.

[247] *Id.* at p. 8, 14. Section 363(b) allows a debtor to sell property of the estate, "other than in the ordinary course of business," after notice and a hearing. 11 U.S.C. § 363(b)(1). Under this section, the Debtors sought to auction seventy-one (71) cement-mixing trucks, three portable cement plants, and certain real property. *See* Motion for Noncore Asset Sale, Doc. No. 242, Ex. A, at p. 14–22. The Debtors believed that the asset sale would produce approximately $4.5 million in revenue. Motion for Cash Collateral, Doc. No. 224, Ex. A, at p. 1. The Debtors sought to employ Cincinnati Industrial Auctioneers ("Cincinnati Auctioneers") to auction the personal property and Chartwell Group ("Chartwell") to auction the real property. *See* Motion for Noncore Asset Sale, Doc. No. 242 at p. 7. The court ultimately approved the sale of and auction procedures for the non-core assets on April 16, 2010. Noncore Asset Sale Order, Doc. No. 285, at p. 4. The court found that the sale was necessary for the Debtors to meet their operating cash needs during the seasonal peak of cement mixing. *Id.* at p. 2–3. The Court approved the payment of Chartwell and Cincinnati Auctioneers through proceeds from the sale; after the sale was completed, however, both auctioneers had to submit a report detailing the auction and the auctioneer's expenses. *Id.* at p. 4–8. Finally, under the court's order, any pre-petition liens attached to the proceeds of the sale of the non-core assets, thereby turning any cash generated from the sale into cash collateral. *Id.* at p. 3.

[248] *See* 11 U.S.C. § 364(d). A debtor must provide the secured lender with adequate protection from diminution in value if the debtor is authorized to use cash collateral under Section 363(b). *Id.*; *see supra* Section II part B for definitions of adequate protection.

to Naples's priming liens for the $3.5 million of the DIP financing that had already been approved.[249] Second, the Debtors agreed to allow the Secured Lenders ongoing access to the Debtors' financial records during regular business hours so that the Secured Lenders could supervise the Debtors' compliance with the court's order.[250] Third, the Debtors agreed to maintain all current insurance levels on their assets and to refrain from increasing the salaries, dividends, or benefits of any officers of the company.[251]

Moreover, the order contained several termination events that were designed to ensure that the case proceeded as the Secured Lenders desired. For example, the Debtors were required to file (1) a motion seeking approval of a sale of non-core assets and (2) a motion seeking approval of a Section 363 sale of substantially all of the Debtors' assets on the same day as the cash collateral order.[252] In connection with those motions, the Debtors were required to obtain a binding letter of intent, with no due diligence or financing contingency, and a five (5) percent earnest deposit for the purchase of substantially all of the Debtors' assets by April 30, 2010.[253] The Debtors were further required to designate a stalking horse bidder and enter into an asset purchase agreement with that bidder, consistent with the letter of intent, by May 14, 2010.[254] Lastly, the Debtors were obligated to conduct an auction by June 2, 2010, and to obtain approval

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[249] Amended Cash Collateral Order, Doc. No. 239, at p. 9–10.

[250] *Id.* at p. 10, 17–18.

[251] *Id.* at p. 10.

[252] *Id*. at p. 13.

[253] *Id*. at p. 14.

[254] *Id*. at p. 15.

of the ensuing sale by June 3, 2010.[255] If Debtors' management failed to meet any of these deadlines or support the marketing and sale effort, then the Debtors' authorization to use cash collateral would correspondingly terminate.[256]

In compliance with the amended cash collateral order, the Debtors also filed motions to approve a Section 363 sale and the auction and bidding procedures associated with the sale on April 5, 2010.[257] The Debtors asked the court to approve the sale of all or substantially all of the Debtors' assets through a bidding and auction process.[258] The Debtors stated that Section 363(b)(1) allowed a debtor-in-possession to sell substantially all of its assets if the debtor satisfied certain elements.[259] Specifically, the Debtors relied on *In re Country Manor of Keaton, Inc.*, 172 B.R. 217 (Bankr. N.D. Ohio 1994), which provided a four-part test requiring the debtor to demonstrate (1) a sound business reason for the sale, (2) accurate and reasonable notice of the sale, (3) an adequate sale price, and (4) good faith behavior throughout the sale.[260]

The Debtors alleged that the value of their businesses was deteriorating because the Debtors could not afford to finance ongoing operations.[261] The Debtors could not fund ongoing operations without using the Secured Lenders' cash collateral, and the court's amended order

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[255] *Id.*

[256] *Id.* at p. 16–17.

[257] *See* Debtors' § 363 Sale Motion, Doc. No. 241; Debtors' Bidding Procedures Motion, Doc. No. 245.

[258] Debtors' § 363 Sale Motion, Doc. No. 241, at p. 7.

[259] *Id.* at p. 9–10.

[260] *In re Country Manor of Keaton, Inc.*, 172 B.R. 217, 220–21 (Bankr. N.D. Ohio 1994); Debtors' § 363 Sale Motion, Doc. No. 241, at p. 10.

[261] Debtors' § 363 Sale Motion, Doc. No. 241, at p. 10.

authorizing the use of cash collateral required the Debtors to obtain approval of a Section 363 sale and auction process.[262] If the Debtors failed to consummate such an auction, then the Debtors would lose the ability to use cash collateral and would be forced to liquidate, thereby significantly lowering the value of the estate.[263] Thus, the Debtors alleged that they had a sound business purpose for seeking approval of the sale.[264]

Further, the Debtors provided several parties with notice of the motion and asked the court to bless their efforts as sufficient.[265] The Debtors also claimed that the proposed auction and bidding process would be conducted at arm's length and in a good faith manner.[266] The Debtors appeared to believe that the proposed bidding process would subject the Debtors' assets to a market check, thereby achieving the highest possible price for the assets.[267] The Debtors accordingly asked the court to approve the sale, as they alleged that they had satisfied all of the elements from *In re Country Manor*.[268]

The Debtors wanted to accomplish the sale under Section 363(f), which allows a debtor-in-possession to sell assets free and clear of all liens and encumbrances.[269] To do so, the Debtors had to demonstrate that "(i) applicable nonbankruptcy law would permit the sale free and clear of

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[262] *Id.*

[263] *See id.* at p. 10–11.

[264] *Id.*

[265] *Id.* at p. 17.

[266] *Id.* at p. 11.

[267] *Id.*

[268] *Id.*

[269] *Id.* at p. 12.

liens, (ii) the secured lenders had consented, (iii) the value of the sold property exceeds the aggregate value of the liens, (iv) such interest is in bona fide dispute *or* (v) the lender could be forced to accept a money satisfaction of its judgment in a legal or equitable proceeding."[270] Because the requirements of Section 363(f) are disjunctive, the Debtors only had to demonstrate one of these scenarios.[271] In this case, the Secured Lenders wanted an asset sale because the petition was filed, so the Debtors easily obtained the Secured Lenders' consent.[272] Therefore, the Debtors moved the court to grant the sale of the Debtors' assets free and clear of *any* liens, claims, and interests, except to the extent expressly assumed by the successful bidder.[273]

The Debtors' original bidding procedures motion provided the actual terms of the sale. Under the bidding procedures, the Debtors had to designate a stalking horse bidder[274] by April 30, 2010.[275] The Debtors were able to aggregate partial bids for component assets in order to compare those bids to a bid on all of their assets.[276] The Debtors had to consult with the Secured

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[270] *See* 11 U.S.C. § 363(f)(1)-(4).

[271] *See In re Kellstrom Indus., Inc.*, 282 B.R. 787, 793–796 (Bankr. D. Del. 2002) (approving a sale "free and clear" when only one of the requirements of Section 363 were met because those requirements were disjunctive).

[272] Debtors' § 363 Sale Motion, Doc. No. 241, at p. 12.

[273] Debtors' Bidding Procedures Motion, Doc. No. 245, at p. 11–12.

[274] A stalking horse bidder is the party that bids first on the debtor's assets. Typically, the stalking horse bidder will execute an asset purchase agreement prior to the actual auction. Then, at the auction, the other bidders will have to bid over the stalking horse bid in agreed-upon bid increments. If the stalking horse bidder loses at the auction, it typically receives a "break-up" fee that compensates it for tying up money and time in the auction process.

[275] Debtors' Bidding Procedures Motion, Doc. No. 245, Ex. B., at p. 5.

[276] *Id.* at p. 9.

Lenders and the Committee throughout the sales process.[277] The proposed assets for sale in the auction included all of the ready-mix operations in Ohio and Florida, the 2,100-acre plot in Florida that contained an orange grove and aggregate deposits, and the lease on the deep-water port in Port Manatee, Florida.[278] The Debtors planned to hold the auction on June 2, 2010, at the office of Hahn Loeser in Cleveland, Ohio.[279]

Moreover, the Debtors' bidding procedures motion contained due diligence limitations and bid requirements that created the process for submitting and processing compliant bids.[280] To submit a compliant bid, a bidder had to transmit, in writing, an executed copy of a form asset purchase agreement to Western Reserve Partners ("Western Reserve") – the Debtors' investment banker – by May 28, 2010, at 17:00.[281] Any bidder's offer had to be irrevocable, and the bidder had to pay the purchase price in cash.[282] The asset purchase agreement set a bid increment of $100,000 over the sum of the stalking horse's bid and break-up fee.[283] The bidder also had to provide evidence that it could complete the transaction, either through third-party financing or some other means, and supply a good faith deposit in the amount of five (5) percent of the

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[277] *See id.* at p. 4.

[278] *Id.*

[279] *Id.* at p. 8.

[280] *Id.* at p. 5–10.

[281] *Id.* at p. 6–7.

[282] *Id.* at p. 6.

[283] At this point, the Debtors had not selected a stalking horse bidder and, accordingly, left the break-up fee open for negotiation for when that party was eventually selected. *See id.* at p. 5. In fact, the Committee would eventually complain about the lack of specificity regarding the break-up fee. Committee's Limited Obj. to Bidding Procedures, Doc. No. 270, at p. 5.

purchase price.[284]

Under the original bidding procedures, any qualified bid could not be subject to any financial or due diligence contingency because of the hurried nature of the sale.[285] If a bidder signed a confidentiality agreement, however, the Debtors provided access to some information.[286] For example, Western Reserve maintained an online "data room" that compliant bidders could access.[287] The bidding procedures also granted a compliant bidder with reasonable access to the Debtors' financial records and business facilities.[288]

Several parties in interest filed objections shortly after the Debtors asked the court to approve the proposed sale and bidding procedures motions. In particular, Port Manatee's Port Authority, Holcim, Inc. ("Holcim"), St. Mary's, Allen Concrete Company ("Allen Concrete"), and National Lime all filed objections to the proposed sale.[289] Ultimately, the Debtors either resolved the objections or the court overruled the objections prior to the auction of the Debtors' assets.[290] Looking at the details of each objection, however, provides insight into the sale process.

The objections by Port Manatee, Holcim, and St. Mary's all related to the Debtors'

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[284] Debtors' Bidding Procedures Motion, Doc. No. 245, Exhibit B, at p. 6.

[285] *Id.* at p. 6.

[286] *Id.* at p. 5–6.

[287] *Id.*

[288] *Id.*

[289] *See* St. Mary's Obj. to Bidding Procedures, Doc. 367; Port Manatee's Obj. to Sale, Doc. No. 423; Allen Concrete's Obj. to Sale Motion, Doc. No. 428; Nat'l Lime's Obj. to Sale Motion, Doc. No. 431; Holcim's Obj. to Sale Motion, Doc. No. 433;

[290] Order Granting § 363 Sale, Doc. No. 455, at p. 21–22.

alleged miscalculation of cure amounts connected with the assumption and assignment of executory contracts or unexpired leases.[291] Port Manatee objected to the Debtors' calculation of a cure amount under its deep-water port lease and demanded that any potential bidder provide adequate assurance of payment under Section 363(f)(2)(B).[292] Likewise, Holcim, a supplier of ready-mix materials, noted that the Debtors planned to assume and assign their executory contract with ECC and alleged that the Debtors miscalculated the cure amount by close to $600,000.[293] Finally, St. Mary's contended that the Debtors' calculation of a cure amount under an executory contract was off by approximately $60,000.[294]

In response to these objections, the Debtors claimed that any potential purchaser would have the financial wherewithal to cure the stated amounts and to continue to adequately perform under the executory contracts.[295] The Debtors did not contest the creditors' revisions to the proposed cure amounts.[296] The court accepted the Debtors' assurances as sufficient to dismiss

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[291] *See* 11 U.S.C. § 365(a)-(b). A debtor, subject to court approval, is allowed to assume or reject any executory contract or unexpired lease. 11 U.S.C. § 365(a). If there has been a default on such a contract or lease, however, then the debtor may not assume the contract or lease, unless, at the time of assumption, the debtor (1) cures, or provides adequate assurance that the debtor will cure, the default, (2) compensates, or provides adequate assurance of prompt compensation, the other party to the contract or lease for any actual pecuniary loss, and (3) provides adequate assurance of future performance. 11 U.S.C. § 365(b)(1)(A)-(C). If the debtor plans to assign an assumed contract or lease, then the debtor must also satisfy Section 365(f)(2). Section 365(f)(2) requires the debtor to assume a contract or unexpired lease before assigning it and to provide adequate assurance of future performance under the contract. *See* 11 U.S.C. § 365(f)(2)(A)-(B).

[292] Port Manatee's Obj. to Sale, Doc. No. 423, at p. 2–4.

[293] Holcim's Obj. to Sale, Doc. No. 433, at p. 1–2.

[294] St. Mary's Obj. to Bidding Procedures, Doc. No. 367, at p. 2.

[295] Debtors' Reply to Objections to Sale Motion, Doc. No. 448, at p. 5–10.

[296] *Id.* at p. 5–10.

the concerns of the creditors.[297] Accordingly, the court did not allow these objections to delay the proposed sale.[298]

By contrast, Allen Concrete and National Lime both objected to the rejection or assignment of specific contracts and leases in the proposed auction. National Lime objected to a potential purchaser's ability to reject a lease covering an 18-acre plot in Ohio that the Debtors had leased to National Lime in 2009.[299] National Lime argued that Section 365(h) allowed it to retain possession.[300] Specifically, Section 365(h)(1)(A)(ii) provides that a lessee may retain its rights for the term of a lease that commenced prior to the trustee's rejection to the extent non-bankruptcy law allows the lessee to do so.[301] National Lime contended that the lease at issue was crucial to its business and moving would pose an undue hardship.[302] National Lime argued that the property provided easy rail access, contained over $ 1 million in inventory, and met all the necessary zoning and permit qualifications under state and federal law.[303] As such, National Lime asked the court to allow it to retain possession of the property under the lease, even if a potential purchaser decided to reject the lease.[304]

Allen Concrete was a fifty (50) percent partner with Schwab Ready-Mix in a company

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[297] Order Granting § 363 Sale, Doc. No. 455, at p. 21–22.

[298] *Id.*

[299] Nat'l Lime's Obj. to Sale, Doc. No. 431, at p. 2–3.

[300] *Id.* at p. 2.

[301] *See* 11 U.S.C. § 365(h).

[302] Nat'l Lime Obj. to Sale, Doc. No. 431, at p. 4–5.

[303] *Id.*

[304] *Id.* at p. 2.

called Allen Concrete Pumping.[305] Allen Concrete had a right of first refusal for Schwab Ready-Mix's partnership interest under their partnership agreement.[306] Allen Concrete objected to the inclusion of the partnership interest in the proposed sale if the Debtors did not offer the interest to Allen Concrete first or seek Allen Concrete's consent to assign the interest.[307]

Again, the Debtors were able to convince the court that these objections should not stall the sale process. The Debtors argued that National Lime misunderstood the law surrounding Section 365(h). Specifically, the Debtors contended that National Lime would not be able to retain possession under non-bankruptcy law—ergo, it should not maintain possession under Section 365(h).[308] The Debtors claimed that Ohio law allowed a mortgagee to foreclose on property subject to a lease if the mortgage was recorded prior to the lease and the mortgagee gave the lessee proper notice.[309] Therefore, KeyBank would have been able to foreclose on the property with notice under Ohio law because KeyBank's mortgage on the property was recorded prior to the lease with National Lime.[310] The Debtors contended that National Lime should be afforded adequate protection at most, but its lease interest should not stall the sale efforts.[311] By contrast, the Debtors agreed not to include the partnership interest in Allen Concrete Pumping in

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[305] Allen Concrete's Obj. to Sale, Doc. No. 428, at p. 2.

[306] *Id.* at p. 4–7.

[307] *Id.*

[308] Debtors' Reply to Objections to Sale Motion, Doc. No. 448, at p. 6–9.

[309] *Id.* at p. 7–8.

[310] *Id.* at p. 7.

[311] *Id.*

the sale, thereby rendering Allen Concrete's objection moot.[312]

Further, the Committee and the Pension Benefit Guaranty Corporation ("PBGC") filed objections to the bidding procedure motion.[313] Neither objection proved substantial enough to change any part of the eventual bidding process. The Committee objected to the lack of specificity in the bidding procedures regarding the stalking horse bidder's break-up fee.[314] The Committee reserved its right to object in the future if that fee was purposefully set high enough to chill bidding.[315] The PBGC contended that the Debtors failed to provide any information to potential bidders about the Debtors' underfunded pension plan.[316] The PBGC asked the court to include such information in the eventual asset purchase agreement to ensure that a potential purchaser would be able to assume approximately $3.2 million in pension liabilities.[317]

The Debtors successfully resolved both of these objections. The Committee reserved its right to object to the stalking horse bidder on any grounds, including the eventual break-up fee or the assignment of any executory contracts.[318] The PBGC withdrew its objection because the Debtors agreed to include information about its pension liabilities in the form asset purchase

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[312] *Id.* at p. 5.

[313] PBGC Obj. to Bidding Procedures, Doc. No. 268; Committee's Obj. to Bidding Procedures, Doc. No. 270.

[314] Committee's Obj. to Bidding Procedures, Doc. No. 270, at p. 4–6.

[315] *Id.*

[316] PBGC's Obj. to Sale, Doc. No. 268, at p. 1–3.

[317] *Id.* at p. 4.

[318] Order Approving Bidding Procedures, Doc. No. 288, at p. 6.

agreement.[319] The Debtors' estate later settled PBGC's by granting PBGC administrative claims and priority claims under Section 507(b)(5) in the amount of $453,113.[320] With these objections resolved, on April 16, 2010, the court approved the bidding and auction procedures for the sale of the Debtors' core assets.[321]

The Secured Lenders and the Debtors filed a final cash collateral order on April 15, 2010. This order largely mirrored the language of the amended order but did contain some differences.[322] Significantly, the final order allowed the Debtors to sell certain hauling trucks located in Florida without the supervision of the court, so long as the Debtors received at least $650,000 for the trucks.[323] The order also acknowledged the validity and nonavoidability of the Secured Lenders' interests in its collateral, excepting only the Committee's right to investigate and challenge these claims.[324]

The court-approved budget attached to the final cash collateral order highlighted the financial status of the Debtors at this point in the case.[325] The Debtors projected a negative operating cash flow for three out of the four weeks between March 20, 2010, and April 10, 2010.[326] Overall, for the period between March and October, the Debtors projected that they

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[319] Order Approving Bidding Procedures, Doc. No. 288, Exhibit A, at p. 20.

[320] Order Approving Settlement of PBGC Claim, Doc. No. 897, Ex. A., at p. 6.

[321] Order Approving Bidding Procedures, Doc. No. 288, at p. 4.

[322] Debtors' Rev. Bidding Procedures Motion, Doc. No. 344, at p. 5.

[323] Final Cash Collateral Order, Doc. No. 280, at p. 9–10.

[324] *Id.* at p. 3, 22–23.

[325] Final Cash Collateral Order, Doc. No. 280, Ex. 1, at p. 1.

[326] *Id.*

would operate with a negative $2,640,000 cash flow.[327] Payroll, freight and fuel, and professional fees were the three highest expenses on the Debtors' balance sheet.[328] The Debtors projected $3,234,000 in professional fees related to the cost of the bankruptcy case.[329]

Subsequently, the Committee filed an objection to the Secured Lenders' interest in the hauling trucks that the court authorized the Debtors to quickly sell in the final cash collateral order.[330] The Committee discovered that the Secured Lenders made a mistake in perfecting their security interest in the trucks. Under Florida Statute 319.27, a lender must note its liens on the title certificate of a vehicle to perfect its security interest in that vehicle.[331] The Committee produced copies of the titles of the trucks that the Secured Lenders claimed as collateral, but the titles did not contain any notation of the Secured Lenders' interests.[332] The Committee accordingly argued that those trucks could not be sold because they were not part of the Secured Lenders' pre-petition collateral.[333]

The Committee's objection proved ultimately correct. The Secured Lenders failed to perfect their security interests on several pieces of inventory, thereby lowering the amount of collateral available to satisfy the Debtors' obligations.[334] This failure by the Secured Lenders

[327] *Id.* at p. 1–3.

[328] *Id.* at p. 1.

[329] *Id.*

[330] Committee's Obj. to Cash Collateral Order, Doc. No. 276.

[331] Fla. Stat. § 319.27 (2010).

[332] Committee's Obj. to Cash Collateral Order, Doc. No. 276, at p. 3–4.

[333] *Id.* at p. 4–5.

highlights the importance of ensuring compliance with state laws regarding perfecting secured transactions. A single financing statement might not always cover every piece of inventory. Now, the Secured Lenders had to worry about their security interests in every vehicle located in Florida.

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[334] *See* Fla. Stat. § 319.27.

V. The Sales Process – Part II

On or before April 28, 2010, the Debtors received a compliant bid from Atlas Holdings and Garmark Partners, doing business together as Cement Resources.[335] Once the Debtors received the compliant bid, they filed a motion to revise the proposed bidding and auction procedures.[336] After this motion, the Debtors' relationship with the Committee began to unravel, as the Debtors, Secured Lenders, and Cement Resources appeared to collude to the detriment of unsecured creditors.

The Debtors agreed to seek approval for the modification of the bidding procedures for the benefit of Cement Resources, so long as Cement Resources promised the Debtors' insiders future employment and equity in the new company.[337] Then, the Secured Lenders agreed to give the Debtors $2,000,000 of post-petition financing because the Debtors did not want to obtain a refund on life insurance premiums, which would have terminated the Debtors' insiders as beneficiaries under the $7 million policies.[338] In return, the Debtors agreed to grant valid and perfected security interests on unencumbered assets[339] that the Secured Lenders had previously

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[335] Debtors' Rev. Bidding Procedures Motion, Doc. No. 344, at p. 6.

[336] *Id.* at p. 1.

[337] *See id.* at p. 10 n.5, 12.

[338] Second Motion for Post-Petition Financing, Doc. No. 369, at p. 3–4; Committee Obj. to Second Motion for Post-Petition Financing, Doc. No. 377, at p. 2.

[339] Those unencumbered assets included a fleet of hauling trucks located in Florida, a tax refund, and deposit accounts. Committee Obj. to Second Motion for Post-Petition Financing, Doc. No. 377, at p. 5. The total amount of the unencumbered assets was approximately $10 million. *Id.*

failed to perfect.[340]

Therefore, the court faced a major turning point in the case. Up until this time, all parties had managed to refrain from self-dealing and collusion—at least on the surface. After a stalking horse bidder was chosen, however, the Debtors finally gave into the temptation to insert perhaps unwarranted benefits into the sales process in hopes that the court would overlook any inequity in the interest of efficiency and finality.

A. The Revised Bidding and Auction Procedures

Atlas Holdings and Garmark Partners formed Cement Resources as a shell corporation solely for the purpose of purchasing the Debtors.[341] The company originally approached the Debtors in mid-April 2010 and asked to negotiate the deal outside of bankruptcy court.[342] Due to the constraints in the amended cash collateral order, the Debtors were obviously unable to perform a private negotiation.[343] Therefore, the Debtors asked Cement Resources if it would serve as the stalking horse bidder.[344] Cement Resources agreed, and the Debtors subsequently filed a revised motion to approve certain bidding and auction procedures.[345]

On April 30, 2010, the Debtors' board of directors met and discussed the sales process.[346] The meeting lasted for about two hours, and the Debtors' legal counsel and investment bankers

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[340] Second Motion for Post-Petition Financing, Doc. No. 369, at p. 4.

[341] *See* Debtors' Rev. Bidding Procedures Motion, Doc. No. 344, at p. 10 n.5.

[342] *Id.* at p. 12 n.7.

[343] *See* Final Cash Collateral Order, Doc. 280, at p. 15–16.

[344] Debtors' Rev. Bidding Procedures Motion, Doc. 344, at p. 6.

[345] *Id.*

[346] *Id.* at p. 9–10.

presented information on the revised bidding procedures.[347] At the conclusion of these presentations, the Debtors' board approved the revised bidding procedure motion and the designation of Cement Resources as the stalking horse bidder.[348] Significantly, the Debtors' board of directors was comprised entirely of four members of the Schwab family, who owned all of the equity in the different businesses.[349] Because Cement Resources was a shell corporation with no existing concrete, ready-mix, or cement operations and no management structure in place, the company approached the Schwabs prior to the board meeting about the possibility of allowing them to retain management positions in the new company.[350] Further, Cement Resources also discussed giving the Schwabs a minority equity position in the new firm in exchange for certain assets that the Schwab family personally owned.[351] Therefore, the board's approval of the sale and bidding procedures was not at all surprising, given that the Schwab family hoped to obtain handsome benefits from the stalking horse bidder.

The Debtors also executed an asset purchase agreement with Cement Resources, which mimicked the Cement Resources bid proposal, in the revised bidding procedure motion.[352] Cement Resources agreed to pay the Debtors $48,350,000 in cash, plus a reimbursement of up to $2 million to the Secured Lenders for proposed financing that would help the Debtors cover

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[347] *Id.*

[348] *Id.*

[349] *Id.* at 10 n.5.

[350] *Id.*

[351] *Id.*

[352] *Id.*

expenses throughout the sale.[353] Cement Resources agreed to purchase all of the Debtors' businesses, including some non-core assets, which the Debtors did not auction in the previous non-core asset sale.[354]

Cement Resources also agreed to assume several liabilities of the Debtors. For example, it agreed to assume up to $602,000 of § 503(b)(9) claims as well as up to $750,000 of post-petition trade payables.[355] The § 503(b)(9) claims consisted of the value of any goods that the Debtors received in the ordinary course of business within 20 days of the commencement of the case and were subject to a vendor's reclamation.[356] Cement Resources also agreed to pay any cure costs associated with the assumption or assignment of executory contracts.[357] In return, Cement Resources granted the Schwabs the right to receive annual earn-out payments equal to twenty (20) percent of the net profits attributable to (1) the mining of the Debtors' quarry in Florida or (2) the sale of any validly permitted mining rights to that property.[358]

Moreover, Cement Resources received solid protections that were not provided to any potential stalking horse bidder in the original bidding procedures motion. First, the asset purchase agreement required the Debtors to pay a variable break-up fee to Cement Resources if

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[353] Debtors' Rev. Bidding Procedures Motion, Doc. No. 344, Exhibit A, at p. 19–20.

[354] *See Id.* at 15–18.

[355] *See* Debtors' Rev. Bidding Procedures Motion, Doc. No. 344, at p. 6; Committee's Obj. to Rev. Bidding Procedures, Doc. No. 378, at p. 9.

[356] *See* 11 U.S.C. § 503(b)(9).

[357] *See* Debtors' Rev. Bidding Procedures Motion, Doc. No. 344, Ex. A, at p. 19.

[358] *Id.* at p. 20.

Cement Resources could not purchase the Debtors.[359] For instance, Cement Resources was entitled to a four (4) percent fee – which would total around $2 million – if another company outbid it at the auction.[360] Cement Resources was also entitled to an expenses reimbursement of up to $750,000.[361] Second, the Debtors agreed to move the auction to May 17, 2010, from June 2, 2010.[362] Cement Resources presumably wanted this change to chill bidding, although the Debtors argued that it was necessary to prevent the need for further post-petition indebtedness.[363] Third, the Debtors' proposed bidding procedures would require potential purchasers to submit bids for all of the Debtors' assets.[364] The Debtors probably eliminated the partial bid option to make submission of a compliant bid more difficult.

The Debtors also discussed the marketing efforts of their investment banker in the revised bidding procedures motion. The Debtors reported the following marketing activity:

- Western Reserve contacted 283 potential bidders,
- Western Reserve sent "teaser" information to at least 201 potential bidders,
- Western Reserve sent confidentiality agreements to 212 potential bidders,
- 56 potential bidders executed confidentiality agreements and received more specific information, and

[359] *See* Debtors' Rev. Bidding Procedures Motion, Doc. No. 344, at p. 12.

[360] *Id.*

[361] *Id.*

[362] *Id.* at p. 20.

[363] *Id.*

[364] *Id.*

- Only three potential purchasers submitted compliant bids.[365]

The Committee and several other creditors filed objections to the proposed revisions to the bidding procedures. Most of the creditors objected to reserve their rights to challenge stated cure amounts or to challenge the assumption of unexpired leases and executory contracts.[366] The Committee's and National Lime's objections, however, challenged the potential collusion between the Debtors and Cement Resources.[367] The Committee claimed that the three main protections afforded to Cement Resources would stifle any further bidding, thereby capping the amount the Debtors could receive in the sale.[368] The Committee alleged specifically that (1) the break-up fee was too high, (2) the new procedures prevented "basket bids" (the combination of two partial bids), (3) the stalking horse offered kickbacks to the Schwabs, and (4) the shortened auction process was unjustified.[369] The Committee argued that these modifications stifled competitive bidding and called into question the Debtors' faithfulness to the estate.[370] The Committee accordingly asked the court to deny the motion.[371]

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[365] *Id.* at p. 9.

[366] *See, e.g.*, Allen Concrete's Obj. to Rev. Bidding Procedures, Doc. No. 355; St. Mary's Obj. to Bidding Procedures, Doc. No. 367; Holcim's Obj. to Rev. Bidding Procedures, Doc. No. 381.

[367] Committee Obj. to Rev. Bidding Procedures, Doc. No. 378, at p. 3–4; Nat'l Lime Obj. to Rev. Bidding Procedures, Doc. No. 379, at p. 2.

[368] Committee Obj. to Rev. Bidding Procedures, Doc. No. 378, at p. 2–4. National Lime's objection to the revised bidding procedures substantially mirrored the Committee's objection. *See* Nat'l Obj. to Rev. Bidding, Doc. No. 279, at p. 2–4. National Lime specifically pointed out that the "undisclosed" participation of the Debtors' insiders in the Cement Resources bid merited closer judicial scrutiny. *Id.* at p. 4.

[369] Committee Obj. to Rev. Bidding Procedures, Doc. No. 378, at 2–5.

[370] *Id.*

Judge Kendig ultimately found a middle ground between the Debtors' requests and the Committee's objections. Judge Kendig approved the revised bidding procedures motion on May 14, 2010, but the judge changed some important features of the sales process.[372] For example, the court set the auction for May 27, 2010, which was ten (10) days later than the requested date.[373] Further, the court required the Debtors to entertain "basket bids" instead of only accepting individual bids for the entire business.[374] The court approved the asset purchase agreement with no substantial changes, however, including the four (4) percent break-up fee, the bid increment of $100,000 over the purchase price and break-up fee, and the ability of the Debtors to sell the assets without any warranties.[375] Moreover, the court found that the Debtors had diligently marketed the sale and had exercised good business judgment by changing the bidding procedures.[376] Therefore, the court rejected the Committee's concern about the Debtors' collusion with Cement Resources.

B. Post-Petition Financing and Other Loose Ends

During the contest over the revisions to the bidding procedures, the Debtors filed a motion for post-petition financing on May 3, 2010.[377] The Debtors asked the court to approve up

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[371] *Id.*

[372] Order Granting Rev. Bidding Procedures, Doc. No. 408, at p. 4.

[373] *Id.* at p. 7.

[374] Order Granting Rev. Bidding Procedures, Doc. No. 408, Ex. A, at p. 13.

[375] Order Granting Rev. Bidding Procedures, Doc. No. 408, at p. 7; Order Granting Rev. Bidding Procedures, Ex. A, at p. 12.

[376] Order Granting Rev. Bidding Procedures, Doc. No. 408, at p. 3–4.

[377] Second Motion for Post-Petition Financing, Doc. No. 369, at p. 1.

to $2,000,000 of additional financing from the Secured Lenders under Section 364(c) and (d).[378] Therefore, the Debtors' obligations under the deal would be secured by (1) first-priority liens on unencumbered assets, (2) liens senior in priority to all except EFO Financial and Naples's priming lien, and (3) administrative expense claims.[379]

The Debtors alleged that the funds would be used to pay professional fees, purchase inventory, and pay general corporate expenses until the sale of all their assets closed.[380] With the consent of the Secured Lenders and the stalking horse bidder, the Debtors had failed to obtain a $3 million refund of insurance premiums in violation of the final cash collateral order.[381] The Debtors argued that the available cash collateral, without the insurance refund, was not enough to continue operating their businesses.[382] As such, the Debtors contended that without post-petition financing, they would have to shut down their businesses, thereby causing irreparable harm to the bankruptcy estate.[383]

The terms of the financing contained significant advantages for both the Secured Lenders and the Debtors. The Debtors would receive the money in two stages: one advance after an interim order and a second advance after a final order.[384] The first advance constituted a

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[378] *Id*. at p. 3–4.

[379] *Id.* at p. 4.

[380] *Id.* at p. 11.

[381] *Id.* at p. 13.

[382] *Id.*

[383] *Id.*

[384] *Id.* at p. 11.

majority of the overall funds, totaling $1,400,000.[385] Further, the Debtors had to pay a $60,000 closing fee on the loan, which was relatively low compared to the fees on the previous financing deal with EFO Financial and Naples.[386] The only conditions on the loan were the court's approval of an interim order, the lack of any materially adverse change in the Debtors' business operations, and payment of the closing fee.[387]

In return for the loan advances, the Secured Lenders would receive a first-priority lien on previously unencumbered assets.[388] The Secured Lenders' request for liens on previously unencumbered assets was significant because the Secured Lenders had failed to perfect their security interests in several pieces of the Debtors' inventory.[389] Further, the Debtors asked the court to require EFO Financial and Naples to satisfy the proceeds of their claims first from assets not subject to the Secured Lenders' liens or claims.[390] The Debtors agreed to waive any rights to challenge the validity and nonavoidability of any of the Secured Lenders' security interests in the Debtors' assets, regardless of whether the security interests were granted pre- or post-petition.[391]

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[385] *Id.* The Secured Lenders agreed to provide $600,000 in the second advance. *Id.*

[386] *Id.* at p. 3.

[387] *Id.* at p. 5–6.

[388] *Id.* at p. 4.

[389] Committee Obj. to Second Motion for Post-Petition Financing, Doc. No. 377, at p. 2.

[390] Second Motion for Post-Petition Financing, Doc. 369, at p. 4. This request had the effect of increasing the likelihood that the Secured Lenders' collateral would be available to satisfy the Debtor's obligations. In this case, the DIP lender did not hold a large enough claim to completely deplete the assets subject to the Secured Lenders' security interests. This request helped ensure that the Secured Lenders' collateral remained untouched, however, until the DIP lenders depleted the value of any asset in which the Secured Lenders did not hold an interest.

[391] *Id.* at p. 5.

Therefore, the Secured Lenders used the post-petition financing motion as an opportunity to insulate their position vis-à-vis the other creditors by expanding their collateral and protecting their liens.

The Committee filed an objection to the Debtors' second post-petition financing motion on May 9, 2010.[392] The Committee argued that the Debtors were involved in a form of self-dealing that violated their fiduciary duty of loyalty to the estate.[393] The Committee alleged that the Debtors needed financing solely because the Schwabs refused to obtain an insurance refund.[394] The Schwabs wanted to avoid obtaining the refund because the insurance refund would extinguish their rights as beneficiaries under the policy and would cause adverse tax consequences.[395] In fact, the Schwab family had already attempted to obtain a loan against the policy, but one of the Secured Lenders, Huntington, denied the loan, thereby creating the current cash flow dilemma.[396]

Further, the Committee claimed that the Secured Lenders had unknowingly failed to perfect their security interests in at least $10 million worth of collateral, including hundreds of motor vehicles, a tax refund, and deposit accounts.[397] The Debtors' motion would grant the Secured Lenders' new liens, which were automatically valid and enforceable under the attached

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[392] Committee Obj. to Second Motion for Post-Petition Financing, Doc. No. 377, at p. 1.

[393] *Id.* at p. 12–15.

[394] *Id.* at p. 6.

[395] *Id.* at p. 8–9.

[396] *Id.* at p. 9.

[397] *Id.* at p. 5.

order, in these assets.[398] Therefore, the Committee asserted that the post-petition financing deal inequitably favored the Secured Lenders at the expense of unsecured creditors.[399]

The court issued an interim order approving the first advance of $1,400,000 of post-petition financing on May 14, 2010.[400] The court found that the Debtors complied with their fiduciary duties while negotiating the DIP facility with the Secured Lenders.[401] Further, the court stated that the financing arrangement was in the best interests of all the parties involved in the case, including the unsecured creditors.[402] The court also concluded that the Debtors acted in good faith and afforded the transaction the protection of statutory mootness under Section 364(e).[403] Therefore, the court overruled the Committee's objection and allowed the Debtors to receive secured financing in lieu of obtaining the insurance refund, as the final cash collateral order required.[404]

The court's conclusion that the financing arrangement was in the best interests of all parties appears incorrect. The Committee had discovered mistakes in the Secured Lenders' efforts to perfect security interests in valuable collateral, which increased the likelihood of meaningful recovery for unsecured creditors in a case that already appeared grim for that class of

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[398] *Id.* at p. 10.

[399] *Id.* at p. 16.

[400] Interim Order Granting Second Motion for Post-Petition Financing, Doc. No. 407, at p. 1.

[401] *Id*. at p. 6 ¶ J.

[402] *Id*. at p. 6 ¶ K.

[403] *Id*. at p. 7 ¶ L.

[404] *See id*. at p. 8.

creditors.[405] The court appeared to ignore the unsecured class when it granted the Secured Lenders' valid and perfected security interests in unencumbered assets, thus allowing the Secured Lenders to cure mistakes in securing their collateral.[406]

Further, the Debtors' proposed need for post-petition financing at this stage in the case was not entirely satisfactory. The Schwabs failed to obtain a $3 million insurance refund, which was a requirement of the final cash collateral order, because they did not want to pay higher income taxes or lose the benefit of the policy.[407] Therefore, the Debtors could have resolved the issue without further impairing the unsecured creditors by obtaining the refund, as all the parties originally agreed.

Nevertheless, the court's order did not completely favor the Debtors' and Secured Lenders' position. The Court did not accept the Secured Lenders' request to marshal EFO Financial's and Naples's priming liens. Instead, the interim order reserved all parties' rights to marshal liens and to determine the source of payments to EFO Financial and Naples.[408] Moreover, despite any other conclusion of fact or law in the order, the court preserved any party's ability to challenge the Debtors' compliance with their fiduciary duties throughout the negotiations for the DIP loan.[409]

In April and May 2010, the Debtors also resolved two other motions that were unrelated to the sale process. Specifically, the Cavaliers Holding Company filed a motion to compel the

[405] *See* Committee Obj. to Second Motion for Post-Petition Financing, Doc. No. 377, at p. 16.
[406] *See id.*
[407] *See id.* at p. 8–9.
[408] Interim Order Granting Second Motion for Post-Petition Financing, Doc. No. 407, at p. 12.
[409] *Id.* at p. 18.

assumption or rejection of an unexpired license agreement for a suite at Quicken Loans Arena, and Ohio Farmers Insurance Company ("Farmers") filed a motion for relief from the stay to terminate a surety bond.[410]

The Debtors owned a license to use suite 233 at the Quicken Loans Arena under a license agreement with the Cavaliers Holding Company.[411] The Debtors fell behind on payments under the license agreement in the amount of $400,000.[412] The Cavaliers Holding Company asked the court to compel the Debtors to assume or reject the license agreement and immediately to cure the deficient amount because the Cavaliers hoped to capture the demand for the suite in the upcoming 2010 NBA playoffs.[413] The Debtors argued that the license agreement was an attractive, unique asset that could increase a potential purchaser's bid amount in the upcoming sale.[414] The Debtors accordingly asked the court to include the license agreement as an asset in the Section 363 sale.[415]

On April 29, 2010, the parties entered into a settlement and filed an order resolving the

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[410] Cav.'s Motion to Compel Assumption or Rejection of Lease, Doc. No. 230; Farmers' Motion for Relief from Stay, Doc. No. 291.

[411] Cav.'s Motion to Compel Assumption or Rejection of Lease, Doc. No. 230, at p. 2. The Quicken Loans Arena is where the Cleveland Cavaliers – an NBA team – play. In 2010, the Cavaliers had LeBron James playing forward and were set to enter the NBA playoffs. Cleveland was not a traditional powerhouse in the basketball world, so the playoff spot was a big deal for the Cavaliers. Further, LeBron James is arguably one of the best NBA players of his generation, if not all time. 2010 was an exciting time to watch Cleveland Cavalier basketball.

[412] *Id* at p. 3.

[413] *Id* at p. 3–6; *see* 11 U.S.C. § 365(d)(2) (providing that a court may, on request of any party to a lease, order a debtor-in-possession to reject or assume an unexpired lease within a specified time period).

[414] Debtors' Obj. to Cav.'s Motion to Compel, Doc. No. 259, at p. 4–6.

[415] *Id.*

matter.[416] The Cavaliers Holding Company was allowed to sublicense the suite during the 2010 NBA playoffs but had to pay the Debtors three (3) percent of any revenue generated from the sublicense.[417] The settlement also gave the Cavaliers Holding Company an unsecured claim for $100,000, though the Cavaliers Holding Company waived any right to assert an administrative expense claim for any cure amount later in the case.[418] Lastly, the Debtors agreed to file a motion to compel assumption or rejection of the license within two (2) weeks of the closing of the Section 363 sale.[419]

Farmers issued a contract performance bond to the Debtors on behalf of the City of Strongsville, as the obligee, prior to the commencement of the bankruptcy case.[420] The Debtors would not have been able to obtain a supply and construction contract with the Strongsville without the pre-petition bond.[421] Farmers moved for relief from the automatic stay under Section

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[416] Order Resolving Motion to Compel, Doc. No. 325, p. 1.

[417] *Id.* at p. 2.

[418] *Id.*

[419] *Id.*

[420] Farmers' Motion for Relief from Stay, Doc. No. 291, p. 2. Under Ohio law, a contractor is required to obtain a "bid bond" from a surety company that is automatically converted into a combined payment and performance bond. James D. Fullerton, *Construction Law Survival Manual* in MANUAL OF CREDIT AND COMMERCIAL LAW, 631 (104th ed. 2013). The state government requires the contractor to obtain such a performance bond because it shifts the risk of completion from the government – that is, the taxpayers – to the surety company. *Id.* at 610. A performance bond guarantees the obligee that the principal will complete the contract according to its terms. *Id.* If the principal fails to do so, as the Debtors did, then the obligee can sue both the principal and the surety company or request the surety company to ensure the completion of the contract through either the original contractor or a new contractor. *Id.*

[421] Farmers' Motion for Relief from Stay, Doc. No. 291, at p. 2.

362(d) to terminate the pre-petition bond, arguing that it had demonstrated "cause" to do so.[422] In particular, Farmers argued "cause" existed because the Debtors could not assign the bond and because the Debtors had failed to pay the premiums on the bond.[423]

The court granted Farmers' motion and allowed it to terminate the bond after the completion of the sale.[424] After Farmers terminated the pre-petition bond, the court authorized the Debtors to obtain a new post-petition bond from Farmers under Section 363(c), but the Debtors were required to pay overdue premiums and execute a new indemnity agreement in order to do so.[425] If Farmers had to pay any of the obligations under the post-petition bond prior to the sale, then Farmers would receive an administrative expense claim of equivalent value.[426]

C. Final Approval of the Sale

A week prior to the auction, the Committee filed another objection to the proposed sale and bidding process.[427] The Committee doubted the legitimacy of the sales process because the Debtors continued to promote the stalking horse bidder, Cement Resources, at the expense of allegedly higher bids.[428] The Committee claimed that the Debtors received two competing "basket bids" that were valued ten (10) percent higher than Cement Resources' bid.[429] Yet, the

[422] *Id.* at p. 8–10.

[423] *Id.*

[424] Order Granting Farmers Relief from Stay, Doc. No. 403, at p. 1.

[425] *Id.* at p. 2.

[426] *Id.* at p. 3.

[427] *See* Committee's Obj. to Sale Motion, Doc. No. 434.

[428] *Id.* at p. 2.

Debtors had failed to qualify these bids for the auction, according to the Committee.[430] The Committee argued that the Debtors wanted a "sham auction process" that was designed to ensure Cement Resources' success rather than obtain the highest market value for the Debtors' assets.[431] The Committee alleged that the Debtors had an incentive to do so because Cement Resources had offered the Schwab family post-sale employment and an equity stake in the new company.[432] Thus, the Committee asked the court to prevent the Debtors from consummating the sale.[433]

The Debtors moved to strike the Committee's objection under Bankr. R. P. 7012 by alleging that it contained materially false information.[434] The Debtors denied all of the damaging allegations in the Committee's objection, except for the claims relating to the Debtors' insiders' potential benefits from the Cement Resources deal.[435] The Debtors continued to maintain, however, that Cement Resources was named as the stalking horse bidder because of the quality of its bid and not because of the prerequisites it offered to the Schwab family.[436]

Ultimately, the Committee's objection was withdrawn prior to the auction.[437] The auction was conducted on May 27, 2010, and the court issued a final order approving the sale of

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[429] *Id.*

[430] *Id.*

[431] *Id.*

[432] *Id*. at p. 2–3.

[433] *See id*. at 17.

[434] *See* Debtors' Motion to Strike Committee Obj. to Sale, Doc. No. 439, at p. 1–2.

[435] *See Id*. at p. 3–4.

[436] *See Id*. at p. 3.

[437] Final Order Approving Sale, Doc. No. 455, at p. 21.

all of the Debtors' assets to the successful bidder the following day.[438]

Seven bidders participated in the auction at Debtors' counsel's offices in Cleveland, Ohio.[439] The auction was conducted in two separate stages.[440] First, the Debtors accepted bids on "component assets" of the Debtors' businesses.[441] Then, the Debtors determined whether any combination of those partial bids would exceed Cement Resources' $48,350,000 offer.[442] The Debtors identified that the combination of OldCastle Materials, Inc.'s ("OldCastle") and Resource Land Holdings's bids collectively exceeded Cement Resources's bid.[443] Second, the Debtors accepted bids on "all of the Debtors' assets."[444] Only five bidders participated in this portion of the auction, and, at its conclusion, the Debtors named OldCastle and Resource Land Holdings as the successful bidders.[445] As such, Cement Resources ultimately lost the bidding war at the auction, even though it had spent months courting the Debtors to favor its position.

OldCastle and Resource Land Holdings purchased the Debtors' businesses for $57,822,181.[446] The purchase price included $54,032,614 of cash and $3,789,559 of non-cash

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[438] *Id.* at p. 12, 23.

[439] *Id.* at p. 12.

[440] *Id.*

[441] *Id*.

[442] *Id*.

[443] *Id*.

[444] *Id*. at p. 12–13.

[445] *Id*. at p. 13.

[446] *Id*.

consideration.[447] OldCastle purchased all of the Debtors' ready-mix operations in Ohio and Florida, whereas Resource Land Holdings purchased the Debtors' Florida real estate containing potential limestone deposits.[448] Resource Land Holdings agreed to pay the Schwab family "earn-out" payments that were keyed to revenue generated from mining operations on the Florida properties.[449] The successful bidders had to pay Cement Resources a break-up fee of $1,900,000 pursuant to the revised bidding procedures that the court had approved in early May.[450]

The Secured Lenders agreed to carve out funds from its collateral to pay the fees of the Debtors' and the Committee's professionals.[451] The Secured Lenders specifically allowed the Debtors' counsel, Hahn Loeser, to collect $575,000 of its fees out of the Secured Lenders' collateral.[452] The Secured Lenders additionally agreed to waive any deficiency claims that it may have had against the Debtors' estate under Section 506(a).[453] Moreover, the court required the Debtors to pay several professional fees out of the purchase price from the sale. For example, the Debtors had to pay their investment banker, Western Reserve, $942,000 of fees related to its services throughout the sales process.[454] The Debtors were also required to pay

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[447] *Id.* at p. 12–13.

[448] *Id.*; *see also* Western Reserve Partners, http://wesrespartners.com/schwab-industries-inc-2/ (last visited Apr. 23, 2016).

[449] Final Order Approving Sale, Doc. No. 455, at p. 13–14.

[450] *Id.* at p. 15.

[451] *Id.* at p. 22.

[452] *Id.* at p. 22–23.

[453] *Id.*

[454] *Id.* at p. 20.

Hahn Loeser $2,064,000 for legal services provided to the bankruptcy estate.[455]

Additionally, the court made a series of significant findings that ensured the finality of the sale process. First, the court found that the asset purchase agreement was negotiated in good faith and that the sale process was thereby entitled to protection under Section 363(m).[456] Second, the court allowed the sale to occur free and clear of any liens, encumbrances, or successor liability.[457] Third, the court found that the sale did not constitute a *sub rosa* plan or a *de facto* merger.[458] Finally, the court granted the Debtors' the ability to assign or assume all of the executory contracts submitted to the court and all applicable parties in interest, provided that the buyer cured any deficient amount.[459]

The court's rulings on the *sub rosa* plan, *de facto* merger, and successor liability require further elaboration. A *sub rosa* plan occurs when a debtor-in-possession attempts to accomplish what a plan would otherwise accomplish through a Section 363 sale order, thereby usurping the requirements of a plan under Section 1129.[460] For example, a debtor might include a scheme for

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[455] *Id.* at p. 39.

[456] *Id.* at p. 28; *see* 11 U.S.C. § 363(m). Section 363(m) provides that the reversal or modification on appeal of an authorization to sell property of the estate under Sections 363(b) and (c) does not affect the validity of a sale or lease to an entity that purchased such property in good faith. *Id.* Put simply, Section 363(m) renders statutorily moot a reversal or modification of a Section 363 sale if the Court finds that the sales process was conducted in good faith.

[457] Final Order Approving Sale, Doc. No. 455, at p. 17–19.

[458] *Id.* at p. 15.

[459] *Id.* at p. 19.

[460] 11 U.S.C. §§ 363 & 1229; KUNEY & BERNSTEIN, *supra* note 66, at 259.

the payment of creditors in a sale order.[461] If the court had determined that the sale was a *sub rosa* plan, then the Debtors would not have been able to complete the sale.[462] Therefore, the court's ruling here was significant in that it demonstrated that the Debtors were not attempting to usurp the Code's procedural protections for plan confirmation through a sale order.[463]

De facto merger and successor liability protections are somewhat related. Successor liability is a non-bankruptcy law doctrine that binds an acquirer of a business to the liabilities of a target – or acquired – business.[464] The *de facto* merger doctrine allows a party to challenge an acquisition by arguing that the "substance" of the transaction results in a merger, notwithstanding the "label" that the parties supply for the transaction.[465] If the party succeeds in such a recharacterization, then the purchaser of the assets may be subject to potential successor liability, as well as other claims.[466]

In this case, the court enjoined any future successor liability claims,[467] even from parties

[461] KUNEY & BERNSTEIN, *supra* note 66, at 259.

[462] *See In re Braniff Airways Inc., 700 F.2d 935 (5th Cir. 1983).*

[463] *See* 11 U.S.C. §§ 1124, 1125 & 1129(a).

[464] KUNEY & BERNSTEIN, *supra* note 9, at 259.

[465] Joan MacLeod Heminway, *Basic Corporate Changes* in BUSINESS ENTERPRISES: LEGAL STRUCTURES, GOVERNANCE, AND POLICY, 823 (2d ed. 2012).

[466] *Id.* at 823–24.

[467] The court provided the following non-exclusive list of potential successor liability claims that were enjoined: (1) claims arising under employment or labor agreements; (2) claims arising under a deed of trust or security interest; (3) any pension, welfare, compensation, or employee-benefit claims; (4) "any other employee, worker's compensation, occupational disease or unemployment or temporary disability related claim"; (5) "any products liability claims"; (6) "reclamation, environmental, or other claims arising from conditions existing on or prior to the closing" of the sale; (7) claims arising from "any bulk sales or similar law"; (8) tax statutes or ordinances; (9) claims arising under "any theory of anti-trust"; and (10) any common-law

that did not have notice or participate in the case, and determined that the sale was not a *de facto* merger.[468] Therefore, the court provided the purchasers with significant protection from liabilities that could have arisen after the closing of the sale.

D. Motion to Vacate

On July 27, 2010, FLSmidth Inc. ("FLS"), an unsecured creditor of ECC, moved the court to vacate the sale order entered on May 28, 2010.[469] Based domestically in Pennsylvania and headquartered in Denmark, FLS is an engineering firm that supplies equipment, services, and expertise to the cement and minerals industries internationally.[470] As a creditor of both ECC and non-debtor Eastern Portland Cement Corporation ("Eastern Portland"), FLS was the principal obligor and guarantor of Eastern Portland's obligations pursuant to a promissory note issued in February 2010.[471] In its motion, FLS argued that, unknown to the court, the assets sold pursuant to the sale order included receivables owned by Eastern Portland and were thus beyond the court's jurisdiction.[472] FLS followed by requesting that the court order an accounting so that all of Eastern Portland's assets that were sold could be identified and repaid.[473] Joined by OldCastle, KeyBank, and the Committee, the Debtors objected, arguing that FLS had notice of

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doctrine of *de facto merger* or successor liability. Final Order Approving Sale, Doc. No. 455, at p. 17–19.

[468] *Id.* at p. 15, 17–19.

[469] FLS's Motion to Vacate Sale Order, Doc. No. 564, at p. 1.

[470] About, FLSmidth, http://www.flsmidth.com/en-us/about+flsmidth (last visited Apr. 25, 2016).

[471] FLS's Motion to Vacate Sale Order, Doc. No. 564, at p. 1–2.

[472] *Id.*

[473] *Id.* at p. 2.

the entirety of the sale process and, in doing so, emphasized the social impact of the sale: that the sale saved jobs and created stability for employees and the entire communities that the Debtors' businesses serviced.[474] The Committee based its objection primarily in arguing that FLS's motion resulted from its own failure to act diligently and in a timely fashion, thus resulting in its assertion of illusory rights and failing to qualify for relief under Rule 60(b) of the Federal Rules of Civil Procedure, via Bankruptcy Rule 9024,[475] which ultimately permits relief in cases of mistake, inadvertence, excusable neglect, newly discovered evidence, or fraud.[476]

KeyBank reiterated that FLS's request was overbroad and without meritorious legal backing.[477] Following a hearing on October 5, 2010, Judge Kendig approved FLS's proposed settlement agreement and release, in which the Debtors would pay $45,000 to FLS.[478] Conversely, the Debtors were entitled to the following payments pursuant to the agreement: (1) $9,000 from OldCastle, (2) $9,000 from funds held by Freeborn & Peters for the unsecured creditors, and (3) $9,000 from KeyBank.[479] The court also noted that it retained jurisdiction to enforce the agreement.[480] While FLS could have upset the entire sale agreement, all parties appeared to have the foresight and sense to make concessions to prevent the case from

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[474] Debtors' Objection to FLS's Motion to Vacate Sale Order, Doc. No. 627, at p. 1; OldCastle's Objection to FLS's Motion to Vacate Sale Order, Doc. No. 628, at p. 1; Committee's Objection to FLS's Motion to Vacate Sale Order, Doc. No. 629, at p. 1; KeyBank's Objection to FLS's Motion to Vacate Sale Order, Doc. No. 631, at p. 1.

[475] Committee's Objection to FLS's Motion to Vacate Sale Order, Doc. No. 629, at p. 2–3.

[476] KUNEY & BERNSTEIN, *supra* note 66, at 338.

[477] KeyBank's Objection to FLS's Motion to Vacate Sale Order, Doc. No. 631, at p. 2–4.

[478] Agreed Order Regarding FLS's Motion to Vacate Sale Order, Doc. No. 671, at p. 8.

[479] *Id.* at p. 9.

[480] *Id.* at p. 2.

essentially unraveling as a result of one fairly insignificant third party's claim to its small share as a result of inactivity and oversight.

VI. The Chapter 11 Plan

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Chapter 11
	)	
SCHWAB INDUSTRIES, INC., *et al.*,[1]	)	Case No. 10-60702-rk
	)	(Jointly Administered)
Debtors.	)	
	)	Judge Russ Kendig
	)	

FIRST AMENDED JOINT PLAN OF LIQUIDATION DATED OCTOBER ~~12,~~ 26, 2010

"Obviously it was a highly complicated case . . . ." –Judge Kendig[481]

A. First Draft of the Chapter 11 Plan and Disclosure Statement

On October 12, 2010, Schwab Industries and the Committee filed the Joint Plan of Liquidation, followed by the Disclosure Statement pursuant to 11 U.S.C. 1125, detailing the summary of claims.[482] The claims included the following: administrative claims, priority tax claims, priority claims, secured claims, general unsecured claims, and equity securities. In detailing the implementation of the plan, the Disclosure Statement explained how the liquidation was to be funded, its effective date, and the process for issuing a structured dismissal of the case.[483] More specifically, the Debtors alleged that the plan provided for the following:

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[481] The transcript of the confirmation hearing revealed that Judge Kendig was irritated with the case by the time it hit the plan confirmation process, and his frustration likely affected the outcomes of several issues that arose leading up to confirmation. Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 19.

[482] Chapter 11 Plan, Doc. No 646, at p. 1; Disclosure Statement, Doc. No. 657, at p. 1, 7–12.

[483] Structured dismissals are a somewhat controversial topic in modern bankruptcy law, as the Code does not expressly provide for it. "Structured dismissals provide parties with an expedited means to distribute the sale proceeds to creditors and dispose of the bankruptcy case following the sale." 2011 Norton Ann. Surv. of Bankr. Law 1. Some courts, namely the Third Circuit, provide for the mechanism "[a]s an alternative to a plan of liquidation . . . permit[ting] the debtor or Chapter 11 trustee to request the approval of distribution mechanisms for any sale proceeds and other administrative provisions in an order dismissing the Chapter 11 case under Section 346." Plan of Liquidation, Adv. Ch. Eleven Bankr. Prac. § 10.3 (2016) (citing *In re Strategic*

- the liquidation of the Debtors' assets in a manner designed to maximize recoveries to all creditors;

- the formation of a creditor trust, to which the Debtors' remaining assets would be transferred. The creditor trust would be charged with liquidating such assets and making distributions to claim-holders;

- cancellation of the Debtors' existing equity securities; and

- structured dismissal of the case if the court determined that the creditor trustee would be unable to generate sufficient cash proceeds from the liquidation of the Debtors' assets.[484]

Regarding the second point as to a creditor trustee, the plan provided that the position would receive supervision from an oversight committee,[485] defined as being "created pursuant to the Creditor Trust Agreement" and deemed to "have the duties and powers set forth in the Creditor Trust Agreement."[486] To that end, such a creditor trust agreement was to be executed pursuant to the plan "as soon as reasonably practicable after the confirmation date among the Debtors, the Committee[,] and the Creditor Trustee, which shall govern the obligations of the Creditor Trustee with respect to oversight of the distribution of the Net Proceeds of the Creditor Trust Assets . . . ."[487]

Labor, Inc., 467 B.R. 11, 17–18, 25–26 (Bankr. D. Mass. 2012) ("denying debtor's motion for structured dismissal order and, ultimately, converting the case to one under Chapter 7")); *see also* Creditors' Rights in Bankruptcy § 16:11 (2d ed.).

[484] Debtors' and Committee's Joint Motion in Support of the Plan, Doc. No. 648, at p. 1–3.

[485] Chapter 11 Plan, Doc. No. 646, at p. 4, 6, 8.

[486] *Id*. at p. 6.

[487] *Id.* at p. 4. At the plan confirmation hearing, however, Judge Kendig agreed to edit the wording in the ensuing order regarding the oversight committee's role in closing the case. The edit would change "may" language to "shall," "[s]o that the Trustee may upon approval of the oversight committee act in a certain way, it would require the Trustee to act in that way." This edit would serve to give the oversight committee a more definite role in distributing the Debtors' assets. Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 19.

Furthermore, the Plan established the following designations for claims and interests:

- Class 1 claims – all allowed unsecured priority claims (other than unsecured priority tax claims);
- Class 2 claims – all allowed secured claims of the Secured Lenders;
- Class 3 claims – allowed claims of unsecured creditors, which included deficiency claims of secured creditors; and
- Class 4 claims – including interests of equity security holders.[488]

That same day, the Debtors and the Committee filed the disclosure statement describing the plan, the Debtors' chapter 11 case, liquidation, wind-down, and the formation and operation of a creditor trust that would oversee liquidating assets, pursuing unsecured creditors' claims, reconciling those claims, and making distributions on those claims.[489] Addressing the somewhat controversial inclusion of permitting structured dismissal in the plan, the Debtors attempted to appeal to efficiency by arguing that the Plan would allow structured dismissal of cases if it was decided that the Creditor Trustee would "be unable to generate sufficient cash proceeds from the liquidation" to fully pay several substantial claims.[490]

Overall, the disclosure statement posited that the plan maximized recoveries for all creditors, although the plan ultimately only benefitted one secured creditor, KeyBank.[491] The Debtors supported the plan by explaining that the creditor trust would receive transfers of myriad tangible and intangible personal property and would subsequently liquidate those assets and pay

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[488] Chapter 11 Plan, Doc. No. 646, at p. 9–10.

[489] Disclosure Statement, Doc. No. 657, at p. 2.

[490] *Id.*; *see supra* note 377.

[491] Disclosure Statement, Doc. No. 657, at p. 3.

claims pursuant to the [P]lan, thus providing streamlined, efficient payments."[492] Furthermore, under the plan, the Debtors' existing equity securities were to be cancelled, and equity security holders were not expected to receive distributions.[493]

B. The Amended Chapter 11 Plan and Disclosure Statement

On October 26, 2010, Debtors and the Committee filed an amended plan, which included updates regarding payment of administrative expenses and claims. There is no indication in the record as to what prompted the amendment, but the amended plan specifically provided for a significant change to Class 2 claims by splitting the category into two subparts:

- Class 2a claims – all allowed secured claims of the Secured Lenders;
- Class 2b claims – all other secured claims.[494]

Subsequently, the Debtors and Committee filed a joint motion seeking (1) approval of procedures for voting on and objecting to the amended plan and amended disclosure statement, (2) approval of documents regarding the amended disclosure statement and confirmation of the amended plan, (3) approval of the amended disclosure statement, (4) setting a joint hearing on the amended disclosure statement, and (5) authorizing and directing them to use certain funds from the administrative expense fund to pay certain administrative claims.[495] The court approved the totality of the motion,[496] and the Debtors were authorized to use $374,645.64 from

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[492] *Id.*

[493] *Id.*

[494] The Debtors likely added this distinction to account for statutory liens, such as mechanics' liens. Amended Chapter 11 Plan, Doc. No 655, at p. 10.

[495] Debtors' and Committee's Joint Motion in Support of the Plan, Doc. No 648, at p. 1–2.

[496] Order Approving Debtors' and Committee's Joint Motion in Support of the Plan, Doc. No 659, at p. 2.

the administrative expense fund to make appropriate payments until December 10, 2010.[497]

[497] Order Granting Use of Administrative Expense Fund to Pay Administrative Claims, Doc. No. 675, at p. 3, 5. Claims due ranged anywhere from around $300 to just under $110,000.

VII. Objections to Confirmation

A. The IRS's Objection

The IRS objected to the Debtors' amended plan because the Debtors had outstanding federal tax liabilities amounting to $10,563,469.45 as of December 10, 2010, which derived from audit deficiencies and unfiled federal tax returns.[498] Thus, the IRS objected specifically to Article V of the amended plan, which permitted payment of unsecured claims before payment of the IRS's unsecured priority claim.[499] The IRS requested that a date and schedule regarding its payment.[500] Additionally, the IRS cited 11 U.S.C. § 1129(a)(9)(C) in arguing that the amended plan failed to ensure that payment would be made within five (5) years, as the law requires, and further argued that the amended plan failed to assert an effective date or describe the nature of "set aside funds," particularly in relation to the administrative expense fund.[501]

B. OldCastle's Objection

Oldcastle objected to the amended plan on two primary grounds: (1) that the amended plan proposed an impermissible use of Section 503(b)(9) deposit of funds, which OldCastle alleged was not the property of the Debtors' estate, and (2) that the amended plan violated

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[498] IRS's Objection to the Plan, Doc. No. 679, at p. 1.

[499] *Id.*

[500] *Id.* at p. 2.

[501] *Id.*

Section 1129(a)(9)(A).[502] As to the first issue, OldCastle contended that the deposit's remainder should be refunded to OldCastle, while the amended plan treated the deposit as if were property of the Debtors' estate.[503] Secondly, OldCastle took issue with amended plan's omission of a method for payment of its administrative claims on the amended plan's effective date.[504] Because the amended plan allowed the Creditor Trustee to retain sole control over the timing of such payments, OldCastle argued – likely validly (though the court ultimately disagreed) – that the amended plan violated Section 1129(a)(9)(A), as the effective date was only defined in the amended plan as "a date not greater than 180 days after the Confirmation Date, unless extended by the Creditor Trustee in his or her sole discretion . . . ."[505]

C. Ohio Bureau of Workers' Compensation Objection

The State of Ohio Department of Taxation and the Ohio Bureau of Workers' Compensation ("Ohio") filed an objection alleging that the Debtors left a hole in their approach to paying priority tax claims pursuant to 11 U.S.C. § 507(a)(8) and 11 U.S.C. § 1129 (a)(9)(C), as the amended plan allowed "for a structured dismissal without payment in full of priority tax claims," which could have had the capacity to ultimately prove fatal to the parties' restructuring

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[502] Oldcastle's Objection to the Plan, Doc. No. 681, at p. 3–7.

[503] *Id.* at 3.

[504] *Id.* at 6–7.

[505] *Id.* at 7; *see* Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 3–4 (noting that the objection was settled and making no reference to Oldcastle's § 1129(a)(9)(A) deferred payment argument); *see also* 20.08 TREATMENT OF TAXES, 1999 WL 629362, 3 ("Section 1129(a)(9)(C) of the Bankruptcy Code provides that holders of priority tax claims may receive payments on a deferred basis over a period of six years."). In essence, OldCastle appeared primarily to seek clarification and specification regarding exact dates for payments.

efforts, as structured dismissal is not provided for anywhere in the Code.[506] Without any further elaboration, Ohio concluded that Debtors' plan was not confirmable by the court unless the amended plan provided for payment of priority tax claims in full.[507] Given that the court would ultimately overrule Ohio's strong argument against the Debtors' broad right to structured dismissal under the amended plan and that the Debtors would provide more complex, convincing reasons to rule in favor of structured dismissal at the hearing a few months later, Ohio likely could have benefitted from submitting a more persuasive motion with greater legal research to back up its position at this stage in the plan process.[508]

D. Former Schwab Industries Employee's Objection

Former Schwab Industries employee Timothy Taylor ("Mr. Taylor"), who maintained an active disability pension claim with the Debtors at the time the bankruptcy case was filed, objected on the grounds that the Debtors failed to acknowledge that claim or Mr. Taylor as an interested third party, thus meriting his objection to the amended disclosure statement as to its incomplete nature.[509] Mr. Taylor was not named as a creditor on the amended plan or amended disclosure statement, thus resulting in his claim that he was wrongfully excluded as an interested

[506] Ohio's Objection to the Plan, Doc. No. 683, at p. 1.

[507] *Id.* at p. 1–2. This objection, totaling three paragraphs, severely lacked in analyzing and arguing the merits of Ohio's objection, which was substantively strong with generally broad legal support.

[508] At the confirmation hearing, the Debtors' argument was better prepared and more extensive, which appeared to serve as the primary reason for Judge Kendig's ruling in their favor, especially considering his clear exasperation with the parties and overall case. *See* Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 18–20.

[509] Taylor's Objection to the Plan, Doc. No. 682, at p. 1.

party.[510] Further, Mr. Taylor provided timely notice, and the Debtors then acted in acknowledgement of the claim, though failed to act in acknowledgement of his interest as a creditor in the bankruptcy case.[511]

E. Allen Concrete's Objection

Allen Concrete, a third party in interest and subsidiary of the Debtors, objected to the amended plan and amended disclosure statement after filing a secured claim against the Debtors for $300,772.50.[512] Taking issue primarily with the contents of the amended disclosure statement, Allen Concrete argued that it did not include "adequate information" as required under Section 1125(a)(1).[513] Further, Allen Concrete argued that the amended plan should not be confirmed by the court for two reasons: (1) because the amended plan failed to address Allen Concrete's secured possessory lien and several other claims that it had previously asserted, and (2) because the amended plan failed to meet the requirements under Section 1129(a)(2), (3), (7), and (8) and Section 1129(b)(1)–(2).[514] In its prayer for relief, Allen Concrete requested that the Debtors amend their amended disclosure statement and amended plan again to rectify the deficiencies outlined in its objection.[515]

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[510] *Id.* at p. 1–2.

[511] Mr. Taylor's objection seemed to stem from an apparent administrative oversight on the Debtors' behalf. *Id.*

[512] Allen Concrete's Objection to the Plan, Doc. No. 684, at p. 2.

[513] *Id.* at p. 5.

[514] *Id.* at p. 5–9.

[515] *Id.* at p. 10.

F. Debtors' Response to the Objections

As the Debtors' claims, noticing, and balloting agent,[516] the Garden City Group filed a declaration regarding the vote to accept or reject the amended plan. The declaration reiterated that Classes 2a, including secured claims of Secured Lenders, and 3, including general unsecured claims, were entitled to vote to accept or reject the amended plan.[517] Accordingly, the Garden City Group reported that of Class 2a, one person voted to accept the amended plan, constituting a dollar amount voted of $59,193,001.20, and no one voted to reject the amended plan.[518] Next, Class 3 produced four votes rejecting the plan, which constituted a dollar amount of $7,494.91, and produced the vast majority of votes, 99, which favored acceptance of the amended plan and represented $29,663,976.30 of the dollar amount voted.[519]

Subsequently, the Debtors and Committee submitted a memorandum to the court again requesting that the amended plan and amended disclosure statement be confirmed for the following reasons: (1) because the amended plan met each requirement for confirmation under Section 1129(a); (2) because the amended plan met each requirement for confirmation under Section 1129(b); (3) because Section 1129(c) was satisfied; (4) because Section 1129(d) was satisfied; (5) because Article VI of the amended plan satisfied the requirement for the assumption or rejection of executory contracts and unexpired leases; (6) because the injunction and

[516] Garden City Group as Balloting Agent, Doc. No. 56.

[517] Declaration Regarding Balloting Methodology, Doc. No. 686, at p. 2.

[518] *Id.* at p. 7–8.

[519] *Id.*

exculpation in the amended plan were proper[520]; and (7) because the consolidation of the Debtors benefits all creditors.[521] In the memorandum, the Debtors and Committee provided extensive, albeit primarily boilerplate, support for their third reason.[522] Additionally, the managing director of Conway MacKenzie, as the financial advisor to the Committee who would be named as the creditor trustee, and the president of the Parkland Group, as the restructuring advisor to the Debtors, both filed declarations supporting confirmation of the amended plan and amended

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[520] Injunction and exculpation releases are a hot-button issue in bankruptcy litigation, and circuit courts have taken a fairly wide range of approaches to such provisions. Such a term in a bankruptcy plan could bar a claim against a debtor, and, in some cases, nondebtors with certain kinds of relationships with a debtor. 5 Bus. & Com. Litig. Fed. Cts. § 51:18 (3d ed.). The majority of circuit courts, however, permit exculpations. *Id.* The Fifth, Ninth, and Tenth Circuits permit such releases only in the context of asbestos cases and in certain scenarios regarding the work of committees; the Third, Sixth, and Seventh Circuits apply rigid tests to such provisions; and the Fourth Circuit applies the most stringent test. *Id.*; *see also* KUNEY & BERNSTEIN, *supra* note 66, at 506–10.

[521] Debtors' and Committee's Memorandum in Support of the Amended Plan, Doc. No. 687, at p. 2.p. 4–33.

[522] The Debtors asserted the following arguments regarding the validity of the plan and its planned implementation: (1) that the amended plan complied with the relevant provisions of 11 U.S.C. § 1129(a)(1); (2) that they complied with the relevant provisions of 11 U.S.C. §1129(a)(2); (3) that the amended plan was proposed in good faith pursuant to 11 U.S.C. §1129(a)(3); (4) that all payments to be made by the Debtors were approved or would be approved by the court as reasonable pursuant to 11 U.S.C. § 1129(a)(4); (5) that the amended plan complied with the disclosure requirements pursuant to 11 U.S.C. § 1129(a)(5); (6) that the amended plan did not contemplate a rate change subject to regulatory approval pursuant to 11 U.S.C. § 1129(a)(6); (7) that the amended plan satisfied the best interest of creditors test pursuant to 11 U.S.C. § 1129(a)(6); (8) that all classes were either not impaired or accepted the amended plan pursuant to 11 U.S.C. § 1129(a)(8); (9) that the amended plan provided for the payment of priority claims pursuant to 11 U.S.C. § 1129(a)(9); (10) that the amended plan was accepted by at least one impaired, non-insider class pursuant to 11 U.S.C. § 1129(a)(10); (11) that the amended plan was feasible pursuant to 11. U.S.C. § 1129(a)(11); (12) that the amended plan provided for the payment of fees pursuant to 28 U.S.C. § 1930 as required by 11 U.S.C. § 1129(a)(12); and (13) that Section 1129(a)(13)–(16) was not applicable. Id. at p. 6–25.

disclosure statement.[523]

In short, the Debtors primarily emphasized two overarching points. First, they asserted that the amended disclosure statement contained "adequate information" to satisfy Section 1125 and, second, that the amended plan complied entirely with Section 1129, which governs the procedural aspects of confirming a plan.[524] Ultimately, their position would prove successful at the confirmation hearing, thus underlying the reasonableness and non-extreme nature of the amended plan and amended disclosure statement.[525]

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[523] Pidcock Declaration in Support of Confirmation, Doc. No. 688, at p. 1–8; Goddard Declaration in Support of Confirmation, Doc. No. 693, at p. 1–8.

[524] *See* Debtors' and Committee's Memorandum in Support of the Amended Plan, Doc. No. 687, at p. 33.

[525] *See* Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 2–3 ("[T]he plan . . . received overwhelming support from creditors.").

VIII. The Confirmation Hearing and Approval of the Chapter 11 Plan

On December 9, 2010, at the joint hearing, the court approved the amended plan and amended disclosure statement and ruled on each of the objections.[526] The amended plan was ultimately approved: Two impaired classes – Class 2a and Class 3 – accepted the amended plan, and the remaining classes were appropriately crammed down pursuant to Section 1129(b), as the court found that the cramdown classes were treated fairly and equitably and without unfair discrimination.[527] As such, the court made two major, required findings necessary to the confirmation: (1) that the amended disclosure statement contained the requisite adequate information under Section 1125, and (2) that the amended plan fully complied with Section 1129.[528]

Next, the court addressed the objections and ruled overwhelmingly in favor of the Debtors.[529] The court recognized that three of the objections had been settled and subsequently

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[526] Order Confirming the Amended Plan, Doc. No. 698, at p. 1–34.

[527] *Id.* at p. 11.

[528] *Id.* at p. 13–14.

[529] The confirmation hearing transcript revealed Judge Kendig's frustration with the case and his somewhat agitated demeanor in ruling on the objections. After the parties argued their cases, he left the bench, and upon returning, he said:

> [T]here were just so many objections filed prior to the hearing, most of which were resolved, that I was really limited by how much time I could spend on a lot of things not knowing what was going to be left standing at the end of the day.

ruled on the two outstanding objections: that of the IRS and that of Ohio.[530] Regarding the settlements, first, the court approved the settlement providing OldCastle with a $75,000 administrative expense claim, so long as its $9,000 contribution was satisfied by an offset against it.[531] Second, Mr. Taylor's pension claim was previously resolved and was handled by The Garden City Group—no further substantive details were provided.[532] Third, Allen Concrete's objection was resolved separately, and the court approved the settlement permitting the creditor trustee to assert expense claims against the Debtors' estates on behalf of Allen Concrete.[533] The other objections, including Ohio's and the IRS's, were overruled by the court.[534] Regarding the IRS, the creditor trustee was to make quarterly distributions from the effective date until five years after that date.[535] Lastly, in addressing Ohio's objection, the court found that Section 1129(a)(9)(C), which pertains to structured dismissal, was appropriately satisfied.[536] Therefore,

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> And so that's why I couldn't just fire at the end of that hearing. And to the extent that I guessed, I guessed wrong.

Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 17.

[530] *Id.*

[531] *Id.* at 3–4, 17, 20–21.

[532] *Id.* at 5, 17, 20–21.

[533] *Id.* at 4–5, 14–15, 17, 20–21.

[534] *Id.* at 17–20.

[535] At the hearing, the IRS argued primarily to receive clarification regarding the intent of the creditor trustee gift pursuant to the sale order. Order Confirming the Amended Plan, Doc. No. 698, at p. 14–15.

[536] Judge Kendig ruled swiftly and somewhat generally on the issue of structured dismissal in favor of the Debtors. He provided three main justifications: (1) that Section 1129(a)(9)(C) doesn't require mathematical certainty; (2) that such a ruling would not result in any prejudice; and (3) that the effect of structured dismissal complied with Section 1129(a)(9)(C). Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 18–20.

the amended disclosure statement was approved in full, and the amended plan was confirmed with minimal edits, rather than substantive, impactful revisions.

IX. Fees and Payments

". . . and it's not over, I understand." –Judge Kendig[537]

After the confirmation hearing, the vast majority of the bankruptcy case's litigation centered on payments of administrative claims, which were, notably, not restricted to being paid solely from the administrative expense fund.[538] Nearly all professional services providers, namely law and accounting firms, filed requests with the court for payment of their administrative claims following the lengthy suit, and nearly all were agreed upon and paid within a year after the amended plan's confirmation. Seven professional services providers collected the majority of the administrative claims payments, as distributed by the creditor trustee, and the final amounts paid are the following (in order of confirmation by the court):

Firm	**Fees Awarded**	**Expenses Awarded**	**Total Award**
Frost Brown Todd[539]	$137,930.00	$3,437.48	$141,367.48
Conway Mackenzie[540]	$531,506.50	$15,944.23	$547,450.73

[537] Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 21.

[538] Order Confirming the Amended Plan, Doc. No. 698, at p. 11–13.

[539] Order for Compensation for Frost Brown Todd, Doc. No. 793, at p. 1.

[540] Order for Compensation for Conway Mackenzie, Doc. No. 794, at p. 1.

Freeborn & Peters[541]	$1,423,846.55	$56,616.30	$1,480,462.85
Bruner Cox[542]	$136,764.06	$2,625.51	$139,389.57
Hahn Loeser[543]	$225,571.50	$4,381.85	$229,953.35
The Parkland Group[544]	$132,036.50	$486.65	$132,523.15
Brouse McDowell[545]	$1,955.00	$7,897.22	$9,852.22
TOTALS:	***$2,589,610.11***	***$91,389.24***	***$2,680,999.35***[546]

As to other payments of claims pursuant to the amended plan, the creditor trustee filed a total of six status updates with the court following the confirmation hearing that documented the progression of those payments, the last of which was filed on August 19, 2014, nearly four years after the amended plan was confirmed.[547] As of the quarter ending on June 30, 2014, about which the final status report was filed, the creditor trustee had distributed a total of $2,824,823.65 as to claims made under the amended plan.[548] Therefore, only an additional

[541] Order for Compensation for Freeborn & Peters, Doc. No. 795, at p. 1.

[542] Order for Compensation for Bruner Cox, Doc. No. 796, at p. 1.

[543] Order for Compensation for Hahn Loeser & Parks, Doc. No. 805, at p. 1.

[544] Order for Compensation for The Parkland Group, Doc. No. 806, at p. 1.

[545] Order for Compensation for Brouse McDowell, Doc. No. 823, at p. 1.

[546] While $2,680,999.35 is certainly a large amount, it does not seem unreasonable or unexpected, given just how long this bankruptcy proceeding lasted, and how much more complicated it became than was necessarily anticipated at the time the petition was filed. *See* Transcript of December 9, 2010 Amended Plan Confirmation Hearing, Doc. No. 743, at p. 21.

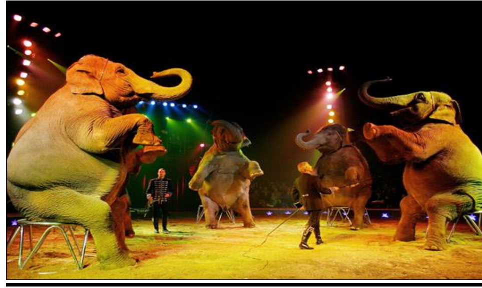
[547] Creditor Trustee Disbursement Status Report, Doc. No. 1124, at p. 1.

[548] *Id*. at p. 2.

$143,824.30 was paid in total after the above administrative expenses were disbursed.[549] Because of just how complex this seemingly ordinary – or, at least, predictable – case became, it is not entirely surprising that the administrative claims comprised the bulk of the claims paid under the amended plan, although such a result essentially prevented most junior classes from standing any chance at recovery.

[549] *See supra* note 438. Given the fact that the administrative claims amounted to well over two (2) million dollars, the remaining $143,824.30 that was left to distribute to all additional claims appears fairly scant, thus realistically only permitting the most senior class stand to benefit from the reorganization.

X. Introduction: The Adversary Proceedings



As is common in most chapter 11 bankruptcy cases, there were a number of subsequent adversary suits filed that "arose in" Schwab Industries' bankruptcy proceedings after the final sale order was entered. The Schwabs brought some of these disputes, and others were brought against the Schwabs. Oftentimes after a chapter 11 bankruptcy process concludes, many of the debtors and creditors tend to believe that they were entitled to more than what they ultimately received. This mindset encourages debtors and creditors to bring these adversary lawsuits against a variety of defendants for how the bankruptcy process was managed and carried out. These adversary proceedings tend to center on claims that exist because of the bankruptcy itself, not for some other unrelated cause of action. Because these proceedings are so related to the bankruptcy process, it is more efficient to deal with these claims in bankruptcy court rather than any other venue. For these reasons, most adversary proceedings related to a chapter 11 bankruptcy case are judged and accordingly ruled on by the bankruptcy judge who was involved in the corresponding chapter 11 case.

XI. *SII Liquidation Co. v. Schwab*

A. Factual and Procedural Background

On February 28, 2012, John Pidcock, acting as the creditor trustee of the estate, brought the *SII Liquidation Co. v. Schwab* adversary complaint alleging breaches of fiduciary duties for alleged malfeasance in the pre-sale bankruptcy case.[550] The defendants were Jerry Schwab, Donna Schwab, and David Schwab (collectively, "Schwabs"). Particularly, the creditor trustee alleged that the Schwabs negotiated side deals with Cement Resources during the bidding process. The creditor trustee claimed that those side deals diminished the sale value of the business and thereby damaged the overall value of the estate.[551]

It is undisputed that the Schwabs negotiated side deals during the bidding process to further their own personal gains, such as guaranteed management positions and other lucrative incentives. Numerous emails were discovered as to the existence of these side deals, and the negotiations were even referenced in the motion for revising the bidding procedures.[552] The Committee even objected to both the negotiations and to Cement Resources being named as the

[550] *See supra*, Section V. Section V of this paper, "The Sale Process – Part II," provides greater details regarding the facts surrounding the alleged breaches of fiduciary duties by the Schwabs.

[551] Adversary Case 12-06022, Doc. No. 1034, at p. 12–16.

[552] Motion for a Revised Bidding Procedures Order, Doc. No. 344, at p. 6–9.

stalking horse bidder.[553] While the particular facts of these negotiations are not in the record, the actual existence of these side deals was not disputed.

The creditor trustee claimed that the side deals between the Schwabs and Cement Resources eventually led to the Schwabs selecting Cement Resources as the stalking horse bidder over OldCastle, whose allegedly outbit Cement Resources. The creditor trustee contended that the estate was damaged by these side deals because the Debtors' businesses would have sold for a higher price if the Schwabs had not negotiated their own management opportunities with potential buyers, namely Cement Resources.

Despite the obvious behind-closed-doors dealing that was further detailed in a hearing on the matter, the parties submitted an agreed order, which stated that the Committee's objections had been resolved, without any further elaboration.[554] The Schwabs' council even disclosed to the court that the Schwabs had discussed their involvement with the company with the potential buyers.[555] Ultimately, however, OldCastle eventually won the bidding process for the Schwabs' assets, and the corresponding sale order was submitted on May 28, 2010. The sale order concluded (1) that the sale at issue was made in good faith and (2) that the purchase price was fair and reasonable.[556]

B. Discussion

Nearly two years after the sale order was put in place, the creditor trustee brought this action against the Schwabs for breaches of their fiduciary duties. The creditor trustee argued that

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[553] Objection to Motion for a Revised Bidding Procedure Order, Doc. No. 378, at p. 1–5.

[554] Agreed Order Granting Motion for a Revised Bidding Procedure Order, Doc. No. 406, at p. 4.

[555] Transcript of Hearing, Doc. No. 1118, at p. 9–15.

[556] Order Approving Sale, Doc. No. 455, at p. 2.

if the Schwabs had participated in negotiating the side deals at issue for their own pecuniary gains, the Debtors' assets would have sold for more at the auction, and the estate would not have been correspondingly damaged.[557] The Schwabs argued that the creditor trustee's claims were barred by the doctrine of *res judicata* and filed a motion for summary judgment as to the creditor trustee's claims.[558]

Four elements must be established for *res judicata* to bar a claim: (1) a final decision on the merits by a court of competent jurisdiction, (2) a subsequent action between the same parties or their privies, (3) an issue in the subsequent action which was litigated or should have been litigated in the prior action, and (4) an identity of the causes of action."[559] The first two elements were not disputed in this adversary proceeding, but the creditor trustee alleged that the latter two elements could not be established.

The court concluded that the creditor trustee's claims should have been brought before the final sale order was entered. The third prong of the *res judicata* doctrine bars an issue that was litigated or should have been litigated in the prior action.[560] The Sixth Circuit recognizes that the key focus here should be whether the claim at issue should have been considered during the prior action.[561]

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[557] *Pidcock v. Schwab* (*In re SII Liquidation Co.*), Nos. 10–60702, 12–6022, 2016 Bankr. LEXIS 146, at *28–31 (U.S. Bankr. N.D. Ohio Jan. 15, 2016).

[558] *Id.*

[559] *Winget v. JP Morgan Chase Bank*, 537 F.3d 565, 572 (6th Cir. 2008).

[560] *Id.*

[561] *Sanders Confectionery Products, Inc. v. Heller Financial, Inc.*, 973 F.3d 474, 484 (6th Cir. 1992).

The court found that the creditor trustee had ample opportunity and time to raise its claims before the final sale order was entered.[562] In opposition, the creditor trustee argued that raising these claims would have been impossible because the Schwabs concealed the negotiations. While the exact details of the negotiations were not revealed in the record, the existence of the negotiations was. The Schwabs' counsel even announced that negotiations had taken place between the Schwabs and potential buyers regarding management opportunities before the final sale. Furthermore, the court held a hearing on the matter before the sale order was finalized, which resulted in the parties agreeing that the Committee's objections had been resolved.[563] Likely the most damaging information to the creditor trustee's argument was that the creditor trustee himself had sent an email acknowledging his awareness that the Schwabs were in negotiations for management agreements and equity.[564] Therefore, because the creditor trustee knew about the negotiations between the Schwabs and potential buyers before the final sale order was entered, the creditor trustee should have raised the issue at that time.

Furthermore, the bankruptcy court also concluded that the fourth element of the *res judicata* doctrine had been satisfied. The fourth prong requires an identification of the causes of action. The test for whether two suits involve the same claim depends on the factual overlap between the cases.[565] "Two suits are . . . in respect to the same claim . . . if they are based on substantially the same operative facts, regardless of the relief sought in each suit.[566] Thus, the

[562] Pidcock, Nos 10–60702, 12–6022, 2016 Bankr. LEXIS at *28–31.

[563] Agreed Order Granting Motion for a Revised Bidding Procedure Order, Doc. No. 406, at p. 4.

[564] Motion to Expedite Hearing, Doc. No. 246, at p. 10–12.

[565] *Heike v. Cent. Mich. Univ. Bd .of Trs.*, 573 F. App'x 476, 483 (6th Cir. 2014).

[566] *Id.*

court looks to determine whether the same set of facts supports both the former and latter causes of action.[567]

Here, the court recognized that the creditor trustee's claims were raised twice before the final sale order was entered and that the claims were withdrawn on both occasions.[568] Even though the latter claim "was not actually litigated during the sale process, the overlap in the findings supporting the sale order, including findings that the process generated the best price for the assets and the sale was fair and reasonable, and the allegations of this complaint suggesting Defendants' actions harmed the sale process, create[d] an identity between the cause of action for Res Judicata purposes."[569] As such, the issues raised and subsequently withdrawn before the final sale order was entered were based on the same facts as the creditor trustee's claims in the ensuing action. This factual overlap was sufficient to satisfy the fourth prong of the doctrine of *res judicata*.

Therefore, because the Schwabs were able to establish all four elements under the *res judicata* doctrine, the creditor trustee was unable to bring this suit because his claims were barred by *res judicata*.

C. Conclusion

Res judicata barred the creditor trustee from asserting claims against the Schwabs following the bankruptcy case. As a result, the Schwabs' motion for summary judgment was ordered and signed. The fact that the creditor trustee knew about the Schwabs' backdoor negotiations before the final sale order was entered proved to be the most damaging evidence to

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[567] *Id.*

[568] Pidcock, Nos. 10–60702, 12–6022, 2016 Bankr. LEXIS at *30.

[569] *Id.*

the creditor trustee's claims. Even though such a ruling appears to incentivize debtors in a bankruptcy case to negotiate behind closed doors for their own interests, this ruling reaffirmed the notion that final sale orders in chapter 11 bankruptcy cases tend to remain final after being ordered and signed. Potential buyers should take care to note that once a final sale order is entered in a chapter 11 proceeding, the property or any other interest that they acquire will be free of liens and a substantial amount of liability as to the case itself. This protection helps drive up liquidation prices and benefits the estate, as a larger estate provides for enhanced recovery for creditors, which is a major goal of bankruptcy law in and of itself.

XII. ***Schwab v. Oscar* (*In re SII Liquidation Co.*)**

A. First Motion

i. Factual and Procedural Background

On May 15, 2012, the Schwabs initiated an adversary proceeding the bankruptcy court and alleged legal malpractice, fraudulent inducement, and negligent misrepresentation[570] against the attorneys who represented the Schwabs during the chapter 11 bankruptcy case. The Schwabs contended that they were never aware of the defendant attorneys' conflict of interest with one of the Schwabs' creditors during the bankruptcy case.[571]

The Schwabs argued that they were never made aware that their counsel had, and still was, representing an affiliate of one the Schwabs' largest creditors. In opposition, the defendant attorneys argued that they had adequately disclosed the conflict of interest with the bankruptcy court and obtained the court's approval to represent the Schwabs in the bankruptcy case.[572] The record shows that the court had in fact previously permitted the defendant attorneys to hire special counsel to represent the Schwabs in matters directly adverse to the creditor on March 24, 2010.[573] The Schwabs also signed a corporate resolution on February 26, 2010, which

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[570] Adversary Case 12-06035, Doc. No. 1047, at p. 6.

[571] *See supra* § V. Section V of this paper – "The Sale Process – Part II" – provides greater details as to the facts surrounding the alleged conflicts of interest pertaining to the Schwabs' counsel during the bankruptcy case.

[572] Application to Employ Hahn Loeser & Parks, Doc. No. 7.

[573] Application to Employ Brouse McDowell as Special Counsel, Doc. No. 8, at p. 8.

acknowledged and authorized the employment of special counsel for the defendant attorneys in matters that would arise and be adverse to the creditor.[574]

In response to the Schwabs' amended complaint, the defendant attorneys, joined by the creditor trustee, filed a motion to dismiss the case. The defendant attorneys argued three main points: (1) a lack of subject-matter jurisdiction, (2) a lack of standing to sue, (3) and *res judicata.* Although the court found that there was proper subject-matter jurisdiction, the court granted the defendant attorney's motion to dismiss because the creditor trustee retained the right to bring the adversary suit as part of the bankruptcy case, not the Debtors, which included the Schwabs. Furthermore, the court explained that if the Schwabs had standing to sue, the doctrine of *res judicata* barred their claims.[575]

ii. Discussion

a. Jurisdiction

The bankruptcy court ruled that it retained jurisdiction over the adversary proceeding because the claims here "arose in" the bankruptcy case.[576] A bankruptcy court "may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11."[577] Therefore, if the Schwabs' causes of actions "arose in" the bankruptcy proceeding, the bankruptcy court would have jurisdiction to hear the case.

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[574] *Id.* at 10.

[575] *Schwab v. Oscar* (*In Re SII Liquidation Co.*) Nos. 10–60702, 12–6035, 2012 Bankr. LEXIS 4374, at * 15 (U.S. Bankr. N.D. Ohio Sep. 20, 2012).

[576] *Id*.

[577] 28 U.S.C. § 157(b).

"Circuit appellate courts generally find that malpractice actions against professionals employed by a bankruptcy debtor are proceedings that 'arise in' a title 11 case, providing a bankruptcy court with the authority to enter final orders and judgments."[578] Because these malpractice claims are so intertwined with the corresponding bankruptcy case, keeping subsequent adversary proceedings with the bankruptcy court provides the quickest and most efficient method for adjudicating such claims. Transferring those malpractice claims to a different court would be too timely and cost-inefficient.

The Schwabs supported their claims by alleged that the defendant attorneys failed to disclose a conflict of interest related to the bankruptcy case. Because all of the Schwabs' causes of actions were directly related to and arose during the bankruptcy proceedings, the court properly concluded that it had jurisdiction to hear this case and enter judgments and orders pursuant to to 28 U.S.C. § 157(b).

b. Lack of Standing

The court held that the Schwabs did not have standing to bring this suit because it consisted of an estate claim, which belonged to the creditor trustee of the estate, not a debtor.[579] In the bankruptcy context, when the harm deals directly with a debtor, the claim belongs to the estate, and the trustee of the estate has standing to bring suit.[580] If the harm does not deal directly with the debtor and is distinguishable and particular in some other way, however, then the claim does not belong to the estate, and some party other than the creditor trustee of the

[578] *Schwab*, Nos. 10–60702, 12–6035, 2012 Bankr. LEXIS 4374, at *8.

[579] *Id*. at 25–26.

[580] *Ahcom, Ltd. v. Smeding*, 623 F.3d 1248, 1250 (9th Cir. 2010).

estate may bring suit.[581] Therefore, if the harm to the Schwabs dealt directly with their role as a debtor in the bankruptcy case, then their claim belonged to the estate, and the Schwabs would not have standing to bring suit.[582]

The court found that the Schwabs had failed to identify any injury or harm that was particular to them.[583] The Schwabs argued that, as a result of the defendant attorneys' actions, the liquidation of the Schwabs' assets as debtors was undervalued, which harmed the corporation and impacted the shareholders. The Schwabs further contended that because they were the main shareholders in Schwab Industries, they felt the substantial impact of the undervaluation. The court found, however, that the harm to the Schwabs was not particular to them and was directly related to their role as debtors in bankruptcy. As such, the claims were property of the estate and were required to be brought by the creditor trustee of the estate.

The Schwabs further contended that they had standing to bring the suit because the creditor trustee waived pursuit of the claims. The court correctly pointed out that such an argument did not have proper legal support. "In order for the cause of action to re-vest in another party, a trustee must abandon the claim."[584] The court therefore properly determined that the creditor trustee of the estate never abandoned the claim and that the standing to sue was property of the estate.

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[581] *Id.*

[582] *Honigman v. Comerica Bank (In re Van Dresser Corp.)*, 128 F.3d 945, 947 (6th Cir. 1997).

[583] Schwab, Nos. 10–60702, 12–6035, 2012 Bankr. LEXIS 4374, at *25–26.

[584] *Id.* at 23.

c. *Res Judicata*

Even though the court determined that the Schwabs did not have standing to bring this suit, the court further elaborated that even if the Schwabs had standing to sue, the doctrine of *res judicata* barred their claims.[585] For a malpractice claim to be precluded by *res judicata*, four elements must be established: (1) a final decision on the merits by a court of competent jurisdiction, (2) a subsequent action between the same parties of their privies, (3) an issue in the subsequent action which was litigated or which should have been litigated in the prior action, and (4) an identify of the causes of action.[586] The court specifically held that the Schwabs should have known from the final fee application of their right to bring the malpractice suit and related claims.[587] Thus, because the Schwabs should have known of their right to sue pursuant to the final fee application and failed to do so accordingly, their claims were barred by *res judicata*.

The Schwabs contended that they did not know of their right to sue until after the fee application had been submitted. The Schwabs further claimed that they did not know that they had a potential claim until consulting with counsel some time after the final fee application was entered. The court correctly found, however, that such a position was not in accordance with the applicable law, as the doctrine of *res judicata*, rather, requires that potential plaintiffs know of the factual basis of their claim, not the actual knowledge of being able to sue.[588]

Next, the Schwabs argued that they were unaware of the factual basis to sue because they were unaware of the conflict of interest until after the final fee application was submitted. The

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[585] *Id.* at 21–23.

[586] *Bittinger v. Tecumseh Prods. Co.,* 123 F. 3d 877, 880 (6th Cir. 1997).

[587] Schwab, Nos. 10–60702, 12–6035, 2012 Bankr. LEXIS 4374, at *31–33.

[588] *Iannochino v. Rodolakis (In re Iannochino)*, 242 F. 3d 36, 48-49 (1st Cir. 2001).

court did not find this argument persuasive. The Schwabs had signed a corporate resolution on February 26, 2010, which acknowledged and authorized the employment of special counsel for the defendant attorneys in matters arising adverse to the creditor.[589] For the court, that resolution provided sufficient evidence to establish that the Schwabs knew about the conflict of interest before the final fee application had been submitted. Therefore, because the Schwabs were factually aware that a conflict of interest had been present and chose not to litigate the issue during the final fee application process, the Schwabs' claims were correctly barred by the doctrine of *res judicata*.

iii. Conclusion

The court properly determined that it had jurisdiction to hear this case according to 28 U.S.C. § 157(b). The malpractice and other related claims properly arose in and during the Schwabs' chapter 11 bankruptcy case. Therefore, the bankruptcy court had jurisdiction to hear this adversary proceeding and issue a judgment. The court also properly determined that the Schwabs did not have standing to bring this suit because a claim that deals directly with the debtor of a bankruptcy proceeding is the property of the estate and should be brought by the estate's creditor trustee. Lastly, the court properly determined that the doctrine of *res judicata* barred the Schwabs' claims because the Schwabs had been factually aware of the conflict of interest and chose not to litigate it before the final application fee was finalized.

B. Second Motion

i. Factual and Procedural Background

On September 20, 2012, the court entered a judgment dismissing the Schwabs' amended complaint against the defendant attorneys because the Schwabs lacked standing to sue and

[589] Application to Employ Brouse McDowell as Special Counsel, Doc. No. 8, at p. 10.

because the doctrine of *res judicata* barred their claims.[590] The Schwabs never appealed that decision. On September 20, 2013, however, the Schwabs filed a motion for relief from that judgment under F.R.C.P. 60(b) claiming that new evidence had been discovered pertaining to their malpractice claim.[591] The Schwabs contended that further evidence had come to light that showed that their bankruptcy counsel had conflicts of interest with some of the secured creditors to the bankruptcy estate.[592] In particular, the Schwabs claimed that one of their counsel's colleagues had advised a secured creditor's trust advisory committee on assigning life insurance policies to the secured creditors.[593] That same attorney had prepared a trust and split-dollar agreement for the Schwabs in 1992.[594]

The Schwabs argued that this new information did not become available to them until May 3, 2013. The Schwabs posited that this new information provided for previously unknown grounds for relief. Recognizing the still-existing issue regarding standing to sue because the malpractice claims belonged to the estate, the Schwabs argued that they would encourage the creditor trustee of the estate to bring the malpractice suit or obtain an assignment of those rights.

ii. Discussion

In the previous related proceeding, the bankruptcy court held that the Schwabs lacked standing to sue because the malpractice claim was the property of the estate and should therefore

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[590] *Schwab,* Nos. 10–60702, 12–6035, 2012 Bankr. LEXIS 4374.

[591] Schwab v. Oscar (In re SII Liquidation Co.), Nos. 10-60702, 12-6035, 2014 Bankr. LEXIS 291, at *3 (U.S. Bankr. N.D. Ohio Jan. 22, 2014).

[592] *Supra* § V Sale Process II. See § V of this paper for more facts surrounding the conflicts of interest by the Schwab's attorneys during the bankruptcy process.

[593] *Id.*

[594] *Id.*

be brought by the creditor trustee of the estate.[595] The Schwabs attempted to circumvent this issue by claiming they would encourage the creditor trustee to bring the suit or obtain an assignment of the right to bring suit. The court has correctly found that because neither of those propositions had yet occurred, the motion for relief from judgment should be denied and was subsequently entered on January 22, 2014.

The court correctly concluded that even if the Schwabs obtained an assignment to sue, they would still be barred from bringing their claim due to lack of standing. Standing to sue is determined at the time of the filing of the complaint, not some time later in a proceeding.[596] This rule helps speed up the judicial process and keeps potential plaintiffs from bringing claims they may never have standing to litigate. Therefore, because the Schwabs did not have standing to sue at the time they filed their complaint, subsequent standing did not remedy their previous standing deficiency.

The court ruled against the Schwabs and emphasized that right to bring the suit belonged to the estate, not individuals. Even if the creditor trustee of the estate assigned its right to sue to the Schwabs, the Schwabs would still not have standing because they did not have standing at the time the motion was filed. As such, assignment of the right to sue from the creditor trustee would not and did not cure the Schwabs' lack of standing.

iii. The Appeal

The Schwabs timely appealed the order denying their motion for relief from judgment to the United States Bankruptcy Appellate Panel for the Sixth Circuit. In its appeal, the Schwabs challenged the bankruptcy court's ruling that they did not have standing to bring their

[595] Schwab, Nos. 10–60702, 12–6035, 2014 Bankr. LEXIS 291, at *3.

[596] *Cleveland Branch, NAACP v. City of Parma*, 263 F.3d 513, 524 (6th Cir. 2001).

malpractice claims. The appeals court concluded, however, that the law-of-the-case doctrine applied and that the Schwabs were barred from bringing their claims.[597]

The law-of-the-case doctrine instructs that challenges to judicial decisions are barred when there was a chance to properly appeal the decision and no appeal was ever made.[598] A plaintiff cannot submit another motion contesting a judge's decision in order to re-litigate the previous case and to add new facts. As such, a Rule 60(b) motion is not a form of appeal in and of itself.[599]

As to the Schwabs, the court found that they had the opportunity to appeal the initial order denying their standing to sue for the malpractice claims against the defendant attorneys. The court further concluded that the judge's order denying the Schwabs' complaint was a final, appealable order. Because the Schwabs did not appeal that order and instead filed a Rule 60(b) motion in hopes of re-litigating their case, the rule-of-the-case doctrine applied, and the Schwabs' Rule 60(b) motion was accordingly dismissed.

iv. Conclusion

The rule-of-the-case doctrine correctly barred the Schwabs from bringing their Rule 60(b) motion. Plaintiffs cannot side-step appeal procedures and re-litigate issues by filing Rule 60(b) motions. Furthermore, the Schwabs had not cured their standing to sue because the creditor trustee of the estate had neither decided to bring suit on behalf of the estate nor assigned the right to bring the suit to the Schwabs. Therefore, the Schwabs' Rule 60(b) motion was properly dismissed.

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[597] *Schwab v. Oscar* (*In re SII Liquidation Co.*), 517 B.R. 72, 76–77 (B.A.P. 6th Cir. 2014).

[598] *JGR, Inc. v. Thomasville Furniture Indus., Inc.,* 505 F. App'x 430, 435 (6th Cir. 2012).

[599] *Id.*

XII. Conclusion

In conclusion, the Schwabs' equity lost. At the beginning of the bankruptcy case, the Schwabs wanted to retain as much equity as possible. This goal required the Schwabs to aggressively negotiate with their pre-petition creditors, who preferred a quick liquidation, and to attempt to secure third-party financing to preserve going-concern value. The Schwabs resisted a quick sale of all of their assets because such a speedy sale would have extinguished their equity interests, and, therefore, erased any chance for future returns from their businesses. The Schwabs' interests quickly changed, however, once they were denied post-petition financing. After the court denied post-petition financing, the Schwabs were eager to make a deal with a potential buyer so that they could retain management positions and secure other lucrative incentives. This quick shift in interests incentivized the Schwabs to agree with pre-petition creditors on certain issues in order to speed up the bankruptcy and sale process. Shortly afterward, Schwab Industries was sold, though not to the stocking horse bidder, and the unsecured creditors and equity were left with nothing.

Additionally, the Schwabs' bankruptcy illustrates the pitfalls of leverage. Schwab Industries was generating $200 million in revenue only a few years before filing for bankruptcy. The Schwabs leveraged their businesses by borrowing large amounts of cash from big banks to pay for the businesses' supplies. Leveraging a business seems to work great when

business goes as planed. But, unfortunately for the Schwabs, the 2008 financial crisis significantly affected the construction industry and drastically reduced Schwab Industries' revenue. Because the Schwabs relied heavily on leverage, their businesses were extremely vulnerable to such market volatility. As a result, Schwab Industries was unable to operate once revenues started to decline, and the Schwabs were consequently forced to file a chapter 11 bankruptcy petition.

The last major takeaway regarding the Schwabs' handling of their bankruptcy is that the debtor's counsel should encourage his or her client to disclose everything. The doctrine of *res judicata* will keep a debtor free and clear of most subsequent litigation so long as all relevant information pertaining to the debtor is disclosed to the court. While this result seems like an unintended consequence of the doctrine, its effects go both ways. On one hand, potential buyers in a chapter 11 bankruptcy need to feel comfortable bidding on a debtor's assets in order to ensure a maximum price. On the other hand, if the doctrine of *res judicata* did not apply to bankruptcy sales, then potential buyers would be hindered from paying the maximum price because they would fear future litigation regarding prior liens and other related issues. Generating a maximum price from a debtor's assets is a central purpose of chapter 11 bankruptcies, and *res judicata* supports this endeavor.