2022

The Guitar Center Bankruptcy: Getting the Band Back Together

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THE GUITAR CENTER BANKRUPTCY

Getting the Band Back Together

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Cast of Characters

The Debtor- Guitar Center

Guitar Center Holdings Inc.- Guitar Center Holdings Inc., a Delaware corporation, was the parent company of Guitar Center Inc, and the primary holder of Guitar Center Inc. stock.

Guitar Center, Inc.- Guitar Center Inc. a Delaware corporation, was the primary debtor in the jointly administrated bankruptcy.

Guitar Center Stores, Inc.- Guitar Center Stores, Inc. a Delaware Corporation, was a subsidiary of Guitar Center, Inc. and oversaw much of the company's brick and mortar leases.

Guitar Center Gift Card Company, LLC- Guitar Center Gift Card Company, a Virginia limited liability company, was a subsidiary of Guitar Center Stores, Inc. and oversaw the company's gift card program.

Music and Arts Instructor Services, LLC- Music and Arts Instructor Services, a Maryland limited liability company, was a subsidiary of Guitar Center Stores and oversaw the music instruction side of Guitar Center's business.

AVDG LLC- AVDG LLC, a Delaware limited liability company, was a subsidiary of GC Business Solutions and specialized in the design and installation of audiovisual and automation systems.

Prepetition Creditors

Ares Management Company ("Ares")- Ares is an American global alternative investment manager operating in the credit, private equity and real estate markets. Ares owned all of the outstanding Guitar Center stock at time Guitar Center filed for bankruptcy

Wells Fargo Bank ("Wells Fargo")- Wells Fargo is an American multinational financial services company. Wells Fargo was Guitar Center's primary revolving door creditor

The Bank of New York Mellon Corporation ("Mellon")- Mellon is an American investment banking services holding company. Mellon owned all of the prepetition superpriority secured notes, the prepetition secured notes, and some of the prepetition unsecured notes

Wilmington Savings Fund Society (“Wilmington”)- Wilmington is an American financial services company. Wilmington owned the rest of the prepetition unsecured notes that Mellon did not own.

Creditors involved in Reorganization

Ares- Ares helped to provide financing to Guitar Center while Guitar Center was in chapter 11 bankruptcy.

The Carlyle Group (“Carlyle”)- Carlyle is an American multinational private equity, alternative asset management and financial services corporation with $325 billion of assets under management. Carlyle provided financing to Guitar Center while Guitar Center was in chapter 11 bankruptcy and provided exit financing once Guitar Center emerged from bankruptcy.

Brigade Capital Management (“Brigade”)- Brigade is a global alternative investment manager specializing in credit investment strategies. Brigade provided financing to Guitar Center while Guitar Center was in chapter 11 bankruptcy and provided exit financing once Guitar Center emerged from bankruptcy.

Terminology

“Sponsor Support Party” means Ares Management Company.

“Brigade Co Investor” means Brigade Capital Management.

“Carlyle Co Investor” means The Carlyle Group.

“Co Investors” means Brigade Capital Management and The Carlyle Group.

“Investor Support Parties” means Ares Management Company, Brigade Capital Management, and The Carlyle Group.

“Creditor Support Parties” means The Bank of New York Mellon Corporation.

The Bankruptcy Players

The Honorable Kevin R. Huennekens- Judge Hunnekens was the United States bankruptcy judge for the Eastern District of Virginia who presided of the Guitar Center bankruptcy.

John P. Fitzgerald III- Mr. Fitzgerald was the United States Trustee for region 4 at the time of Guitar Center’s bankruptcy.

Founding

The story of Guitar Center began in 1959 when Wayne Mitchell opened a small appliance and organ store in Hollywood, California. As rock and roll music began to gain popularity across the country in the early 1960s, Mitchell realized that Americans were more interested in electric guitars than dusty old organs.[1] In 1964, Mitchell took a huge risk and bought several guitars and amplifiers to create the first Guitar Center.[2] Mitchell sought to overhaul the traditional customer understanding of music stores and give customers the "Guitar Center experience."[3] Instead of looking at the instrument before purchasing it, customers were encouraged to feel, touch, and play the instruments on the wall for an immersive experience.[4] Furthermore, Mitchell encouraged musicians to sell Guitar Center equipment and merchandise to grow the brand organically.[5] The success of this first store would propel Guitar Center to become the leader in the music retail industry.[6]

Expansion

In 1972, Guitar Center began expanding its locations into other American markets such as San Francisco, Dallas, and Houston.[7] In 1984, Guitar Center purchased its iconic corporate headquarters on Sunset Boulevard, which remains one of the nation's largest and most famous retail stores.[8] The opening of the new corporate headquarters also inaugurated the world-famous "Rockwall", a sidewalk gallery, where hundreds of famous musicians have pressed their prints into the sidewalk.[9]

A Buying Spree Funded by an IPO

Throughout the 1990s, Guitar Center continued to expand its locations around the nation. In March of 1997, Guitar Center conducted an initial public offering to become the first publicly traded music retail company.[10] With an infusion of public capital and an eye towards aggressive

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[1] *Our History*, GUITAR CENTER, https://perma.cc/EPQ8-85YT.
[2] *Id.*
[3] Disclosure Statement for Joint Pre-Packaged Chapter 11 Plan of Reorganization of Guitar Center, Inc. Et Al. Case 20-34656 (KRH). ("Initial Disclosure Statement") 15 at 18.
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] *Our History*, *supra* note 1, https://perma.cc/EPQ8-85YT.
[8] *Id*.
[9] *Id*.
[10] *Id*.

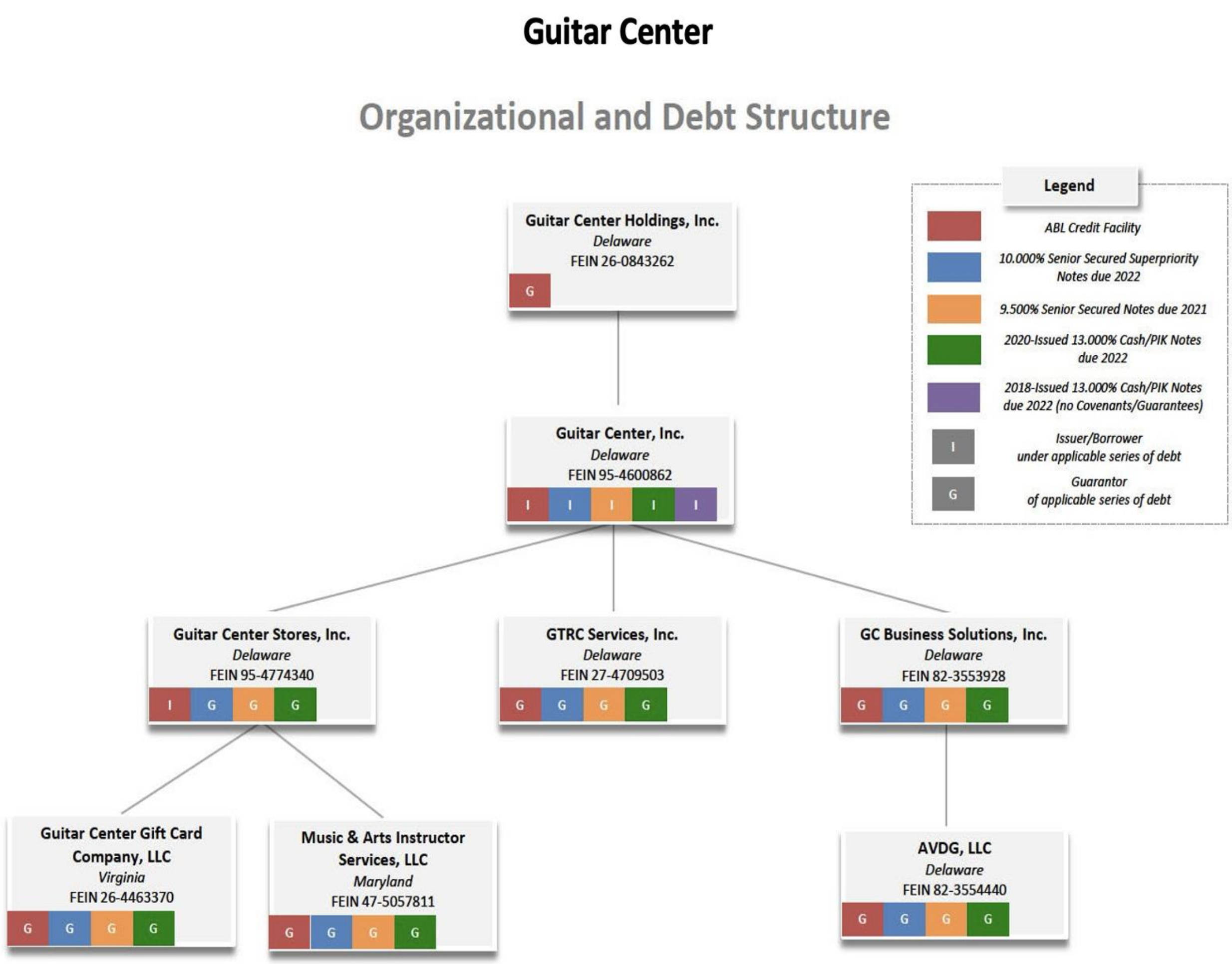
expansion, Guitar Center began to purchase several smaller music retail companies. In 1999, Guitar Center acquired Musician's Friend—then the world's largest mail-order and e-commerce retailer of musical instruments—to expand its e-commerce presence with the dawn of the internet.[11] Continuing their expansion in the early 2000's, Guitar Center acquired American Music Group, an instrument retailer who specialized in providing instruments to educators, band directors, and students. [12] Looking to further increase its influence on the music industry, Guitar Center bought Music and Arts, a music products retailer that supplied education and equipment to new musicians. [13] In 2007, Guitar Center acquired substantially all of the assets of two musical instruments retailers: The Woodwind & The Brasswind and Music 123.[14] Lastly, between 2017 and 2020, Guitar Center acquired the majority of the assets of three residential and commercial audio visual design and integration businesses to form its AVDG business.[15]

After its acquisition spree, Guitar Center was positioned in the music industry primarily through two business lines. Guitar Center's core business offered a multitude of exclusive products and services including new, used and vintage guitars, amplifiers, percussion, instruments, keyboards and much more.[16] The "Music & Arts" business of Guitar Center was a band and orchestral provider of products and services.[17] The "Music & Arts" business appealed primarily to a younger demographic beginning their journey into organized music.[18]

A Shift to Private

Guitar Center operated as a public company until October 2007 when Bain Capital Partners, LLC ("Bain Capital) and a co-investor acquired ownership of Guitar Center for $1.9 billion and assumed debt.[19] Under the terms of the deal, Guitar Center stockholders received $63 for each of their shares, which was a 26 percent premium over the stock's closing price.[20]

[11] *Id*.
[12] *Id*.
[13] *Id*.
[14] *Id*.
[15] *Id*. AVDG stands for audio visual design group.
[16] Declaration of Tim Martin of Guitar Center, Inc., in Support of Chapter 11 Petitions and First Day Motions. Case 20-34656 (KRH). ("Declaration of Tim Martin"). 254 at 6.
[17] *Id.*
[18] *Id.*
[19] Reuters, *Equity Firm Is Acquiring Guitar Center*, N.Y. TIMES Jun. 28, 2007, https://perma.cc/J6RN-JHG9.
[20] *Id*.



Several credit analysts believed the leveraged buyout was a prudent move by Bain Capital.[21] Guitar Center had a dominant retail position in a high-service business, yet significantly underearned as compared to other high-service-oriented retail segments.[22] Unfortunately for Bain Capital and its investors, Guitar Center had stumbled upon hard times and an influx of debt only hastened their problems.

[23]

[21] *Id.*
[22] *Id.*
[23] Initial Disclosure Statement, 15 at 349.

What Led to Chapter 11

The primary issues that faced Guitar Center before their Chapter 11 case were the sales challenges presented by an expanding e-commerce market, their mounting debt, and the COVID-19 “whammy”.

Sales Challenges

There can be no doubt that the music industry has been an integral part of American culture. As Guitar Center grew into a music giant, it connected itself to the culture of American music. However, this did not prevent Guitar Center from struggling in the harsh economic environment of the early 2000’s. Moreover, e-commerce retailers, such as Sweetwater Sound, made their way onto the scene during the 1990’s and presented serious challenge to the existing business model that Guitar Center operated under.[24] Further, discount retailers, such as Walmart Stores, Inc., began to undercut Guitar Center’s prices by selling cheaper versions of Guitar Center’s key products.[25] The effect of the widespread economic downturn paired with challenges to its business model placed Guitar Center under significant strain. It was clear that e-commerce had become paramount to the success of a music retailer in the modern era. As a primarily brick and mortar retailer with a marginal e-commerce presence, Guitar Center looked to embrace this new reality by hiring new marketing and e-commerce executives in 2018.[26] However, the existing and emerging market difficulties were not the sole culprit to blame for Guitar Center’s journey towards chapter 11.

Debt

By its own admission, the main reason Guitar Center filed for Chapter 11 was their “long dated debt load.”[27] Since 2007, the company was unable to exit the private equity merry-go-round. In that year, the economic downturn that plagued the United States hit retailers hard, and Guitar Center was not immune. Guitar Center hired Goldman Sachs to find a potential buyer for

[24] Staff Author, *Can Guitar Center Find New Rhythm?*, THE LOS ANGELES BUSINESS JOURNAL (Dec. 28, 2017), https://perma.cc/K8P5-E5XU.
[25] *Id*.
[26] Daphne Howland & Ben Unglesbee, *Guitar Center Adds 2 Executives Amid Online Push*, RETAIL DIVE (May. 29, 2018), https://perma.cc/5SY6-CD4N.
[27] Initial Disclosure Statement, 15 at 22.

the company.[28] Ultimately, affiliates of Bain Capital Partners bought out the company for $1.9 billion, while also assuming $200 million of Guitar Center's debt for a total transaction value of $2.1 billion.[29]

In April 2014, Guitar Center entered into a deal with private equity group Ares Management. The goal of the deal was to reduce Guitar Center's debt and improve Guitar Center's financial position, allowing it to allocate cash towards areas such as personnel, store bases, and brands.[30] The 2014 deal with Ares Management was a debt-to-equity exchange that reduced Guitar Center's total debt load by about $500 million and its cash interest expense by $70 million.[31] Here, Ares Management exchanged a portion of Guitar Center's debt that it held for preferred stock in order to assume a controlling interest in the company.[32] Bain Capital would retain partial ownership of the company, as well as representation on the Board of Directors.[33] Along with these moves, Guitar Center refinanced its remaining debt through issuing new senior secured notes, senior unsecured notes, and obtained a new revolving credit facility.[34]

In 2017, Guitar Center carried an enormous long term debt load and its revenues had remained stagnant since 2012.[35] In November 2017, Guitar Center had approximately $615 million in senior secured first lien notes, due in 18 months.[36] Because the company's cash flow was unlikely to materially reduce debt and improve leverage within this time frame, rumblings emanated from financial services companies that the company's outlook was negative.[37] With maturity dates fast approaching, refinancing the company's debt was necessary. As a result, in

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[28] The Associated Press, *Guitar Center to Be Acquired by Bain Capital for $1.9 Billion*, CNBC (June. 27, 2007), https://perma.cc/SE3C-KCMG.
[29] *Id*.
[30] Chris Witkowsky, *Ares Management Takes Controlling Stake Through Debt of Bain-backed Guitar Center*, PE Hub (Apr. 4, 2014), https://perma.cc/AZ9R-N7FE.
[31] *Id*.
[32] Declaration of Tim Martin, 254 at 17.
[33] *Id.*
[34] Initial Disclosure Statement, 15 at 19.
[35] Staff Author, *Can Guitar Center Find New Rhythm?*, THE LOS ANGELES BUSINESS JOURNAL (Dec. 28, 2017), https://perma.cc/K8P5-E5XU.
[36] *Id*.
[37] *Moody's Downgrades Guitar Center Inc. to Caa1; Outlook Negative*, MOODY'S INVESTORS SERVICE (Nov. 28, 2017), https://perma.cc/S2YF-3FTF.

December 2017, Ares increased its ownership in Guitar Center by purchasing all of the outstanding voting shares in Guitar Center's parent entity, Guitar Center Holdings, Inc.[38]

Around the same time,[39] the company entered into refinancing transactions aimed at addressing the $615 million in debt that was nearing its maturity date.[40] Guitar Center's total debt load at this point was more than $1 billion, and about sixty-five percent of this amount matured in April 2019.[41] The company had to buy itself some time or risk default. Ultimately, Guitar Center: (i) completed a bond exchange that added three years to the maturity date of $325 million in senior unsecured bonds due in 2020; (ii) issued $635 million in new senior secured notes at a higher interest rate with a new maturity date in 2021; and (iii) extended the due date for its existing $375 million Asset Based Lending Facility[42] from 2019 to 2022.[43] The company used cash and proceeds from the newly issued bonds to pay off the maturing $615 million in existing senior secured notes.[44]

The 2018 refinancing transactions allowed Guitar Center some breathing room in the form of short term liquidity, but various financial reporting services still viewed the company's status as dubious.[45] The refinancing was heralded as a "distressed exchange" by financial analysts, primarily because Guitar Center added $50 million to its already gigantic debt burden while having limited opportunity for growth.[46] Guitar Center would pay a high price for the short term financial flexibility it found from the 2018 transactions: it saw its interest expenses grow in the amount of $56.6 million by the end of the 2019 fiscal year.[47] Ultimately, Guitar Center would be stuck with net losses of $42.8 million and $61.9 million for the 2018 and 2019 fiscal years,

[38] Guitar Center Holdings was created to serve as the parent company of the different entities that comprised Guitar Center. Initial Disclosure Statement, 15 at 22.
[39] *Id.*
[40] *Id.*
[41] *Moody's Downgrades Guitar Center's Ratings*, MusicIncMag.com, Nov. 30, 2017, https://perma.cc/UM96-7KT2.
[42] An asset based loan is an agreement to loan money secured by assets of the borrower. The loan is secured by the assets of the company which may be the inventory, accounts receivables, equipment or other property owned by the borrower. INVESTOPEDIA.COM, https://perma.cc/DN6S-JLX7.
[43] Initial Disclosure Statement, 15 at 14.
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] Guitar Center's interest expenses increased by49.6% from $84.8 million to $126.8 million in the 2018 fiscal year and further increased by another 11.5% to $141.4 million in the 2019 fiscal year. Initial Disclosure Statement, 15 at 23.

respectively.[48] Despite these losses, management felt that positive trends underlying Guitar Center's business rendered these recent pitfalls sustainable in predictable circumstances.[49] Unfortunately for the company, 'predictable circumstances' were not on the horizon.

COVID-19 Pushes a highly leveraged Guitar Center into chapter 11

Guitar Center's 2018 refinancing gave the company short term liquidity and breathing room. The company saw sustained growth for ten consecutive quarters after the refinancing.[50] However, the arrival of the COVID-19 pandemic served to upset the "delicate balance" the company had struck between servicing its longstanding debt burden and financing its operations.[51] In March 2020, the pandemic forced the music giant to shut the doors of nearly all of its 500 locations and furlough approximately 9,000 of its estimated 13,000 employees.[52] The resulting loss of sales revenue obliterated any positive momentum accrued over the past 10 quarters and put the company in serious jeopardy of defaulting on upcoming principal and interest payments due in April 2020.[53] In total, Guitar Center faced an interest payment on the $325 million in unsecured notes from 2018 and an interest payment on the $635 million in secured notes from 2018. Furthermore, Guitar Center was required to pay the full amount owed on outstanding senior unsecured notes.[54] A global pandemic could not have come at a worse time for an overleveraged non-essential retailer.

After reports surfaced that Guitar Center was late on its payments, the company was able to negotiate with its lenders and come up with another refinancing transaction for near term liquidity.[55] The 2020 refinancing transactions resulted in Guitar Center: (a) exchanging a substantial majority of the 2018 unsecured cash/PIK[56] notes in order to defer a significant portion of the cash interest payment due on the 2018 notes in April 2020; (b) issuing Superpriority

[48] *Id.*
[49] *Id*.
[50] *Id.* at 14.
[51] *Id.* at 15. *See also* Howland & Unglesbee *supra* note 26 (as of February 2020, Guitar Center held 1.2 billion in debt and 3 million in cash, was working with investment banks to negotiate with its lenders).
[52] Declaration of Tim Martin, 254 at 3,7.
[53] *Moody's Downgrades Guitar Center*, *supra* note 37; *see also* Initial Disclosure Statement, 15 at 15.
[54] Initial Disclosure Statement, 15 at 15.
[55] *Id.*
[56] Payment-in-kind (PIK) refers to a financial instrument that pays the interest or dividends on a note with additional securities or equity instead of cash.

Secured Notes[57] to certain Secured Noteholders; (c) exchanging a majority of the remaining then-outstanding senior unsecured notes that matured in April 2020 for additional secured notes and repaying the remaining un-exchanged senior unsecured notes due 2020 in cash.[58]

The 2020 refinancing transaction helped Guitar Center in the short term, but the impacts of the COVID-19 pandemic would continue to affect its business. The company's net sales during the first half of the fiscal year of 2020 would decrease by 20%.[59] Because of the COVID-19 pandemic, Guitar Center was forced to shut down its second largest revenue source– instrument lessons.[60] Even as retail locations began to commence limited operations later in the year, they were still faced with challenges from intermittent closures and expenditures targeted at addressing health and safety costs. An extremely overleveraged and reeling Guitar Center would outright default on a $45 million interest payment in October 2020.[61] This default spurred the company and its creditors towards negotiations for a potential reorganization. For approximately three months, Guitar Center and its creditors worked out the terms of several restructuring transactions with an eye towards filing for chapter 11.[62] These transactions served as the foundations of Guitar Center's eventual initial plan in its chapter 11 case.[63] Ultimately, the company would file a petition to enter Chapter 11 on November 22, 2021.[64] On the petition date, Guitar Center's existing Pre-Petition debt totaled in the amount of $1,329.8 million under five financing arrangements described below.[65]

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[57] The net proceeds of Superpriority notes were used to fund the April 2020 cash interest payment due on the secured notes, as well as related fees and expenses of the 2020 refinancing transactions. Initial Disclosure Statement, 15 at 23.
[58] *Id*. at 23–24.
[59] Tim Martin Declaration, 254 at 29.
[60] *Id.* at 12, 17, 28.
[61] Jem Aswad, *Guitar Center, Laden with Debt, Considers Restructuring Options, Including Bankruptcy*, VARIETY (Oct. 27, 2020) https://perma.cc/K2YF-UUK6.
[62] Tim Martin Declaration, 254 at 29–35.
[63] *Id*. at 34.
[64] *Id.*
[65] Initial Disclosure Statement, 15 at 20–22.

Creditor	Type	Amount
Wells Fargo	ABL Facility & Letters of Credit	$276.6 Million
NY Mellon	Superpriority Secured Notes	$35.7 Million
NY Mellon	Secured Notes	$640 Million
NY Mellon	PIK/Cash	$5.8 Million
Wilmington	Unsecured Notes	$379.3 Million

[66]

The Restructuring Support Agreement

Before Guitar Center filed for bankruptcy, it negotiated a restructuring support agreement with its key credit holders. The restructuring support agreement contemplated and discussed certain restructuring and recapitalization transactions to be taken place while Guitar Center entered bankruptcy.[67] The parties to the restructuring support agreement were Guitar Center, the Sponsor Support Party, the Brigade Co-investors, the Carlyle Co-investor, and the creditor support parties[68] each of whom would be closely involved in the reorganization. The restructuring support agreement acted as map for Guitar Center and its key secured credit holders and equity holders because it stated how Guitar Center was to acquire financing during its bankruptcy, how Guitar Center's new equity structure was to be set up and implemented as it would exit Chapter 11 under a confirmed plan of reorganization.

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[66] *Id.* *See also* Declaration of Tim Martin, 254 at 20–22.
[67] Initial Disclosure Statement, 15 at 172.
[68] The preamble to the RSA describes the "creditor support parties" as the holders of unsecured notes claims, the holders of secured notes support parties and the superpriority secured notes support parties.

Milestones

There were several "milestones" included in the restructuring support agreement that set up a timeline for the reorganization process.[69] These milestones obligated Guitar Center and other parties to meet certain deadlines along the way to the plan's effective date.[70]

The first milestone in the restructuring support agreement provided that Guitar Center would pay the reasonable professional fees and expenses of the other parties to the agreement by November 18, 2020.[71]

Term DIP Commitment Letter Milestone

Another milestone included in the restructuring support agreement obligated Guitar Center to pay the reasonable fees and expenses that were documented under the Term DIP Commitment Letter (included in the restructuring support agreement) by no later than November 18, 2020.[72] Guitar Center and the creditor support parties who participated in restructuring support agreement planned to have Guitar Center serve as a "debtor in possession"[73] ("DIP") for the duration of the upcoming chapter 11 case.[74] It was necessary for Guitar Center to obtain DIP financing to avoid immediate and irreparable harm to its business, their estates, the creditors and other parties-in-interest.[75] Furthermore, the DIP financing would enable Guitar Center to continue business operations.[76] Guitar Center entered Chapter 11 with limited cash on hand, and the Prepetition Secured Lenders' consent to use their cash collateral was conditioned upon the transactions outlined in the restructuring support agreement, including Guitar Center's access to

[69] Initial Disclosure Statement, 15 at 183.
[70] *Id.* at 183–84.
[71] *Id.* at 183.
[72] *Id.*
[73] In the majority of chapter 11 cases, a debtor will remain in possession of its assets, while assuming the fiduciary and other responsibilities that a trustee would normally have in a bankruptcy case. Such responsibilities include investigation and oversight of a chapter 11 case. MICHAEL L. BERNSTEIN, GEORGE W. KUNEY, BANKRUPTCY IN PRACTICE 17 (6th ed. 2022).
[74] Declaration of Eric Winthrop in Support of Debtors' Motion for Entry of Interim and Final Orders: (I) Authorizing the Debtors to Obtain Senior Secured Priming Superpriority Postpetition Financing; (II) Authorizing Use of Cash Collateral; (III) Granting Liens and Providing Claims with Superpriority Administrative Expense Status; (IV) Granting Adequate Protection; (V) Modifying the Automatic Stay; (VI) Scheduling a Final Hearing; and Granting Related Relief. Case 20-34656 (KRH). ("Declaration of Eric Winthrop"). 31 at 6.
[75] Debtors' Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, 503, 506, and 507: (I) Authorizing Debtors to Obtain Senior Secured Priming Superpriority Postpetition Financing; (II) Granting Liens and Providing Claims with Superpriority Administrative Expense Status; (IV) Granting Adequate Protection; (V) Modifying the Automatic Stay; (VI) Scheduling a Final Hearing; and (VII) Granting Related Relief. Case -2034657 (KRH) ("Debtors' Motion for DIP Financing"). 30 at 41.
[76] *Id.* at 13.

DIP financing. Most importantly, Guitar Center commenced their bankruptcy case during the most critical time for retailers, the holiday season.[77] Guitar Center had to pay their employees, vendors, and other crucial entities to keep inventory stocked and cash flow up. The Term DIP Commitment Letter referenced in this milestone was written between Guitar Center and its creditors who held superpriority secured notes pre-petition.[78] Under the restructuring support agreement, Guitar Center was to obtain, pursuant to Section 364(c)[79] and 364(d)[80] of the Bankruptcy Code, a Term DIP Facility that would provide Guitar Center with $325 million in senior secured superpriority funding. This facility would be used to refinance the pre-petition ABL credit facility and provided Guitar Center with general working capital for the duration of its chapter 11 case.[81] This funding source would play a large role in Guitar Center's restructuring endeavors.[82]

New Common Equity Investment

The restructuring support agreement further provided that by November 18, 2020, Guitar Center and the Investor Support Party[83] would have executed and delivered counterparty signature pages to the New Common Equity Investment Agreement and New Common Equity Commitment Letters.[84] This "New Common Equity Investment" referred to a substantial equity transaction between Guitar Center and the Investor Support Party.[85] Under the terms of the New Common Equity Investment Agreement and Commitment Letters, Guitar Center would issue new common equity as part of its chapter 11 plan of reorganization, pro rata, to each of the

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[77] Declaration of Eric Winthrop, 31 at 7.
[78] Initial Disclosure Statement, 15 269, 281.
[79] Under section 364(c)(3) of the Bankruptcy Code if the trustee is unable to obtain unsecured credit, the court after notice and hearing, may authorize the obtaining of credit or the incurring of debt secured by a junior lien on property of the estate that is subject to a lien. 11 U.S.C. §§ 364(c)(3).
[80] Under section 364(d) of the Bankruptcy Code, the Court after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if the trustee is unable to obtain such credit otherwise and there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted. 11 U.S.C. §§ 364(d).
[81] Initial Disclosure Statement, 15 at 224.
[82] There were further milestones included in the term dip commitment letter which imposed deadlines on guitar center for filing motions relating to the term dip facility and obtaining the court's approval throughout the case. *Id.* at 224.
[83] The Investor Support Party was defined in the Restructuring Support Agreement as Ares Management, Carlyle Group and Brigade Management. *Id.* at 181.
[84] *Id.* at 183.
[85] *Id.* at 177.

investors inside the Investor Support Party at a rate of 33.3% each.[86] One party inside the Investor Support Party, Brigade Management, would also receive warrants[87] under the New Common Equity Investment Agreement.[88] In consideration for the new common equity, each investor would commit an amount not exceeding $55 million, for a total amount of $165 million.[89] This restructuring transaction was a centerpiece of Guitar Center's reorganization efforts. The restructuring transactions allowed Guitar Center to access a necessary source of funding and afforded the investor support parties with equity and governance rights upon the Effective Date of the to-be-confirmed chapter 11 plan.[90] Because of the role that this transaction would play in Guitar Center's reorganization, the restructuring support agreement sought to ensure that the New Common Equity Investment documents had been fully executed before moving forward in the chapter 11 process.

The next milestone that was included in the restructuring support agreement required Guitar Center to commence prepetition solicitation of the chapter 11 plan in accordance with Bankruptcy Code Section 1126(b), no later than November 19, 2020.[91] Bankruptcy Code Section 1126(b)(1)-(2) provides that a holder of a claim or interest that has accepted or rejected the plan before the commencement of a chapter 11 case is deemed to have accepted or rejected the plan if the solicitation of such acceptance or rejection was in compliance with any applicable non-bankruptcy law, or if there is no such law, acceptance or rejection was solicited after disclosure of adequate information.[92] This milestone was included in the restructuring support agreement to prompt Guitar Center to solicit votes on a plan for reorganization from key parties that would be entitled to vote on its plan before the chapter 11 proceedings began. In order for the pre-petition votes to "count" for purposes of confirmation of the plan, Guitar Center had to

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[86] *Id.* at 314.
[87] *Id.* *See also* James Chen, *What is a Warrant?*, INVESTOPEDIA (Oct. 6, 2021), https://perma.cc/LXS7-Y9BG.
[88] Initial Disclosure Statement, 15 at 314.
[89] *Id.*
[90] Ares Management was to nominate 3 members to the Guitar Center board, Brigade Capital was to nominate 3 members to the Guitar Center board, and CSP IV Acquisitions was to nominate 3 members to the Guitar Center board. The proceeds from the New Common Equity Investment Agreement would be used to pay off the Term DIP Facility. *Id.* at 211.
[91] Initial Disclosure Statement, 15 at 183.
[92] 11 U.S.C. §§ 1126. *See also* S. REP. NO. 95-989, https://perma.cc/2NRH-QREV; BERNSTEIN & KUNEY, *supra* note 78, at 570.

meet the adequate disclosure requirements of Section 1126(b).[93] Essentially, this required voting parties receive: (i) a disclosure statement, with all exhibits, (ii) the proposed plan, and (iii) an applicable ballot to cast a vote on the plan.[94] These documents had to be distributed to substantially all members of each voting class that Guitar Center solicited pre-petition.[95]

The restructuring support agreement included a milestone that imposed a November 22, 2020 deadline for Guitar Center to commence the chapter 11 case and file its first day motions.[96] Within one day after filing the voluntary petition for chapter 11 and the first day motions, the restructuring support agreement called for Guitar Center to file a DIP Financing Motion, the pre-packaged plan, the disclosure statement, and a motion seeking approval of the disclosure statement and confirmation of the plan in a combined hearing.[97] Because Guitar Center and its creditors had negotiated the terms and timing of this chapter 11 case before it was filed, the restructuring support agreement called for the first day motions to be filed quickly and to push the proceedings forward.[98] This was a boon to Guitar Center, as court approval of the DIP Motion would afford it essential funding to continue with the chapter 11 case as planned in the restructuring support agreement.[99]

The restructuring support agreement contemplated that the court would grant Guitar Center's DIP Motion and enter an Interim DIP order 2 days after Guitar Center filed its voluntary petition for chapter 11.[100] The fact that the parties to the restructuring support agreement expected such a short timeframe demonstrates the efficiency and speed that can accompany the use of prepetition out of court restructuring agreements in a chapter 11 case. Since the plan was negotiated outside of court and had been approved by Guitar Center's key creditors, the

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[93] The adequate disclosure requirements of Bankruptcy Code Section 1126 are spelled out in Bankruptcy Code Section 1125. The kind and form of information that meets the adequate disclosure confirmation requirement is left to judicial discretion, and will be governed by the circumstances of the case. 11 U.S.C. §§ 1125.
[94] Christina Pullo, *Undertaking a Prepackaged Plan Solicitation*, PRIME CLERK LLC, at 8, Practice Note w-016-7091.
[95] 11 U.S.C. §§ 1126(b); FED. R. BANK. P. 3018 (this rule allows a court to invalidate a pre-petition vote on a plan if distribution of solicitation was not distributed to substantially all members of a voting class).
[96] Initial Disclosure Statement, 15 at 184.
[97] *Id*.
[98] *Id*. at 183.
[99] *Id. See also The Prepackaged Bankruptcy Strategy*, THOMPSON REUTERS, Practical Law Practice Note 9-503-4934.
[100] Initial Disclosure Statement, 15 at 184.

expectation was that the proposed DIP motion would be granted by the court without issue in this case.

The restructuring support agreement set milestones 45 days after the petition date for the court to enter a Final DIP Financing order, an order approving Guitar Center's disclosure statement, and an order confirming the plan.[101] The final milestone included in the restructuring support agreement stipulated that the Effective Date[102] of the plan would be no later than February 1, 2021.[103]

Other Terms of the Restructuring

In addition to the milestones leading to the DIP Financing and plan confirmation, the restructuring support agreement also addressed other matters.

Critical Vendors

The restructuring support agreement called for Guitar Center to file a motion with the court, seeking permission to pay its critical vendors prepetition claims under the administrative expense priority in Bankruptcy Code Section 503(b).[104] Critical vendors are vendors whose goods and/or services are required by the debtor and who will not supply them absent payment of their pre-petition claims.[105] Guitar Center and its key credit holders desired to deem certain vendors as "critical vendors" because the vendors were unlikely to continue supplying Guitar Center with inventory without payment of their prepetition claims.

The ABL (Asset Based Loan) DIP Facility

Guitar Center's lenders under the prepetition ABL credit agreement intended to provide Guitar Center with financing under the ABL DIP Facility.[106] Obtaining an ABL facility during

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[101] Each of these were necessary for the Effective Date of the plan to occur. Initial Disclosure Statement, 15 at 184. Guitar Center included its initial disclosure statement in the prepetition plan and solicitation, so the major players in this case likely did not expect a lot of pushback to getting the disclosure statement approved.

[102] Once the plan had been confirmed by the court, the "Effective Date" was the date contemplated in the Restructuring Support Agreement on which the restructuring transactions and distributions included in the plan would take place. *Id.* at 52–54.

[103] *Id.* at 184.

[104] *Id.* at 216.

[105] BERNSTEIN & KUNEY, *supra* note 73, at 288.

[106] An asset based loan is an agreement to loan money secured by assets of the borrower. The loan is secured by the assets of the company which may be the inventory, accounts receivables, equipment or other property owned by the borrower. Asset-Based Lending, INVESTOPEDIA.COM, https://perma.cc/DN6S-JLX7.

the chapter 11 proceedings allowed Guitar Center to continue paying payroll expenses, purchase inventory from critical vendors, and pay rent due under its leases.

New First Lien Debt

On the Effective Date of the confirmed plan, the New First Lien Debt[107] was to be issued in the amount of $335 million to Guitar Center on prevailing market terms.[108] Guitar Center and its key credit holders knew the New First Lien Debt was necessary so Guitar Center could have working capital after emerging from chapter 11.

New Preferred Equity

On the Effective Date of the confirmed plan, the New Preferred Equity was to be issued to each holder of a Prepetition Secured Notes, on a pro rata basis.[109] Essentially, Guitar Center desired to do a debt/equity swap with the holders of the Prepetition Secured Notes claims. [110] The restructuring support agreement required Guitar Center to create a whole new class of stock to satisfy the Prepetition Secured Notes claims.[111]

New Junior Preferred Equity

On the plan Effective Date, Guitar Center was mandated to issue the New Junior Preferred Equity to each holder of the Prepetition Unsecured Notes Claim on a pro rata basis.[112] Guitar Center could call[113] in the New Junior Preferred Equity at any time after it had called and redeemed the New Preferred Equity, but not before then. Furthermore, the New Junior Preferred Equity did not have any rights to dividends or voting.[114]

[107] First lien debt is a form of senior secured debt where the first lien debt is secured by having the first claim on collateral. First Lien/Second Lien Debt, FINANCIAL EDGE.COM, https://perma.cc/JH4W-BBVE.
[108] Initial Disclosure Statement, 15 at 216.
[109] *Id.*
[110] A debt/equity swap is a refinancing deal in which a debt holder gets an equity position in exchange for the cancellation of the debt. The logic behind this is an insolvent company cannot pay its debts or improve its equity standing. Debt/Equity Swap, INVESTOPEDIA.COM, https://perma.cc/6P8E-MDC5.
[111] Initial Disclosure Statement, 15 at 216.
[112] The New Junior Preferred Equity was created with a liquidation preference totaling $2 million.
[113] Guitar Center could call in the New Junior Preferred Equity at a total price of $2 million.
[114] Essentially, the New Junior Preferred Equity is a $2,000,000 lottery ticket. If Guitar Center was successful and retired its New Preferred Equity, which it could only do if it has paid off all its current debt, then it can call the New Junior Preferred Equity and give the holders $2,000,000.

The Management Incentive Plan

On or after the Plan Effective Date, Guitar Center planned to adopt and implement a management incentive plan.[115] The management incentive plan was designed to keep Guitar Center's high-level executives on board while Guitar Center went through Chapter 11 by providing management with a small percentage of the New Common Equity that would be issued as part of the restructuring transactions.[116] Guitar Center and its key credit holders found it desirable to keep the most senior executives because they knew the most about Guitar Center's business.

Director and Officer Insurance ("D&O Insurance")

After the plan's Effective Date, Guitar Center could not terminate or otherwise reduce the coverage under any directors' and officers' insurance policies in effect or purchased as of the petition date.[117] It has become common for trustees, creditors' committees, and individual creditors or groups of creditors to assert breach of fiduciary duty and other claims against officers and directors of a bankrupt corporation.[118] When this occurs, the defendant directors and officers will need to make use of the D&O Insurance policy to fund their defense and pay any resulting settlement or judgement.[119]

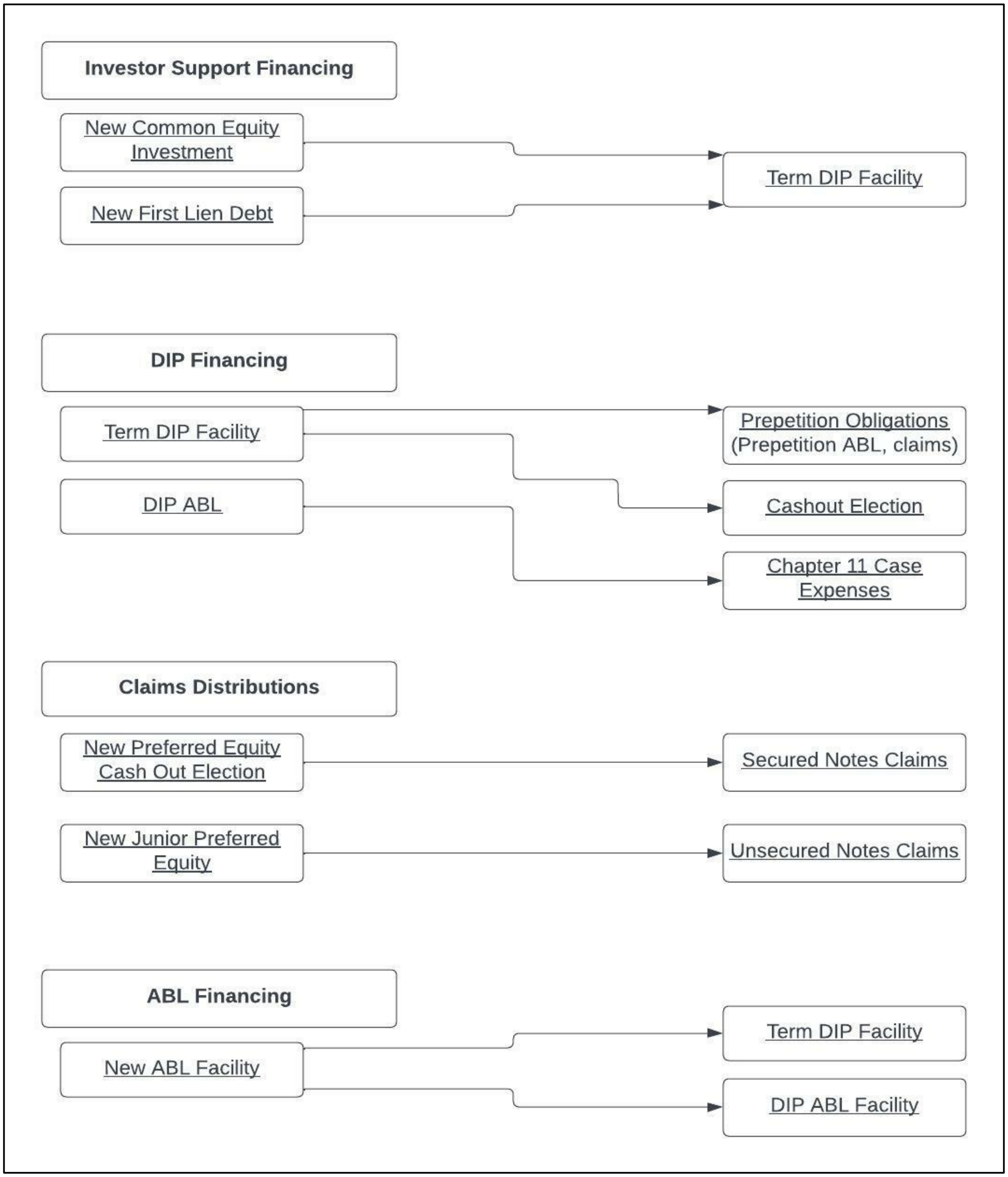
Unexpired Leases and Executory Contracts

On the Plan Effective date, all contracts and unexpired leases to which Guitar Center was a party were to be assumed or deemed assumed, unless Guitar Center previously rejected the lease. [120] Guitar Center and its key credit holders knew they needed a plan for Guitar Center's leases because Guitar Center had over 300 leased properties when they entered bankruptcy.

Summary of the Restructuring Transactions

Below is a chart that outlines the key restructuring transactions included in the restructuring support agreement that served as the foundation for Guitar Center's prepetition plan for reorganization.

115 Initial Disclosure Statement, 15 at 218.
116 *Id.*
117 *Id.*
118 BERNSTEIN & KUNEY, *supra* note 78, at 205.
119 *Id.*
120 *Id*. at 219.



Pre-Petition Solicitation and Voting

After the restructuring support agreement was executed, prepetition, Guitar Center proceeded to solicit approval of its plan of reorganization before filing for relief under chapter 11. Although Guitar Center characterized this as a pre-packaged plan in the disclosure statement, it would be more accurate to label the pre-petition plan as pre-negotiated, as Guitar Center solicited approval from only their key creditors and interest holder, not all creditors.[121]

The Bankruptcy Code contains certain requirements regarding the treatment of classes of claims[122] and interests[123] that exist against the bankruptcy estate. To satisfy these requirements, a plan must group creditors into similarly situated "classes" and then requires a determination of whether or not the class is "impaired" by the plan.[124] Pursuant to Bankruptcy Code Section 1124, in order to leave a class of claims or interests unimpaired, a plan must either: (i) leave unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or (ii) decelerate and reinstate the prepetition contract, and cure any default.[125] If a class is impaired by a plan, it must vote to accept the plan under Bankruptcy Code Section 1126(c), which provides that a plan is binding on a class if it is approved by a majority in number and two thirds in amount of voting creditors.[126]

Here, some advantages of pre-packaged and pre-negotiated plans can be seen. When done properly, a debtor can obtain the approvals needed to satisfy the disclosure and solicitation requirements of Bankruptcy Code Section 1125(a), as well as the confirmation requirements of 1129(a). When the requirements of these sections are met, a chapter 11 case can progress much quicker, since the essential requirements for plan confirmation have presumptively been met.[127] Pursuant to Bankruptcy Code Section 1126(f), holders of claims and interests that are not impaired are conclusively presumed to have accepted the plan.[128] Therefore, Guitar Center had no need to solicit votes from these classes during its pre-petition activities. There were only two classes of claims under Guitar Center's plan which the plan treated as impaired: Secured Notes

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121 A pre-packaged plan complies with the requirements set out in Bankruptcy Code Section1129(a)(8), because all Guitar Center's creditors were not involved in the prepetition solicitation process, this one did not.

122 Bankruptcy Code Section 101(5)(A) defines a "claim" as "a right to payment" whether or not such a right is reduced to a judgment, liquidated, unliquidated, fixed, contingent, matured, unmeasured, disputed, undisputed, legal, equitable, secured, or unsecured. 11 U.S.C. §§ 101(5)(A). See also BERNSTEIN & KUNEY, *supra* note 78, at 346.

123 While not defined expressly in the Bankruptcy Code, Section 1126 informs that a working definition of "interests" essentially means equity securities. BERNSTEIN & KUNEY, *supra* note 78, at 347.

124 BERNSTEIN & KUNEY, *supra* note 78, at 540.

125 11 U.S.C. §§ 1124. *See also* BERNSTEIN & KUNEY, *supra* note 78, at 540.

126 11 U.S.C. §§ 1126. *See also* BERNSTEIN & KUNEY, *supra* note 78, at 540.

127 Of course, there is a risk that the pre-packaged plan may have failed to satisfy a requirement and the court will reject the plan. Dennis J. Connolly, *Current Issues Involving Prepackaged and Prenegotiated Plans*, NORTON ANNUAL SURVEY OF BANKRUPTCY LAW, Sep. 2004.

128 Initial Disclosure Statement, 15 at 14.

Claims and Unsecured Notes Claims.[129] These were the only claim holders who were able to vote to approve the plan during pre-petition solicitation. In order to meet the confirmation requirements laid out in Bankruptcy Code Section 1129(a)(10), at least one of these two classes had to vote to accept[130] the plan.[131] The window to vote began on November 17, 2020 and ran through December 10, 2020. The classes were sent ballots to vote with as well as a disclosure statement to satisfy the requirements of 1125(a).[132] Ultimately, the holders of the Secured Notes Claims and the Unsecured Notes Claims each voted to approve the plan.[133] This gave Guitar Center a great deal of creditor support as it approached the time for filing for relief under chapter 11.[134]

The Initial Plan

On November 22, 2021, Guitar Center filed its voluntary petition for chapter 11. On the same day that Guitar Center filed its case, Guitar Center submitted the pre-negotiated plan that had been approved prepetition. The company also filed the prepetition disclosure statement, which included the restructuring support agreement, agreements outlining the restructuring transactions, a liquidation analysis, and financial projections relating to the plan. Furthermore, Guitar Center filed various administrative motions on the same day. The plan was filed with the Court immediately after Guitar Center filed for bankruptcy in accordance with the restructuring support agreement. The goals of the initial plan were to carry out the transactions and agreements outlined within the milestone of the restructuring support agreement and mirrored the terms that were voted on during the pre-petition solicitation process.[135]

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[129] *Id.*

[130] A class of Claims accepts the Plan where: the holders of (i) at least two-thirds in dollar amount of the Claims voting in such Class vote to accept the Plan; and (ii) more than one-half in number of the Claims voting in such Class vote to accept the Plan. 11 U.S.C. §§ 1126(c)–(d).

[131] 11 U.S.C. §§ 1129(a)(10). *See also* BERNSTEIN & KUNEY, *supra* note 78, at 540.

[132] Initial Disclosure Statement, 15 at 2–5.

[133] 100% of superpriority note claimholders, 71% of secured notes claimholders, 84% of unsecured notes claimholders voted to approve the plan. *Id.* at 5.

[134] At the same time, it is important to note that Guitar Center did not involve trade creditors, landlords, insurance providers, and so on during the pre-petition solicitation process. This created the potential for roadblocks and objections during the case. *See also* Connolly, *supra* note 132, at 7 (explaining that some disadvantages of prepetition solicitation include adverse effects on debtors and their suppliers).

[135] Joint Pre-packaged Chapter 11 Plan of Reorganization of Guitar Center, Inc. Et Al Case 20-34656 (KRH). (hereinafter "Initial Plan"). 16 at 1.

Classification of Claims and Interests

When Guitar Center filed its initial plan with the Court, it had already solicited approval of the plan during the pre-petition process from the classes of claim holders that were "impaired" by the plan.[136] However, along with the two impaired classes, Guitar Center provided for the treatment of 10 total classes of claim and interests, shown below.

Class	Designation	Treatment	Voting Status
1	Other Priority Claims	Unimpaired	Not entitled to vote (deemed to accept)
2	Prepetition ABL Claims	Unimpaired	Not entitled to vote (deemed to accept)
3	Superpriority Secured Notes Claims	Unimpaired	Not entitled to vote (deemed to accept)
4	Secured Notes Claims	Impaired	Entitled to vote
5	Other Secured Claims	Unimpaired	Not entitled to vote (deemed to accept)
6	Unsecured Notes Claims	Impaired	Entitled to vote
7	General Unsecured Claims	Unimpaired	Not entitled to vote (deemed to accept)
8	Intercompany Claims	Either (i) Unimpaired or (ii) Impaired	Either (i) deemed to accept/not entitled to vote or (ii) deemed to reject/not entitled to vote
9	Intercompany Interests	Either (i) Unimpaired or (ii) Impaired	Either (i) deemed to accept/not entitled to vote or (ii) deemed to reject/not entitled to vote
10	Existing Common Equity	Impaired	Not entitled to vote (deemed to reject)

[137]

[136] Initial Disclosure Statement, 15 at 14.
[137] Initial Plan, 16 at 25.

Secured Notes Claims

Class 4 of claims as outlined in Guitar Center's chapter 11 plan consisted of all Secured Notes Claims against the bankruptcy estate.[138] Class 4 was one of the two classes impaired by the initial plan.[139] They were impaired because the initial plan altered the legal, equitable, and contractual rights owed to the secured notes holders.[140] Consequently, the holders of Secured Notes Claims were required to approve Guitar Center's initial plan for reorganization in order for the court to confirm it.[141] Since this class had already voted to approve the initial plan during the pre-petition solicitation process, there was no need to solicit approval of the initial plan during the case. This removed a major obstacle to confirmation of the initial plan.[142]

Additionally, Guitar Center sought to confirm the initial plan under Bankruptcy Code Section 1129(b), therefore the initial plan's treatment of this class of claims had to comply with the 1129(b) "fair and equitable" requirement.[143] With respect to classes of secured claims, one manner in which a plan can satisfy the confirmation requirements of 1129(b happens when the plan provides that "the proponent 'rewrites the contract' to provide for payments over time, with a present value at least equal to the value of the collateral."[144]

Here, the plan stated that such claims were allowed in the principal amount of $640,000,000, plus all accrued and unpaid interest and expenses related to the secured notes during the chapter 11 cases.[145] Pursuant to the plan, as of the Effective Date, Guitar Center would make pro rata distributions (the Secured Notes Claims Distribution) to holders of this

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[138] *Id.* at 27.
[139] *Id.* at 25.
[140] 11 U.S.C. §§ 1124(2)(E).
[141] 11 U.S.C. §§ 1129(a). However, a court can still confirm a plan that does not have the requisite votes for approval under Bankruptcy Code Section 1129(b). 11 U.S.C. §§ 1129(b); *see also* BERNSTEIN & KUNEY, *supra* note 78, at 542.
[142] So long as the court found that Guitar Center had complied with the applicable Bankruptcy Code requirements. *See generally* Connolly, *supra* note 132.
[143] 11 U.S.C. §§1129(b). This rule is known as the "cramdown rule", and allows the proponent of a plan to impose a plan on dissenting classes where one class of impaired creditors has voted to accept the plan. BERNSTEIN & KUNEY, *supra* note 78, at 542.
[144]The absolute priority rule in 1129(b) requires the claims of a dissenting class of creditors to be paid in full before any junior class of creditors may receive or retain any property in satisfaction of their claims. 11 U.S.C. §§ 1129(b)(2)(A)(i). *See also* BERNSTEIN & KUNEY, *supra* note 73, at 547 (explaining that "a class may not receive or retain value under a plan unless all classes that enjoy higher priority are paid in full, unless they agree otherwise.")
[145] Initial Plan, 16 at 30.

class of claims in exchange for full and final satisfaction of the claims against the estate.[146] This distribution provided holders of the Secured Notes Claims with a pro rata share of cash in the aggregate amount of $450 million and 100% of the New Preferred Equity.[147] By providing this class of claims with a distribution of cash, shares of the New Preferred Equity, and paying interest and expenses that accrued during the chapter 11 cases, the plan's treatment of the class satisfied the "fair and equitable" requirements of Bankruptcy Code Section 1129(b).[148] Further, the initial plan's treatment of the Secured Notes Claims did not violate the "absolute priority rule," as this distribution would satisfy the secured claims against the bankruptcy estate which allowed for the initial plan to afford distributions to unsecured creditors.[149]

Unsecured Note Claims

Class 6 of claims as outlined in Guitar Center's chapter 11 plan consisted of all Unsecured Note Claims against the bankruptcy estate.[150] This was the only other class left impaired by the initial plan. As such, Class 6 had been involved in pre-petition solicitation, ultimately voting to approve the plan.[151]

Because Guitar Center sought to confirm the plan under Section 1129(b), the plan's treatment of this class of claims had to conform to 1129(b)'s confirmation requirements.[152] With respect to unsecured claims, a plan can meet confirmation standards under 1129(b) if it pays creditors in full upfront or over time with interest at a rate calculated to provide the creditor with the present value of the claim amount; or it pays nothing to junior classes of creditors.[153]

Here, Guitar Center's initial plan stated that this class of claims shall be allowed in the amount of $385,088,767 in unsecured notes relating to the 2018 Cash/PIK Notes.[154] Further, it also included an amount of $5,782,295 relating to the 2020 Cash/PIK unsecured notes for a total

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[146] *Id.* at 32.
[147] *Id.* at 32, 51.
[148] *See supra* text accompanying note 149.
[149] The plan afforded distributions to the secured notes claims, provided the unsecured notes claims with pro rata shares of New Junior Preferred Equity, and no other class received or retained value under the plan. Initial Plan, 16 at 30, 51.
[150] *Id.* at 30.
[151] Initial Disclosure Statement, 15 at 14.
[152] 11 U.S.C. §§ 1129(b).
[153] 11 U.S.C. §§ 1129(b)(2)(B)(i); *see also* BERNSTEIN & KUNEY, *supra* note 78, at 550.
[154] Initial Plan, 16 at 32.

aggregate principal amount of $379,406,472 of allowed claims within this class.[155] Per the initial plan, each holder of a claim in this class would receive its pro rata share of the Unsecured Notes Claims Distribution[156] on the initial plan's Effective Date or as soon as practicable thereafter.[157] The distribution would give the class of claims pro rata shares of 100% of New Junior Preferred Equity[158] in exchange for full and final satisfaction and release of claims against Guitar Center.[159]

The New Junior Preferred Equity would only total in the amount of $2 million, meaning that the plan's treatment of this class of claims did not pay this class of creditors the full value of pre-petition claims.[160] Creditors in this class voted to accept the initial plan during the pre-petition solicitation phase.[161] This is likely due to the fact unsecured note holders lacked priority, and would receive nothing under a traditional chapter 7 liquidation analysis.[162] Because the initial plan did not provide for full satisfaction of this class of claims, in order to satisfy the requirements of Section 1129(b), no class junior to the Unsecured Notes Claims could receive distributions under the initial plan.[163]

Intercompany Claims (and Interests)

Class 8 of claims in Guitar Center's initial plan consisted of Intercompany Claims.[164] These claims consisted of claims that Guitar Center held against itself, by way of intercompany accounts receivable, payables, and other intercompany transactions.[165] The initial plan

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155 *Id.*
156 The Unsecured Notes Claims Distribution would give the class of claims pro rata distributions of 100% of New junior preferred equity. *Id.*at 33.
157 *Id.*
158 *Id.* *See also* Initial Disclosure Statement, 15 at 212.
159 Initial Plan, 16 at 33.
160 *Id.*
161 Initial Disclosure Statement, 15 at 14.
162 *Id.* at 361.
163 *See supra* text accompanying note 149.
164 Intercompany Transactions result in the daily creation of intercompany receivables and payables (collectively, the "Intercompany Claims"). Intercompany Claims exist at any given time, resulting in the existence of prepetition Intercompany Claims. The Debtors' treasury department oversees the cash collections and disbursements and maintains records of any transfers among the Debtors. Debtors' Motion for Entry of Interim and Final Orders: (I) Authorizing the Debtors to (A) Continue to Operate their Cash Management System and Maintain Existing Bank Accounts and Business Forms, (B) Continue Using Credit Cards, and (C) Engage in Intercompany Transactions; (II) Providing Administrative Expense Priority for Postpetition Intercompany Claims; (III) Granting an Extension with Respect to Compliance with Requirements of Section 345(b) of the Bankruptcy Code; and (IV) Granting Related Relief. Case 20-34656 (KRH). (hereinafter "Cash Management Motion"). 11 at 27.
165 *Id.*

contemplated the reinstatement of these prepetition claims, with the consent of the Investor Support Parties.[166] With respect to this class of claims, Guitar Center moved the court to apply administrative expense priority for any postpetition Intercompany Claim, so as to allow each subsidiary to continue to bear repayment responsibility for the underlying obligation.[167]

Existing Common Equity

In the initial plan, Class 10 was comprised of interests in Existing Common Equity in Guitar Center. Pursuant to the initial plan, all prepetition Guitar Center common equity would be cancelled on the Effective Date of the initial plan.[168] No holder of any existing common equity was to receive a distribution or retain property or other value on account of its prepetition equity interests.[169] These claims were fully impaired.[170]

It might seem alarming that this initial plan could be confirmed despite all existing common equity being impaired, without having the right to vote on the initial plan.[171] However, the application of Bankruptcy Code Section 1129(b) provides clarity on this issue. The confirmation requirements of Section 1129(b) allow a court to confirm a plan that meets the standards of the "fair and equitable requirement" and absolute priority rule.[172]

Here, it is important to remember that this plan was pre-negotiated between Guitar Center and its key creditors. Some of these key creditors were the also members of the prepetition existing common equity class.[173] Therefore, these members, in particular, had to agree to the treatment of class 10 under initial plan before it was filed. An integral function of the initial plan was incorporating a new equity structure upon the Effective Date of the initial plan.[174] Because the initial plan's treatment of class 6 opted not to pay unsecured note holders in full, any class

[166] Initial Plan, 16 at 34.
[167] Cash Management Motion, 11 at 19.
[168] Initial Plan, 16 at 34.
[169] *Id.*
[170] *Id.*
[171] Initial Plan, 16 at 30.
[172] *See supra* text accompanying note 149.
[173] Ares Management held substantially all prepetition common equity in Guitar Center Holdings, Inc. and was involved in the prepetition negotiations in this case.
[174] This proposition is evidenced by the fact that the Effective Date could not occur without the completion of the New Common Equity Investment, as this source of funding was needed for multiple restructuring transactions. *See supra* text accompanying note 101.

junior to class 6 was unable to receive payment in order for the initial plan to meet confirmation requirements of 1129(b).[175]

Means of Implementation

After discussing the classification of claims and interest, Guitar Center's initial plan provided for the means of implementation of the initial plan. The initial plan provided for a New Board of Directors of Guitar Center and the issuance of new equity.[176] The New Corporate Governance Documents outlined the management structures and governance of Guitar Center upon reorganization[177] The New Board was designed primarily to allow the new equity holders to direct and control the Reorganized Guitar Center.

Furthermore, the initial plan provided the procedures for disputed claims. Since the restructuring support agreement was negotiated between Guitar Center and its key creditors, Guitar Center knew some interested parties were likely to be upset regarding their distributions under the initial plan. As such, Guitar Center had to implement a disputed claims process so interested parties could dispute their distributions. Initially, Guitar Center desired to pay all claims in the ordinary course of business.[178] If Guitar Center disputed any claim, the dispute would be resolved as if the chapter 11 cases had not commenced, and would survive the Effective Date.[179] Moreover, Guitar Center or an interested party could object to the any of the claims filed. The objections had to be filed ninety days before the Effective Date or the date that a proof of claim was filed.[180] Without such a process, the interested parties could have subjected Guitar Center voluminous litigation.

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[175] *See supra* text accompanying note 149.
[176] Initial plan, 16 at 37–38.
[177] The New Corporate Governance Documents stated: i. there would be a New Board of directors consisting of ten persons; ii. the Sponsor Support party, the Carlyle Co-Investor and the Brigade Co-Investor each had the right to designate three persons to the New Board, and in the case of the Sponsor Support Party, one of such three persons planned to serve as the Chairman of the New Board; (iii) the Sponsor Support Party, the Carlyle Co-Investor and the Brigade Co-Investor were entitled to designate one director to each committee of the New Board; and (iv) the chief executive officer of Reorganized Guitar Center was appointed by the New Board. *Id.* at 39.

[178] *Id.* at 43.
[179] *Id.* If Guitar Center initiated any claims while in bankruptcy, they wanted to litigate them in the proper forum and venue without disruption from the bankruptcy court. Moreover, Guitar Center wanted the claims to survive the effective date in case they desired to pursue them further.
[180] *Id.*

Furthermore, the initial plan provided for a management incentive program.[181] Under the management incentive program, Guitar Center was required to reserve, exclusively for directors and management employees, a pool of shares of new common stock representing 10-12% of the New Common Equity.[182] The final amount of the pool had to be reasonably acceptable to Guitar Center and each of the Investor Support Parties.[183] Guitar Center desired to keep its high level executives after they emerged from bankruptcy because these executives had substantial knowledge of Guitar Center's business and large turnover could be costly. Therefore, it was likely these executives wanted to be compensated for the work they had already done for Guitar Center and the work they did to negotiate the restructuring support agreement.

Finally, the initial plan discussed a cash out election process as part of the Secured Notes claims distribution.[184] Each holder of an allowed secured notes claims was to be granted a piece of the New Preferred Equity to satisfy their claim against Guitar Center. If an allowed Secured Note holder did not want a part of the New Preferred Equity, then they could elect to receive cash at a dollar to dollar basis.[185] However, the initial plan also instituted a cash out election cap, which capped the aggregate amount of dollars that were allocated to the cash out election.[186] If the amount the cash out elections exceeded the cash election cap, then holders of allowed Secured Notes claims making a cash out election had their election automatically reduced on a pro rata basis.[187] The cash out election process was used as an incentive to entice certain credit holders to go along with the restructuring support agreement and initial plan.

Treatment of Contracts and Unexpired Leases

Additionally, the initial plan addressed the milestone in the restructuring support agreement regarding the assumption or rejection of contracts and unexpired leases. Under Bankruptcy Code Section 365(a) "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."[188] Furthermore, under Bankruptcy Code Section 1123(b)(2) "a plan may provide for the assumption, rejection, or

[181] *Id.* at 44.
[182] *Id.*
[183] *Id.*
[184] *Id.* at 41.
[185] *Id.*
[186] *Id.*
[187] *Id.*
[188] 11 U.S.C. §365(a).

assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section."[189] Here, Guitar Center planned to assume all executory contracts ("contracts") and unexpired leases ("leases") unless a contract or a lease was otherwise assumed or rejected, was the subject of a motion disputing the assumption/rejection of the lease or contract, or was listed on the schedule of rejected contracts.[190]

Moreover, the initial plan provided a cure of defaults for assumed contracts and leases.[191] Guitar Center had to pay cash to satisfy the monetary defaults for each contract and lease that was being assumed under the initial plan.[192] If Guitar Center and a counterparty had a dispute regarding the amount necessary to cure a default and they could not resolve the dispute consensually, then no cure was to be paid until entry of a final order resolving the dispute.[193]

Next, the initial plan developed a process for claims arising out of the rejection of certain contracts and leases. Claims arising from the rejection of contracts and leases had to be filed thirty days after the entry of the confirmation order with respect to the contracts and leases. Additionally, claims could be filed on the date on which Guitar Center informed the applicable counterparty of their determination to reject its contract or lease.[194]

Finally, the treatment of contracts and unexpired leases section of the initial plan considered the assumption of Guitar Center's insurance policies. Similarly to the management incentive program, Guitar Center desired to assume all D&O ("directors and officers") liability insurance policies primarily for the benefit of their high level executives. Many of the executives would only participate in the negotiations of the restructuring support agreement and the initial plan if Guitar Center's insurance policies remained effective throughout the bankruptcy. Keeping the insurance policies in place was important, so executives could protect themselves from liability for their actions during the bankruptcy. All of Guitar Center's insurance policies and any agreements, documents, or instruments relating thereto, were treated as executory contracts.[195] Guitar Center preferred to treat the insurance policies as executory contracts because then they

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[189] 11 U.S.C §1123(b)(2).
[190] Initial Plan, 16 at 47.
[191] *Id.* at 48.
[192] *Id.*
[193] *Id.*
[194] *Id.* at 48-49.
[195] *Id.*

could treat the insurance policies as an administrative claim and cure the claim in full. On the Effective Date, pursuant to Bankruptcy Code section 365(a), Guitar Center assumed all insurance policies and any agreements, documents, and instruments related thereto.[196] Maintaining Guitar Center's insurance policies were crucial to sustaining their ongoing business to ensure no gaps in liability emerged while Guitar Center was in bankruptcy.

Conditions Precedent to Plan Confirmation

Next, the initial plan discussed the conditions precedent to confirmation. Here, the only condition to confirmation was the restructuring support agreement could not terminate due to a default by Guitar Center.[197] As discussed above, the restructuring support agreement was the map intended to guide Guitar Center through its chapter 11 case. Guitar Center's key creditors wanted to hold the power to direct Guitar Center throughout its bankruptcy. Therefore, this condition was designed so the initial plan could not be confirmed if the DIP lenders [198] declared a default based upon an event of default in the restructuring support agreement.[199] However, if an event of default in the restructuring support agreement did occur, then the DIP lenders could waive the term and give Guitar Center more time to comply with the applicable term.

Conditions Precedent to the Effective Date

Furthermore, the initial plan provided for conditions that needed to be satisfied before the Effective Date and consummation of the plan could occur.[200]

The Restructuring Support Agreement Effective

The restructuring support agreement needed be in full force and effect, and there could not be a default under the restructuring support agreement or termination event after the expiration of the applicable grace period.[201]

Definitive Documents Effective

The plan had to be confirmed, the disclosure statement needed to be approved, and any other definitive documents[202] had to be in full force and effect. Furthermore, the plan, the

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196 *Id.*
197 *Id.*
198 The DIP Lenders were the Term DIP Commitment parties and Wells Fargo.
199 Some examples of events of default in the restructuring support agreement were if Guitar Center withdrew the plan or if Guitar Center publicly announced their intention not to support the restructuring transactions
200 *Id.* at 55.
201 *Id.*

disclosure statement, and any other definitive documents had to be consistent in all aspects with the restructuring support agreement and reasonably acceptable to all parties.[203] Here, Guitar Center and its key creditors desired to predicate the Effective Date on plan confirmation, approval of the disclosure statement and the definitive documents being in full force and effect because the restructuring transactions contained within the initial plan were to occur on the Effective Date and were cross conditioned on the performance of other transactions. Ensuring that the initial plan, disclosure statement, and other definitive documents were in effect before the occurrence of the Effective Date would guarantee the availability of funding sources necessary on the Effective Date.

Plan Confirmation Order

The Bankruptcy Court would have entered the Final Confirmation Order, which had to be consistent in form with all material aspects of the restructuring support agreement and also reasonably acceptable to the ABL DIP agent, Guitar Center, and the Investor Support Party.[204] When a court enters a confirmation order, it acknowledges the plan satisfies the statutory requirements found in Bankruptcy Code Section 1129 and will constitute a binding collective contract between and among all parties in interest after the effective date.[205] Furthermore, if the court denies confirmation, the court may grant the debtor leave to amend, allowing the debtor to come back and ask for confirmation of a new plan.[206]

New Common Equity Investment and Equity Commitment Letters

Once the plan had been confirmed by the court, the restructuring support agreement and initial plan provided that on the morning of the Effective Date, the New Common Equity Investment Agreement would be executed.[207] The New Common Equity Investment represented one of the restructuring transactions that Guitar Center and its creditors considered essential to

[202] Essentially, the definitive documents were all the documents that governed the restructuring transactions. These documents included the New Corporate Governance documents, the New Common Equity documents, and the New Preferred Equity documents. Initial Plan, 16 at 57.
[203] These documents included the disclosure statement, plan, first day motions, new common equity documents, corporate governance, and management incentive plan.
[204] Initial Plan, 16 at 56.
[205] 11 U.S.C. §1129(a).
[206] BERNSTEIN & KUNEY, *supra* note 78, at 539.
[207] Initial Disclosure Statement, 15 at 329.

the reorganization as a whole.[208] The funding that Guitar Center would receive from the New Common Equity Investment would be used to satisfy the Term DIP Facility on the Effective Date.[209] Consequently, without the execution of this agreement and the subsequent delivery of the investment funds, the entire reorganization would be in jeopardy. In contemplation of this, the initial plan included a condition that required this agreement to be executed and funding delivered to Guitar Center before the Effective Date of the reorganization could occur.[210]

No DIP Default

No event of default under and as defined in the applicable DIP Facility could have occurred under the DIP Facilities or the DIP Order.[211]Some of the events of default were: (i) a failure to make payment when due, (ii) noncompliance with covenants or breaches in any material respect of representations and warranties, in either case, (iii) change of ownership, (iv) termination of exclusivity, etc.[212]

New Common Equity and Warrants Issued.

The initial plan contained a condition precedent to the Effective Date, that required the New Common Equity and Warrants to have been delivered in accordance with the terms set forth in the New Common Equity Investment Documents.[213] Guitar Center and the parties involved in the pre-petition solicitation process predicated the occurrence of the Effective Date on this condition because this transaction was integral to the overall reorganization efforts.[214]

Here, occurrence of the Effective Date was cross-conditioned on the execution of the New Common Equity Investment Agreement.[215] The New Common Equity Investment Agreement was set to close on the morning of the Effective Date.[216] Upon closing, Guitar Center would provide evidence that it allocated the securities (and with respect to Brigade, the warrants) in book entry form for the respective Investor Parties.[217] Once Guitar Center delivered such

[208] *Id.* at 172. *See supra* text accompanying note 101.
[209] Initial Disclosure Statement, 15 at 10
[210] *Id.* at 220.
[211] Initial Plan, 16 at 56.
[212] *Id.*
[213] Initial Disclosure Statement, 15 at 184.
[214] *See supra* text accompanying note 101.
[215] Initial Plan, 16 at 56.
[216] Initial Disclosure Statement, 15 at 329.
[217] *Id.*

evidence, the Investor Support Parties would irrevocably release a wire transfer for the funds in the amount of the agreed upon purchase price for the securities.[218] This condition precedent to the occurrence of the Effective Date was important because per the terms of the initial plan, the Effective Date also represented the maturity date for the Term DIP Facility, and other significant financial obligations.[219] Without the funding from the New Common Equity Investment, Guitar Center would not be able to make the required payments upon the Effective Date.

New First Lien Debt Issued

The New First Lien debt needed to be issued and the New First Lien documents had to be in full force and effect, and consistent in all aspects with the restructuring support agreement.[220] Here, The New First Lien Debt was necessary for Guitar Center to have working capital after it emerged from bankruptcy. Guitar Center was concerned that if the New First Lien Debt was not issued before the Effective Date, then they would have a cash flow problem the first day out of bankruptcy.

ABL Facility Effective

The New ABL Facility had to be in full force and effect.[221] Furthermore, the New ABL Facility documents had to be consistent in all material aspects with the restructuring support agreement and reasonably acceptable to the Support Parties and Guitar Center.[222]The New ABL facility was necessary so Guitar Center could continue to purchase inventory and pay payroll expenses. Guitar Center funded many of its operations through a revolving ABL, therefore it was likely Guitar Center needed to continue using an ABL after they emerged from bankruptcy.

Professional Fee Reserve

The professional fee reserve had to be established and fully funded.[223] The professional fee reserve was a reserve of cash to pay all the professionals associated with Guitar Center and its key creditors during the chapter 11 proceeding.

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[218] *Id.*
[219] *See supra* text accompanying note 101.
[220] Initial Plan, 16 at 56.
[221] *Id.*
[222] *Id.*
[223] *Id.*

Moreover, the initial plan provided Guitar Center a course of action to waive the conditions discussed above. The conditions to the Effective Date could only be waived by Guitar Center with the written consent of the Support Parties.[224]The required parties had the ability to withhold their consent in whole or in part.[225] Here, the Support Parties provided for a safety valve in case Guitar Center could not accomplish one of the conditions precedent. They could in their sole discretion waive a condition if Guitar Center asked or failed to satisfy a condition. Furthermore, the conditions relating to the ABL DIP Claims could only be waived with the consent of the ABL DIP Agent.[226]

Finally, the initial plan contemplated the effect of a failure of a condition. If the conditions of the plan discussed above were not satisfied or improperly waived before the termination of the restructuring support agreement, then the plan became null and void in all respects.[227]

Withdrawal and Modification of the Plan

Lastly, Guitar Center's initial plan discussed the procedures for withdrawal or modification of the plan during the chapter 11 process. Drawing again from the restructuring support agreement, Guitar Center sought to introduce certain safeguards if the initial plan did not work out in their favor. Bankruptcy Code Section 1127 states "the proponent of a plan may modify such plan at any time before confirmation."[228] Bankruptcy Code Section 1127 allowed Guitar Center, with the reasonable consent of its key creditors, to amend or modify the plan before the Effective Date.[229] Here, Guitar Center reserved the right to seek to withdraw the plan at any point prior to the Effective Date.[230] If the plan were withdrawn, then the plan and the confirmation order would be null and void in all aspects.[231] Holders of claims that have accepted the plan would be deemed to accept the modified plan if the modification did not materially and adversely change the treatment of their claims.[232] After the initial plan was filed, Guitar Center's

[224] *Id.*
[225] *Id.*
[226] *Id.*
[227] *Id.*
[228] 11 U.S.C. §1127(a).
[229] *Id.*
[230] Initial Plan, 16 at 58.
[231] *Id.*
[232] *Id.*

bankruptcy truly began because all of the creditors Guitar Center left out of the negotiations regarding the restructuring support agreement and the initial plan now had the opportunity to interject their claims.

First Day Motions

After Guitar Center filed their initial plan, the milestones in the restructuring support agreement called for Guitar Center to file critical administrative motions that would help expedite the proceedings.[233] First day motions and orders are governed by Federal Rules of Bankruptcy Procedure Sections 6003 and 4001.[234] Rule 6003 governs the notice requirements regarding first day motions.[235] Rule 4001 governs first-day financing motions.[236] The ability to plan and prepare salient first day motions is another way that Guitar Center benefitted from structuring its reorganization before filing for chapter 11. In chapter 11 cases, filing first day motions is often a chaotic process that can leave debtor's counsel scrambling.[237] However, Guitar Center's initial plan was pre-negotiated, and filing first day motions was considered in the restructuring support agreement.[238] This allowed Guitar Center to enter chapter 11 with a battle plan for its first day motions. These motions generally involve facilitating the administration of an estate, smoothing day to day operations, and substantive matters in a chapter 11 case[239]

Orders Facilitating Administration of the Estate

Motion for Joint Administration of the Estate

One of the first motions the Court addressed was Guitar Center's motion for joint administration. Because Guitar Center Holdings, Inc. and its wholly owned subsidiaries entered chapter 11 in separate cases, moving the court to administer the cases together would afford Guitar Center and the Court significant administrative convenience.[240] Guitar Center and its

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[233] *Id.* at 184.
[234] BERNSTEIN & KUNEY, *supra* note 76 at 289.
[235] Rule 6003 requires 21 days' notice before the court may grant certain relief, except to the extent that relief is necessary to avoid "immediate and irreparable harm. FED. R. BANKR. P. 6003.
[236] Rule 4001 states that a final hearing on cash collateral motion or on a motion to obtain financing may commence "no earlier than fourteen days after service of the motion." Rule 4001 further provides that relief can be granted at a preliminary hearing before the end of the 14 day period, but only to the extent "necessary to avoid immediate and irreparable harm to the estate pending a final. FED. R. BANKR. P. 4001.
[237] BERNSTEIN & KUNEY, *supra* note 78, at 287.
[238] Initial Plan, 16 at 184.
[239] *Id.* at 290–91. BERNSTEIN & KUNEY, *supra* note 78, at 310.
[240] Debtors' Motion for Entry of an Order: (I) Directing Joint Administration of Chapter 11 Cases; and (II) Granting Related Relief. ("Joint Administration Motion"). Case 20-34656 (KH). 3 at 9.

subsidiaries moved for joint administration of their cases under Rule 1015(b) of the Federal Rules of Bankruptcy and Bankruptcy Code Section 105(a).[241] Bankruptcy Rule 1015(b) permits that "the court may order a joint administration of the estates" if "two or more petitions are pending in the same court by or against a debtor and an affiliates."[242] Furthermore Bankruptcy Code Section 105(a) authorizes the court to issue "any order, process, or judgement that is necessary or appropriate to carry out the provisions of this title."[243] The Court granted the motion for joint administration of the cases.[244]

Motion To Employ Prime Clerk As Claims Agent

Next, the Court considered Guitar Center's application to employ Prime Clerk as notice and claims agent. Prime Clerk employed leading industry professionals with significant experience in both the legal and administrative aspects of chapter 11 cases.[245] In the capacity of claims agent Prime Clerk transmitted, received, docketed, and maintained proofs of claims filed in connection with the cases.[246] The Court approved Guitar Center's application.[247]

Motion To Continue Using Existing Cash Management System

Guitar Center also filed a cash management system motion.[248] Here, Bankruptcy Code Section 345(b) required Guitar Center to keep all estate funds in an FDIC or other government insured depository.[249] Moreover, the United States Trustee overseeing the chapter 11 case had its own guidelines regarding Guitar Center's cash management system. These guidelines stated Guitar Center had to establish three brand new bank accounts at the time they filed their bankruptcy case.[250]

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[241] *Id.* at 8–9.
[242] FED. R. BANKR. P. 1015(B).
[243] 11 U.S.C. §§105(a)
[244] Order: (I) Directing Joint Administration of Chapter 11 Cases; and (II) Granting Related Relief. Case 20-34656 (KRH). 63 at 4.
[245] Debtors' Application for Entry of an Order Authorizing Retention and Appointment of Prime Clerk LLC as Claims, Noticing, and Administrative Agent, Effective as of the Petition Date. Case 20-34656 (KH). 17 at 7.
[246] *Id.* at 6
[247] Order Authorizing Retention and Appointment of Prime Clerk, LLC as Claims, Noticing, and Administrative Agent, Effective as of the Petition Date. Case 20-34656 (KH). 112 at 2.
[248] Cash Management Motion, 11 at 16.
[249] If Guitar Center declined to use an FDIC bank, then they would have to post a bond to secure repayment. 11 U.S.C. § 345(b).
[250] The three new accounts had to be (1) a general expense account, (2) a payroll account, and (3) a taxes/special escrow account. U.S. Trustee Guideline 2.1-2.3 2020. 4 https://perma.cc/ENN6-DT8U.

Guitar Center requested that the court continue to allow them to use their existing cash management system, which included fifty-eight bank accounts at six different banks.[251] Furthermore, Guitar Center contended that their cash management system was an integral part of their intercompany transactions, and any disruption to their cash management system would severely disrupt their business operations to the detriment of the estate, creditors, and other stakeholders.[252] Essentially, Guitar Center found it unnecessary and burdensome to remove all of their money from their various accounts to comply with the requirements of Bankruptcy Code Section 345(b) and the trustee guidelines. Guitar Center argued that if they were forced to adjust the cash management system the estate would incur needless costs that would erode the value of Guitar Center to the detriment of their creditors.[253] Finally, Guitar Center stated it is within the Court's discretion to modify the requirements of 345(b) and waive the US trustee guidelines. The Court granted Guitar Center's motion and authorized their banks to continue maintaining, servicing, and administering Guitar Center's accounts without interruption.[254]

Orders to Smooth Day-to-Day Operations

Utilities

Pursuant to Bankruptcy Code Section 366, Guitar Center requested the court's authority to pay utilities in the ordinary course of business.[255] Bankruptcy Code Section 366 offers protection to a debtor against utility service providers altering or terminating service postpetition if the debtor provides "adequate assurance" of payment[256] within thirty days after filing for chapter 11.[257]

Guitar Center maintained utilities for its 563 retail and service locations, distribution centers, and corporate offices through two utility service providers—Engie Insight Services and

[251] Cash Management Motion, 11 at 7.
[252] *Id.* at 12.
[253] *Id.* at 23.
[254] Order: (I) Establishing Certain Notice, Case Management, and Administrative Procedures; and (II) Granting Related Relief. Case 20-34656 (KRH). 78 at 3.
[255] Debtors' Motion for Entry of Interim and Final Orders: (I) Approving the Debtors' Proposed Adequate Assurance of Payment for Future Utility Services; (II) Prohibiting Utility Companies From Altering, Refusing, or Discontinuing Services; (III) Approving Debtors' Proposed Procedures for Resolving Additional Assurance Requests; and (IV) Granting Related Relief. Case 20-34656 (KRH) (hereinafter "Utilities Motion"). 9 at 5.
[256] 11 U.S.C. §§ 366(c)(1)(a)
[257] 11 U.S.C. §§ 366(c)(2).

Cass Information Systems, Inc.[258] These providers would manage the payment of Guitar Center's utility bills, a total expense of around $1,324,368 each month.[259] The company paid these two utility service providers approximately $11,600 per month.[260] At the time of filing its chapter 11 petition, Guitar Center owed the utility service providers an estimated $16,000.[261] To satisfy the requirements of Bankruptcy Code Section 366, Guitar Center proposed making an "Adequate Assurance Deposit" of $662,184 into a specified bank account.[262] This account would name utility providers as the sole beneficiaries.[263]

The court granted Guitar Center's motion and issued an interim order before entering a final order. Specifically, the court held that the Adequate Assurance Deposit in the amount of $662, 184, together with Guitar Center's ability to pay for future utilities services would constitute adequate assurance of future payment as required by Bankruptcy Code Section 366.[264]

Substantive Orders

DIP Financing

DIP Marketing Process

Guitar Center needed DIP funding to pay off their prepetition claims and the prepetition obligations of the ABL. Guitar Center with the help of their advisors, engaged in a competitive marketing process to obtain DIP financing on the best available terms. [265] Before they filed for chapter 11, Guitar Center negotiated heavily with their key creditors and contacted 20 different financial institutions to solicit offers for DIP financing.[266] Because the majority of Guitar Center's assets were encumbered by liens granted to the prepetition secured lenders, any

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[258] Utilities Motion, 9 at 6–7.
[259] *Id.*
[260] *Id.*
[261] *Id.*
[262] *Id.* at 8.
[263] *Id.* at 9.
[264] Final Order: (I) Approving the Debtors' Proposed Adequate Assurance of Payment for Future Utility Services; (II) Prohibiting Utility Companies From Altering, Refusing, or Discontinuing Services; (III) Approving Debtors' Proposed Procedures for Resolving Additional Assurance Requests; and (IV) Granting Related Relief. Case 20-34656 (KRH). 233
[265] Declaration of Eric Winthrop, 31 at 10.
[266] *Id.*

potential third party lender was hesitant to agree to provide DIP financing without priority over the liens held by the prepetition secured lenders.[267]

Ultimately, Guitar Center's key creditors came together to propose a term sheet for a Term DIP facility of $325 million.[268] Furthermore during the Term DIP facility negotiation process, Guitar Center obtained a $50 million ABL DIP facility from their Prepetition ABL Agent, Wells Fargo.

DIP Financing Proposal

The Term DIP Commitment Parties and Wells Fargo wanted to provide credit to Guitar Center under Bankruptcy Code Section 364(c) and requested senior secured and superpriority status for their DIP financing liens.[269] As such, the DIP financing would: receive priority over all administrative expenses outlined in Bankruptcy Code Sections 503(b) and 507(b); would be secured by a lien on property of the estate not otherwise subject to a lien; and would be secured by a junior lien on property subject to a lien.[270] To obtain this priority, Guitar Center had to show that "financing was not available otherwise" on an unsecured or administrative basis.[271] As discussed above, Guitar Center spoke with 20 different financial institutions and none of them were willing to provide DIP financing on a unsecured or junior secured basis.

Next, the Term DIP Commitment Parties and Wells Fargo wanted to lend pursuant to Bankruptcy Code Section 364(d), which provides for a super priority priming liens over existing liens. Since they were the existing lienholders, they implicitly consented to this treatment. The DIP Lenders emphasized that their existing liens required adequate protection, under Bankruptcy Code Sections 363 and 364, in the form of junior and senior liens on Guitar Center's prepetition property, which the court approved. The Lenders wanted these protections because Guitar Center's obligations under the ABL Credit Agreement, Superpriority Secured Notes, and Secured Notes are secured by "crisscrossing" senior-and-junior- priority liens on almost all of Guitar Center's assets.[272] Some of the new judicially imposed liens would only last until the

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[267] *Id.* at 11.
[268] *Id.* The key creditors were Ares, Brigade, Caryle, and New York Mellon.
[269] Debtors' Motion for DIP Financing, 30 at 30.
[270] 11 U.S.C. §364(c).
[271] *Id.*
[272] Declaration of Eric Winthrop, 31 at 6.

Prepetition ABL payoff date, when Guitar Center would use certain DIP funds to pay off its Prepetition ABL loan. The new judicially imposed liens were divided into six different categories:

ABL Adequate Protection Liens

The first category comprised the ABL Adequate Protection Liens. These liens were created for the benefit of Prepetition ABL Agent and were effective until the Prepetition ABL loan was paid in full, which would be immediately upon the funding of the ABL DIP Facility.[273] The ABL Adequate protection liens were secured by perfected postpetition liens on all DIP collateral and were only junior to (i) the Carve Out[274], (ii) Permitted prior Senior Liens, (iii) the ABL DIP Liens, (iv) the Prepetition ABL liens and with respect to the Term DIP priority Collateral, (A) the Term DIP liens, (B) the prepetition Notes liens, (C), the notes adequate protection liens and (D) the ABL DIP Liens[275]

Superpriority Notes Adequate Protection Liens

The second category comprised the Superpriority Notes Adequate Protection Liens. These liens were created for the benefit of the Superpriority Noteholders.[276] Superpriority Notes Adequate Protection Liens were secured by perfected postpetition liens on all DIP Collateral and junior only to (i) the Carve out, (ii) Permitted Prior Senior Liens, (iii) the Term DIP Liens, and with respect to the ABL DIP Priority Collateral, (A) the ABL DIP Liens and (B) the ABL Adequate Protection Liens.[277]

Senior Secured Notes Adequate Protection Liens

The third category comprised the Senior Secured Notes Adequate Protection Liens. These liens were created for the benefit of the Senior Secured Noteholders and were secured by DIP

[273] Final Order Pursuant to 11 U.S.C. §§105, 361, 362, 363, 364, 503, 506, and 507: (I) Authorizing Debtors to Obtain Senior Secured Priming Superpriority Postpetition Financing; (II) Authorizing use of Cash Collateral; (III) Granting Liens and Providing Claims with Superpriority Administrative Expense Status; (IV) Granting Adequate Protection; (V) Modifying the Automatic Stay; (VI) Granting Related Relief. Case 20-34656 (KH). ("Final Order on DIP Financing"). 315 at 31.

[274] The Carve out was, an amount sufficient or a sum certain, for the payment of professional fees and expenses "carved out" from liens granted by the court. These administrative fees are "carved out" of the DIP facilities and had to be used by Guitar Center in a certain manner. Examples of Carve out fees include but are not limited to: (i) all fees required to be paid to (A) the Clerk of the Court and (B) the U.S Trustee. So What Does a Bankruptcy Carve Out Clause Really Mean?, NATIONALLAWREIVIEW.COM, https://perma.cc/G4ZE-YSHG.

[275] Final Order on DIP Financing, 315 at 31.

[276] *Id.* at 32.

[277] *Id.*

Collateral and junior only (i) the Carve Out, (ii) Permitted Prior Senior Liens, (iii) the Term DIP Liens, (iv) the Prepetition Superpriority Notes Liens, (v) the Superpriority Notes Adequate Protection Liens and (vi) with respect to the ABL DIP Priority Collateral, (A) the ABL DIP Liens and (B) the ABL adequate Protection Liens

<u>ABL Superpriority Claim</u>

The fourth category comprised the ABL Superprority Claim. Until the Prepetition ABL obligations were paid in full, the Prepetition ABL Agent was granted a superpriority administrative expense claim.[278] The Superpriority Claim was junior only to (i) the Superpriority DIP Claims (except with respect to the ABL DIP Priority Collateral, in respect of which the ABL Superpriority Claim will be senior to the Superpriority DIP Claim of the Term DIP Agent) , (ii) the Carve Out, and (iii) the Notes Superpriority Claims (except with respect to the ABL DIP Priority Collateral).[279]

<u>Superpriority Notes Superpriority Claim</u>

The fifth category comprised the Superpriority Notes Superprority Claim. The Superpriority Notes holders were granted a Superprioity administrative expense claim, which was junior only to (i) the ABL Superpriroity Claim with respect to the Priority ABL Collateral, (ii) the Superpriority DIP Claims (except with respect to the Term DIP Priority Collateral, in respect of which the Superpriority Notes Superpriority Claim will be senior to the Superpriroity DIP Claim of the ABL DIP Agent) and (iii) the Carve out.[280]

<u>Senior Secured Notes Superpriority Claim</u>

The sixth and final category comprised the Senior Secured Notes Superpriority Claim. The Senior Secured Notes Holder were granted an allowed superpriority administrative expense claim, which was junior to (i) the ABL Superpriority Claims with respect to the Priority ABL Collateral, (ii) the Superpriority DIP Claims (except with respect to the Term DIP Priority Collateral, in respect of which the Senior Secured Notes Superpriority Claim will be senior to the

[278] *Id.* at 34.
[279] *Id.*
[280] *Id.* at 36.

Superpriority DIP Claim of the ABL DIP Agent), (iii) the Superpriority Notes Superpriority Claim, and (iv) the Carve Out.[281]

The net effect of this lien structure was to ensure that the prepetition secured debt remained secured until it was retired and paid off by the DIP Facilities. After the prepetition debt was retired, the DIP Facility would enjoy the protection of senior lien status, junior only to certain government tax liens.

Objections to DIP Financing

Certain Texas Taxing Entities and the Maricopa County Treasurer ("MTC") filed objections to Guitar Center's Interim Order for DIP financing.[282] MTC objected to Guitar Center's Interim Order for DIP financing to the extent that Guitar Center sought to prime MTC's tax liens.[283] MTC held a secured tax lien on the property Guitar Center owned in Maricopa County, Arizona.[284] According to Arizona law, the personal property tax liens attached on January 1 of the respective tax year and the taxes could not be discharged until the taxes and interest were paid in full or title to the property vests in a purchaser of the property for taxes.[285] Finally, the tax liens were superior to any other liens of every kind and description regardless of when another lien attached.[286]

Moreover, Certain Texas Taxing Entities also possessed tax liens on Guitar Center's property in Texas.[287] The Texas tax liens attached pre-petition and were secured by tax liens on the real and tangible personal property of Guitar Center. Additionally, Guitar Center had failed to provide adequate protection for the Certain Texas Taxing Entities' senior liens.[288] The Certain

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[281] *Id.*

[282] Maricopa County Treasurer's Objection to Interim Order Pursuant to 11 U.S.C. §§105, 361, 362, 363, 364, 503, 506, and 507: (I) Authorizing Debtors to Obtain Senior Secured Priming Superpriority Postpetition Financing; (II) Authorizing use of Cash Collateral; (III) Granting Liens and Providing Claims with Superpriority Administrative Expense Status; (IV) Granting Adequate Protection; (V) Modifying the Automatic Stay; (VI) Granting Related Relief. Case 20-34656 (KH) 230 at 1. (hereinafter "MTC Objection to DIP Financing"). Limited Objection of Certain Texas Taxing Entities to Motion to Approve Use of Cash Collateral Debtors' Motion for entry of Interim and Final Orders (I) Authorizing the Debtors to use Cash Collateral; (II) Granting Liens and Providing Claims with Superpriority Administrative Expense Status; (III) Granting Adequate Protection; (IV) Modifying the Automatic Stay; (VI) Granting Related Relief. Case 20-34656 (KRH) 206. ("Certain Texas Tax Entities Objection to DIP Financing").

[283] MTC Objection to DIP Financing, 230 at 1.

[284] *Id.* at 3.

[285] A.R.S. §42-17153; A.R.S. §42-19106.

[286] A.R.S.§42-19106

[287] Certain Texas Tax Entities Objection to DIP Financing, 206 at 2.

[288] *Id.*

Texas Taxing Entities requested adequate protection in the DIP Final Order by not allowing post-petition liens to prime their tax liens.[289]

The Final Order on DIP Facilities

The Court filed and entered the Final Order on December 17, 2020 approving both the ABL and Term DIP facilities.[290] The Court sustained the objection by MTC and Certain Texas Taxing Entities and in the Final Order directed that no lien granted in the Final Order could prime any of the tax liens imposed by MTC or Certain Texas Taxing Entities on Guitar Center's property.[291] Wells Fargo and the Term DIP Commitment parties were satisfied with the new judicially imposed liens because they protected the DIP facilities post-petition, pursuant to Bankruptcy Code Sections 364(c) and 364(d). Guitar Center was ordered to maintain all of the DIP collateral until the obligations were paid in full.[292]

Motion to Continue Customer Programs

Pursuant to Bankruptcy Code Sections 105(a) and 363(b) and 507(a)(7), rules 6003 and 6004 of the Federal Rules for Bankruptcy Procedure and local rule 9013-1 of the United States Bankruptcy Court for the Eastern District of Virginia, Guitar Center filed a motion with the Court for authority to continue administering certain customer programs.[293] The motion requested the authority to pay certain prepetition unsecured claims relating to customer programs which are generally prohibited without court approval until they are paid pursuant to a confirmed plan of reorganization.[294] At the time of filing, Guitar Center had an estimated amount in excess of $34 million outstanding customer programs claims.[295] Guitar Center's customer programs consisted of a refund and exchange program, a rewards program for the Musician's Friend brand, a private level credit card, and a gift card program.[296] Guitar Center also requested authority from the court to continue operating its layaway program and payment processing agreements

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[289] *Id.*
[290] Final Order on DIP Financing, 315 at 18.
[291] *Id.* at 77.
[292] *Id.* at 49
[293] Debtors' Motion for Entry of Interim and Final Orders: (I) Authorizing the Debtors to Maintain and Administer Certain Customer Programs and to Honor Certain Related Prepetition Obligations; and (II) Granting Related Relief. Case 20-34656 (KRH) (hereinafter "Customer Programs Motion") 12.
[294] *Id.* at 5–6.
[295] *Id*. at 6–11.
[296] *Id.*

for non-cash transactions.[297] Guitar Center primarily argued that it should be authorized to maintain these consumer programs under Bankruptcy Code Section 363(b) and 363(c)(1) because these sections authorized the company to maintain the customer programs in the ordinary course of business.[298] Guitar Center also argued that under Bankruptcy Code Section 507(a)(7), certain obligations for up to $3,025 in claims under its gift card program, purchase deposits, and layaway program could enjoy priority claim status.[299] After entering an interim order granting the motion, the court entered a final order granting the motion.[300]

Critical Vendors Motion

Pursuant to Bankruptcy Code Sections 363, 105(a), and 503, Guitar Center filed a motion to pay prepetition trade creditor's claims.[301] Guitar Center noted in this motion that many of the existing trade claimants were vendors of specialty products, goods, and services that were integral to its business.[302] These vendors were general unsecured creditors who supplied Guitar Center with specialty merchandise that could not be replaced.[303] Guitar Center's critical vendors were not heavily involved in the pre-petition negotiations that resulted in the initial plans for reorganization. As such, this motion was of particular importance, because it would allow Guitar Center to ensure that its critical vendors continued to supply necessary goods and services throughout its chapter 11 case. Guitar Center argued that it should be permitted to satisfy these claims because they were entitled to priority under Bankruptcy Code Section 503(b)(9).[304] This section provides for an administrative expense priority for the value of any goods a debtor receives in the ordinary course of business within 20 days of the petition date.[305] Applying Section 503(b)(9) to critical vendor claims would allow Guitar Center to satisfy these claims

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[297] *Id.*
[298] *Id.* at 11.
[299] *Id.* at 14.
[300] Final Order: (I) Authorizing the Debtors to Maintain and Administer Certain Customer Programs and to Honor Certain Related Prepetition Obligations; and (II) Granting Related Relief. Case 20-34656 (KRH) 235.
[301] Debtors' Motion for Entry of Interim and Final Orders: (I) Authorizing Payment of Prepetition Obligations Owed to Trade Creditors in the Ordinary Course of Business; (II) Granting Administrative Expense Priority to All Undisputed Obligations On Account of Outstanding Orders; and (III) Granting Related Relief. Case 20-34656 (KRH) (hereinafter "Critical Vendors Motion"). 6 at 8.
[302] *Id.*
[303] *Id.*
[304] *Id.* at 12.
[305] 11 U.S.C. §§ 503(b)(9).

during the chapter 11 proceedings and prevent potential operations stoppages.[306] There were no objections to the motion and the court granted a final order after issuing an interim order.[307]

Insurance

Guitar Center filed a motion seeking the Court's authority to pay all amounts that become due relating to insurance policies, without regard to whether such obligations accrued or arose before or after it filed for chapter 11.[308] In its motion, Guitar Center stated that it maintained 28 insurance policies with various third party insurance carriers, paying an annual premium amount in the aggregate of $5,012,130.[309] Guitar Center first argued that pursuant to Bankruptcy Code Section 363(b), courts have authorized debtors in possession, to pay certain prepetition obligations, including insurance, when such payment was shown to be justified by the debtor's sound business judgment.[310] Additionally, Guitar Center made the point that under Bankruptcy Code Sections 1107(a) and 1008, as a debtor in possession during a chapter 11 proceeding, it owed a fiduciary duty to hold and operate the business for the benefit of its creditors, which obligated Guitar Center to maintain its insurance policies therefore.[311] Further, it cited Bankruptcy Code Section 1112(b)(4)(C) and the U.S. Trustee's Operating Guideline to support the proposition that a failure to maintain adequate insurance throughout the chapter 11 case would require the case to be dismissed.[312] There were no objections and the court entered a final order granting the motion.[313]

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[306] In order to prevent a halt in operations, Guitar Center requested authority to satisfy all pre-petition trade claims whether or not the initial plan providing for the full satisfaction of trade claims in the chapter 11 cases was confirmed, arguing that this was permitted by 503(b)(9). Critical Vendors Motion, 6 at 12–15.

[307] Final Order: (I) Authorizing Payment of Prepetition Obligations Owed to Trade Creditors in the Ordinary Course of Business; (II) Granting Administrative Expense Priority to All Undisputed Obligations On Account of Outstanding Orders; and (III) Granting Related Relief. Case 20-34656 (KRH) 237.

[308] Debtors' Motion for Entry of Interim and Final Orders: (I) Authorizing the Debtors to (A) Continue and Renew Their Insurance Policies and Honor Obligations Thereunder, and (B) Continue Surety Bond Program; and (II) Granting Related Relief. Case 20-34656 (KRH) (hereinafter "Insurance Motion"). 8 at 8.

[309] *Id.* at 7.

[310] *Id.* at 11.

[311] *Id.*

[312] *Id.* at 14–15.

[313] Final Order: (I) Authorizing the Debtors to (A) Continue and Renew Their Insurance Policies and Honor Obligations Thereunder, and (B) Continue Surety Bond Program; and (II) Granting Related Relief. Case 20-34656 (KRH) 234.

Taxes

Guitar Center filed a motion to authorize the payment of prepetition income taxes, franchise taxes, property taxes and other regulatory fees.[314] At the time of filing, Guitar Center owed $10.2 million in sales and use taxes, $1.15 million in income and franchise taxes, $8.32 million in property taxes, $5.7 million in import taxes, $700k of miscellaneous taxes and fees, and $1.35 million in estimated pending audits.[315] In total, Guitar Center estimated its pre-petition tax burden to be $27.42 million, approximately $8.547 million of which could become due within 21 days after it filed this motion.[316]

Guitar Center presented three main arguments in its motion. First, it argued that the court was able to grant the requested relief and authorize it to pay certain pre-petition obligations under Bankruptcy Code Section 363(b) if payment was shown to be justified by its sound business judgment.[317] Here, Guitar Center claimed that paying the prepetition taxes was within its ordinary course of business and also claimed that the failure to pay the existing taxes could materially disrupt the administration of the bankruptcy cases in a number of ways. If the existing taxes were not paid, the taxing authorities would likely take action against Guitar Center that would interfere in its existing operations.[318] Guitar Center also argued that that under Bankruptcy Code Section 541(d), certain taxes held in trust for the government were not property of the bankruptcy estate, because the estate did not hold an equitable interest in those funds.[319] Guitar Center also offered that under Bankruptcy Code Sections 507(a)(8) and 1129(a)(9)(C), certain taxes and fees would have been entitled to priority status payment before general unsecured claims, and that priority claims must be paid in full before any plan could be confirmed in chapter 11 cases.[320] There were no objections and the Court entered a final order granting Guitar Center's motion.[321]

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[314] Debtors' Motion for Entry of Interim and Final Orders: (I) Authorizing the Payment of Certain Prepetition Taxes and Fees; and (II) Granting Related Relief. Case 20-34656 (KRH) (hereinafter "Taxes Motion") 10.
[315] *Id.* at 7–11.
[316] *Id.*
[317] *Id.* at 11.
[318] *Id.* at 10–11.
[319] *Id.* at 13.
[320] *Id.* at 14.
[321] Final Order: (I) Authorizing the Payment of Certain Prepetition Taxes and Fees; and (II) Granting Related Relief. Case 20-34656 (KRH) 237.

Wages

Guitar Center filed a motion to authorize the payment of prepetition wages, salaries, other compensation, employee benefits and expenses relating to its 13,000 employees.[322] Guitar Center's primary argument in the motion was that continuing to compensate it's employees was critical to its uninterrupted operations and, as such, may be authorized by Bankruptcy Code Sections 363, 105(a), 503, 507, and under the "doctrine of necessity."[323] Guitar Center claimed that unless the court authorized it to continue with existing compensation and related employee programs, its business operations would be substantially impaired.[324] Further, Guitar Center highlighted that without the requested relief, its employees would face significant financial consequences and it could lose employees critical to preserving the value of the estates.[325]

In the motion, Guitar Center estimated that no employee had an existing claim for an amount that exceed the cap under Bankruptcy Code Section 507(a)(4).[326] This section provides for an up-to $13,650 priority claim for unpaid prepetition wages owed to employees by a debtor in bankruptcy.[327] Additionally, Guitar Center argued that it would be required by Bankruptcy Code Section 1129(a)(9)(B) to pay priority claims, collectively, in full to confirm a chapter 11 plan.[328] There were no objections and the court entered a final order that authorized Guitar Center to pay and honor all the claims described in the motion under the statutory priority cap in Section 507(a)(4).[329]

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[322] Debtors' Motion for Entry of Interim and Final Orders: (I) Authorizing the Debtors to (A) Pay Prepetition Wages, Salaries, Other Compensation, and Reimbursable Expenses, and (B) Continue Employee Benefits Programs; and (II) Granting Related Relief. Case 20-34656 (KRH) (hereinafter "Wages Motion"). 7 at 6.

[323] Wages Motion, 7 at 29. The Doctrine of Necessity is a principle used in bankruptcy law which permits the use of certain provisions of the Code or common law ostensibly in contradiction to other law in order to accomplish a vital objective in a bankruptcy case. The Doctrine exists simply because it works. The proper use of the Doctrine helps to stabilize a debtor's business relationships without significantly hurting any party. Russell A. Eisenberg, Frances F. Gecker, *The Doctrine of Necessity and Its Parameters*, 73 MARQLR 1.

[324] Wages Motion, 7 at 8.

[325] *Id.*

[326] *Id.* at 9.

[327] 11 U.S.C. §§ 507(a)(4).

[328] Wages Motion, 7 at 29.

[329] Final Orders: (I) Authorizing the Debtors to (A) Pay Preppetition Wages, Salaries, Other Compensation, and Reimbursable Expenses, and (B) Continue Employee Benefits Programs; and (II) Granting Related Relief. Case 20-34656 (KRH) 249.

The Net Operating Loss Preservation Motion

On November 22, 2020, Guitar Center filed a motion with the court seeking approval of notification and hearing procedures for certain transfers of and declarations of worthlessness with respect to its common stock.[330] Guitar Center filed this motion to preserve existing beneficial tax attributes.[331] Specifically, Guitar Center wanted to continue to capitalize on net operating losses ("NOLs") that it carried.[332] A taxpayer has an NOL[333] when its allowable tax deductions exceed its gross operating income in a specific year.[334] These NOL's can be carried forward and are considered to be an asset as they offset future income and shield it from income taxation.[335] Guitar Center estimated in its motion that its cumulative NOL carryforward totaled approximately $213.38 million.[336] Guitar Center also estimated that it had other tax attributes available to reduce future taxable income: tax credits of $1.98 million and interest expense carryforwards in the amount of $136.78 million.[337]

The key issue that Guitar Center's motion focused on was the Internal Revenue Code's ("IRC") treatment of its existing tax attributes.[338] Specifically, Guitar Center's motion focused on the rules regarding NOL and "ownership change" in Sections 382 and 383 of the IRC.[339] Pursuant to Bankruptcy Code Section 362(a)(3), any act by a holder of a debtor's equity securities that causes the termination or limits the use of the debtor's valuable tax attributes violates the automatic stay.[340] These IRC sections provide for limitations on tax attributes, including NOLs, in the event of an "ownership change".[341] In order to avoid impairing benefits

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330 Debtors' Motion for Entry of Interim and Final Orders: (I) Approving Notification and Hearing Procedures for Certain Transfers and Declarations of Worthlessness With Respect to Common Stock' and (II) Granting Related Relief. Case 20-34656 (KRH) (hereinafter "NOL Motion"). 13 at 1.
331 *Id.* at 6.
332 *Id.* at 6–7.
333 I.R.C. § 172; *see also* *Bankruptcy: Overview of the Chapter 11 Process*, THOMPSON REUTERS, Practical Law Practice Note.
334 *Id.*
335 *Id.*
336 NOL Motion, 13 at 6-7.
337 *Id.*
338 *Id.*
339 Sections 382 and 383 of IRC limit the amount of taxable income that can be offset by a corporation's tax attributes in taxable years following an 'ownership change. The 'ownership change' rule can be triggered if a five percent shareholder has increased its ownership to 50% or more, or if a holder of 50% of common stock takes a worthless stock deduction in a new taxable year. I.R.C § 382; I.R.C. § 383; NOL Motion, 13 at 7.
340 11 U.S.C. §§ 362(a)(3); NOL Motion, 13 at 13.
341 *See supra* text accompanying note 339.

of its tax attributes, Guitar Center looked to have the court implement certain procedures and guidelines for transfers and sale of its existing common stock that would have the stock declared null and void if not followed.[342] A major concern here was that Ares Management, as primary shareholder, might consider taking a worthless stock deduction in the future, which Guitar Center sought to prevent.

There were no objections to the motion, and the court ultimately entered an interim, and a final order that implemented the guidelines that would prevent any transfer of stock or deduction that could put Guitar Center's tax attributes at risk.[343]

Objections to the Initial Plan

With the first day motions behind it, Guitar Center confronted the objections to its initial plan of reorganization from creditors and counterparties that had not been part of the prepetition negotiation of the restructuring support agreement and the prepetition solicitation of acceptances of the plan.

Landlords

Guitar Center's landlords were the first counterparty to object to Guitar Center's initial plan of reorganization. The landlords' initial objections predominantly centered around a lack of adequate information in the procedure order and rejection notice, a lack of cure information, and a need for more time. Under Bankruptcy Code Section 365(b)(1)(A), debtors are responsible for providing adequate assurance regarding their ability to perform under the lease.[344] Here, several landlords were objecting to the initial plan to ensure that Guitar Centers complied with the requirements of Bankruptcy Code Section 365(b)(1)(A), including but not limited to, paying all amount due and owed under the lease through the Effective Date. [345] Many landlords were still

[342] NOL Motion, 13 at 12–16.
[343] Final Order: (I) Approving Notification and Hearing Procedures For Certain Transfers and Declarations of Worthlessness With Respect to Common Stock' and (II) Granting Related Relief. Case 20-34656 (KRH). 232.
[344] U.S.C. §365(b)(1)(C)–(f)(2). Adequate assurance requires a foundation that is non-speculative and sufficiently substantial so as to assure the non-debtor party that it will receive the amount of the default. Risa Lynn Wolf-Smith & Erin L. Connor, The Meaning of "Prompt and Adequate", 13 J. Bankruptcy Law and Prac. 95, 97 (2013) https://perma.cc/8EHH-5ZWB.
[345] Limited Objection of GRI-EQY (Presidential Markets), LLC to Notice of Assumption of Certain Executory Contracts and Unexpired Leases in Connection with Confirmation of the Debtors' Joint Pre-Packaged Chapter 11 Plan of Reorganization. Case 20-34656 (KRH). 210 at 2.

evaluating the appropriate cure amount and were worried that Guitar Center was not going to pay back rent owed to them while Guitar Center was in chapter 11.[346]

Additionally, other landlords were upset about the time given to file claims arising out of the rejection of certain leases.[347] The procedures order and the rejection notice required that claims arising from the rejection of Guitar Center's leases would be due thirty days after the entry of the confirmation order or the date on which Guitar Center informed the applicable landlord that Guitar Center was rejecting the lease.[348] Many landlords found this procedure objectionable because it did not allow them enough time to ascertain the state of the leased premises or determine if they had any claims against Guitar Center.[349] The landlords, instead, advocated for an order that would provide that claims arising from the rejection of leases should be filed within thirty days of the Effective Date or the date when Guitar Center informed the applicable landlord that they were rejecting their lease.[350] Moreover, the landlords noted that neither the procedures orders or the rejection notice contained provisions regarding the disposition of personal property remaining at the premises following the return of possession by Guitar Center.[351] The landlords claimed that any final order regarding the premises provide that any personal property remaining in the premises on the Effective Date be deemed abandoned.[352]

Finally, some landlords objected to the initial plan because they claimed the initial plan did not comply with Bankruptcy Code Section 365(d)(4), as Guitar Center sought to indefinitely postpone their obligations to reconcile and object to unsecured claims.[353] Under Bankruptcy Code Section 365(d)(4), a debtor must decide which commercial leases it wishes to assume or

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346 *Id.*
347 Limited Objection of Greenway Plaza LLC to Debtors' Notice of Assumption of Certain Executory Contracts and Unexpired Leases in Connection with Confirmation of the Debtors' Joint Pre-Packaged Chapter 11 Plan of Reorganization. Case 20-34656 (KRH). 188 at 2–3.
348 Notice of Rejection of Certain Executory Contracts and Unexpired Leases in Connection with Confirmation of the Debtors' Joint Pre-Packaged Chapter 11 Plan of Reorganization. Case 20-34656 (KRH). 158 at 2-3.
349 Limited Objection of LBA Realty Fund III-Company XII, LLC to Notice of Rejection of Certain Executory Contracts and Unexpired Leases in Connection with Confirmation of the Debtors' Joint Pre-Packaged Chapter 11 Plan of Reorganization. Case 20-34656 (KRH). 248 at 4.
350 *Id.*
351 *Id.* at 5.
352 *Id.* at 6.
353 Limited Objection of Various Landlords to Confirmation of the Chapter 11 Plan. Case 20-34656 (KRH) ("Limited Objection by Various Landlords"). 278 at 2.

reject no later than the entry of the Final Order confirming the plan.[354] Here, some landlords claimed that Guitar Center's initial plan allowed it to reject leases post-confirmation of the plan.[355]

Next, the landlords were concerned with Guitar Center's ability to indefinitely postpone their obligations to reconcile and object to unsecured claims. The landlords theorized that since claims were to be paid in full under the initial plan, a prolonged delay of the claims reconciliation process would deprive affected landlords of prompt distributions on potentially significant claims.[356] To mitigate this issue, the landlords suggested that the Court limit Guitar Center's right to seek a ninety-day extension of the claim objection deadline for cause.[357]

United States Trustee Objection

After Guitar Center filed its initial plan, the United States Trustee ("UST") filed an objection to the disclosure statement and the plan.[358] The objection focused on provisions for the release and exculpation of creditors against other non-debtor parties that were included in the initial plan.[359] According to the UST, Guitar Center's disclosure statement and plan failed to show that such releases were appropriate and therefore the court could not confirm the initial plan in its current state.[360]

First, the UST argued that Guitar Center's initial plan contained release provisions, injunction and exculpation provisions that deprived non-voting claim holders of their rights against third parties on a non-consensual basis.[361] Consequently, the initial plan had the potential to 'impair' certain non-voting claim holders, even though they would receive payment under the plan.[362] The UST acknowledged that there was no per se prohibition on imposing third party releases of non-debtors on other non-debtors, but claimed that such releases are not appropriate

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[354] U.S.C. §365(d)(4).
[355] Limited Objection by Various Landlords, 278 at 2.
[356] *Id.*
[357] *Id.* at 7.
[358] Objection of the United States Trustee to Confirmation of the Plan and Related Relief. Case 20-34656 (KRH) (hereinafter "UST Objection") 200.
[359] *Id.* at 6.
[360] *Id.* at 10.
[361] *Id.*
[362] *Id.* at 11.

in most cases.[363] The UST argued that the appropriateness of such provisions are determined by the facts of each case, meaning Guitar Center needed to make an evidentiary showing to the Court that these releases were essential to its reorganization efforts and overall plan.[364]

The next key argument in this objection focused on the method of "opting out" of the release provisions included in Guitar Center's initial plan.[365] Not only would the third party releases be effective against any creditor or interest holder that was deemed to accept the initial plan, but also against those creditors and interest holders who abstained from voting or outright rejected the plan, but failed to "opt out" of the releases.[366]

Here, the UST's objection focused on the notion that releases of non-debtors must be accompanied by 'unambiguous consent'.[367] As written, the UST was concerned that certain creditors could be "caught asleep at the switch" in consenting to these releases unintentionally.[368] The UST also included a policy oriented argument directed at the court which claimed that if it confirmed this plan, debtors in chapter 11 cases going forward would include similar provisions in their own plans, under which at least a few creditors would inadvertently "consent" to releases.[369] In order to remedy this issue, the UST requested that the third-party releases in the plan be deemed consensual only by parties who have voted to accept the plan.[370]

The UST's objection also raised an issue with the Management Incentive Plan included in the initial plan.[371] Because the initial plan required Guitar Center to adopt the Management Incentive Plan, the UST argued that the intial plan violated Bankruptcy Code Section 503(c).[372] The UST requested that the court reject the initial plan unless Guitar Center made a showing that the Management Incentive Plan complied with Section 503(c).[373]

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[363] *Id.* at 13.
[364] *Id.*
[365] *Id.* at 14–17.
[366] *Id.*
[367] *Id.*
[368] *Id.*
[369] *Id.*
[370] *Id.* at 17.
[371] *Id.* at 21.
[372] *Id.*
[373] *Id.*

Finally, the UST objected to the plan's confirmation in its current state because it did not include a "carve out" for governmental claims[374] in the releases, exculpation and injunctions provisions, and did not provide enough information regarding the management and control of guitar center post-reorganization.[375]

Taxing Agencies

The next group of creditors to object to Guitar Center's initial reorganization plan were the Texas Taxing Agencies and the Internal Revenue Service ("IRS"). The Texas Taxing Agencies claimed the initial plan should not be confirmed unless and the plan provided that the Texas Taxing Agencies' pre- and post-petition liens remained on Guitar Center's real and tangible personal property until the taxes were paid in full.[376] Furthermore, the Texas Tax Agencies objected to the initial plan to the extent it provided Guitar Center an option to pick and choose which secured parties had rights on certain collateral over similarly situated secured parties. This would result in preferential treatment of the claims to the detriment of junior secured creditors.[377] The Texas Taxing Agencies wanted similar treatment for claims of similarly situated creditors.

Additionally, the IRS objected the initial plan because the IRS asserted that the plan did not purport to discharge, satisfy, or release priority taxes that were not paid in full as required by the Bankruptcy Code[378].[379] Moreover, the IRS could not estimate the amount of claims they had against Guitar Center because Guitar Center had several unfiled tax returns, therefore the IRS needed time to amend their proofs of claims.[380] To remedy this objection, the IRS proposed that any IRS claim that were not paid in full on the Effective Date shall accrue (and be paid) interest

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[374] *Id.* at 20.
[375] *Id.*
[376] Limited Objection of Certain Texas Taxing Entities to the Joint Pre-Packaged Chapter 11 Plan of Reorganization of Guitar Center. Case 20-34656 (KRH). 199 at 3.
[377] *Id.*
[378] With respect to [priority tax claims] the holder of such claim will receive on account of such claim regular installment payments in cash of a total value, as of the effect date of the plan, equal to the allowed amount of such claim. 11 U.S.C. §1129.
[379] Objection to Confirmation of Chapter 11 Plan, Notice of Objection to Confirmation of Plan and Notice of Scheduling Hearing on this Objection. Case 20-34656 (KRH). ("IRS Objection to Plan") 214 at 4.
[380] *Id.*

on the unpaid balance at the underpayment rate established by the Internal Revenue Code[381].[382] The IRS declared their interest plan would satisfy their priority tax claims in full.

The Amended Plan

After the various objections filed against the initial plan, Guitar Center prepared and filed the First Amended Plan of Reorganization in response.[383] The amended plan attempted to address the issues raised in the objections to the initial plan.

First, the amended plan provided that there was no requirement to file a proof of clam (or move the Bankruptcy Court for allowance of a claim) to have a claim allowed for the purposes of the plan.[384] Furthermore, Guitar Center amended the process in which an interested party or Guitar Center could dispute a claim. Under the amended plan the Bankruptcy Court would resolve any claims dispute with a final order before the Effective Date.[385] By allowing the Bankruptcy Court to issue a final order regarding the leases, contracts, and administrative claims before the Effective Date, Guitar Center addressed the landlords concerns that Guitar Center might later object to those claims and seek to reduce or eliminate them.

Moreover, the amended plan addressed a long-standing concern of the landlords that Guitar Center was not going to pay back rent accrued during the chapter 11 proceedings.[386] Upon the assumption of a lease, Guitar Center was required to pay or perform any unfulfilled obligations under the lease in accordance with terms of the lease.[387] This made the plan explicitly meet the mandates of Bankruptcy Code Section 365(b).[388] Under the amended plan, Guitar

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[381] If any provision of this title requires the payment of interest on a tax claim or an administrative expense tax, the rate of interest shall be the rate determined under applicable nonbankruptcy law. 11 U.S.C.§ 511.
[382] IRS Objection to Plan, 214 at 4.
[383] Redline Version of Amended Joint Pre-Packaged Chapter 11 Plan of Reorganization of Guitar Center. Case 20-34656 (KRH). (hereinafter “The Amended Plan”). 286 at 1.
[384] Many landlords had filed limited objections to the initial plan under the theory that they needed to file an objection just to get on Guitar Center’s radar of claims. However, many of the objecting landlords unexpired leases had already been accepted by Guitar Center under the schedule of accepted leases. *Id.* at 50.
[385] *Id.*
[386] The amended plan stated that Guitar Center would pay cash to satisfy the monetary defaults on the Effective Date unless otherwise agreed to and negotiated by the parties to the executory contracts or unexpired leases. *Id.*at 56.
[387] *Id.* at 44
[388] Limited Objection by Various Landlords, 278 at 2.

Center was required to pay the accrued obligations regardless of whether such obligations arose before or after the Petition Date.[389]

Additionally, there was very little detail regarding the disputed cure process in the initial plan and many interested parties could not ascertain the proper steps that needed to be taken to dispute a cure. To remedy this issue, the amended plan stated that if a counterparty to a contract or lease disputed the amount of cure paid by the Guitar Center on the Effective Date, then the counterparty had to raise the dispute no later than 30 days after the Effective Date.[390] If Guitar Center and the counterparty could not resolve a dispute consensually, then the counterparty had to file a proof of claim no later than 60 days after the Effective Date and no disputed portion of the cure would be paid.[391] If a proof of claim was filed, then Guitar Center had 45 days to either file an objection to the proof of claim or schedule a conference call with the Bankruptcy Court to discuss the proof of claim.[392]Unless Guitar Center filed an objection or a requested a status conference, the amount of cure asserted in the proof of claim would be allowed and Guitar Center would pay the additional cure.[393] The new cure dispute process provided more clarity on the steps necessary for an interested party to dispute the cure amount.[394]

Furthermore, the amended plan addressed the concerns of the landlords that Guitar Center had too much discretion to reject leases at any point after the Effective Date. The new paragraph in the amended plan described exactly when Guitar Center was deemed to reject a lease. In the amended plan, Guitar Center rejected all contracts and leases on the date stated on the schedule of rejected contracts or leases, or on the date on which Guitar Center informed the landlords that they had vacated the leases premises.[395] Moreover, many of the objections filed by the landlords, complained that Guitar Center did not have a plan for left over personal property. As a result of the landlord objections, the amended plan needed to provide some sort of remedy for the left-over property. In response, in the amended plan any personal property (including furniture, fixtures, equipment, and inventory) remaining, on the rejection date would be deemed

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[389] The Amended Plan, 286.
[390] *Id.*
[391] *Id.*
[392] *Id.*
[393] *Id.*
[394] If no dispute was timely raised or no proof of claim was timely filed, then the cure paid by Guitar Center would be binding on the applicable counterparty. *Id.* at 55.
[395] *Id.* at 57.

abandoned without further order from the Court.[396] The landlords would be authorized to use or dispose of any such property in their sole discretion, without liability to Guitar Center.[397]

The amended plan addressed some of the concerns that were raised in the UST objection to Guitar Center's disclosure statement and the initial plan. First, Guitar Center modified its plan to incorporate some changes the UST requested regarding the opt-out procedure for third party releases.[398] Specifically, the changes provided that any holder of a claim or interest who objected to the plan, either informally or formally, would not be considered to release its claims against third parties under the provisions in Guitar Center's plan.[399] These changes were minor alterations to the language of the third party releases, but because Guitar Center and its creditors agreed on the major terms and restructuring transactions provided for in the plan, it was relatively simple to modify specific language in order to placate the issues raised in the objection.

Further, Guitar Center and its creditors sought to take advantage of the efficiency and quickness of reorganizing under a pre-packaged plan, while also operating within the parameters set out in the restructuring support agreement milestones. Achieving a speedy confirmation of a plan was paramount to all parties involved and making minor changes of this nature was likely met with little resistance in order to prevent any confirmation delays. Guitar Center further addressed the UST's objection through modifications to the plan during the process of amending its initial plan by filing a plan supplement which included the identity of the persons who were to manage and control Guitar Center post-reorganization.[400]

Finally, the amended plan changed the process in which claims could be filed based on the rejection of contracts and leases. Initially, all proof of claims on account of the rejection of a contract and lease had to be filed no later than 30 days after the entry of the confirmation order or on the date Guitar Center gave notice to the countparty regarding the rejection of the lease. In the amended plan, all proofs of claim for rejection damages had to be filed no later than 30 days

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[396] *Id.*
[397] *Id.*
[398] Amended Plan, 286 at 15.
[399] UST Objection, 200 at 14–15; Amended Plan at 42.
[400] *Id.* at 22–23.

after the rejection date.[401] Moreover, if a counterparty to a rejected contract or lease failed to timely file a proof of claim, then they would be barred from pursuing that claim against anyone.

Notably, most of the new provisions and adjusted provisions in the amended plan were geared towards Guitar Center's landlords. While the landlords were not a secured creditor or a DIP financer, they still had considerable influence because Guitar Center's business involved brick and mortar locations. If Guitar Center did not address many of the concerns raised in the landlords objections they could hamper Guitar Center by filing extensive and expensive litigation after Guitar Center emerged from chapter 11. Therefore, it made considerable sense for Guitar Center to address the landlords concerns in the amended plan.

The Final Order

On December 17, 2020, the Court entered its final order: (I) Approving, on a final basis, adequacy of the disclosure statement; (II) Confirming the amended plan. When it entered the Final Order, the Court found that Guitar Center's amended plan met the statutory requirements of the Bankruptcy Code. The Final Order confirmed all the provisions within the amended plan and explained how each provision should be carried out by Guitar Center.

First, the Court approved the disclosure statement. It was extremely important for Guitar Center to have the disclosure statement approved because it contained all the background information surrounding Guitar Center's bankruptcy. The Final Order stated that the disclosure statement contained "adequate information"[402] as defined in Bankruptcy Code Section 1125(a)(1).[403] Furthermore, the disclosure statement satisfied Bankruptcy Rule 3016(b)[404].

Solicitation

After approving the disclosure statement, the Court found that the prepetition plan solicitation and voting procedures satisfied the requirements of the Bankruptcy Code and all

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[401] The amended plan simplified the proof of claims process by having a 30-day cutoff date as opposed to different dates based on when the Court ruled on the matter. The Amended Plan, 286 at 57.

[402] Adequate information means information of a kind, and in sufficient detail, as far as is reasonable or practicable in light of the nature and history of the debtor. 11 U.S.C. § 1125(a)(1)

[403] Findings of Fact, Conclusions of Law, and Order: (I) Approving, on a Final Basis, Adequacy of the Disclosure Statement; (II) Confirming the Amended Joint Pre-Packaged Chapter 11 Plan; and (III) Granting Related Relief. Case 20-34656 (KRH). ("Final Order"). 320 at 6.

[404] In chapter 9 or 11 cases, a disclosure statement under section 1125 of the code shall be filed with the plan or within a time fixed by the court. 11 U.S.C. §1125.

applicable non-bankruptcy rules, laws, and regulations.[405] In so doing, the Court concluded that the solicitation materials[406] provided adequate information to the holders of claims entitled to vote on the plan of the procedures and deadline for completing and submitting the ballots. Additionally, the solicitation materials adequately informed holders of Secured Notes Claims of the cash out election process and the procedures and deadline for making such election.[407]

Here, one can observe a key benefit of approaching a chapter 11 reorganization with a pre-packaged plan in hand. Because creditors and classes of holders voted to approve the plan during the pre-petition solicitation process, the court had a straightforward path to finding that the solicitation and voting procedures satisfied the requirements of the Bankruptcy Code. When Guitar Center filed for chapter 11, it brought with it the support of most of its secured creditors who had already voted to approve the initial plan.[408] The restructuring transactions aimed at satisfying the Secured Notes Claims, including the cash out election and Secured Notes Claims Distribution, were vital aspects of Guitar Center's plan. This was the largest class of pre-petition claims in this case, and arguably no class had its rights affected as severely.[409] By establishing that this class had notice of and voted to support the plan before the case had been filed, Guitar Center was able to enjoy a much smoother route to confirmation. It's likely that these facts served as strong evidence to the court that the solicitation and voting procedures satisfied the requirements necessary for confirmation of the plan.

Court Addresses The Issues Raised In The UST's Objection

In the Final Order, the court approved of Guitar Center's modifications in its amended plan relating to the classification, indemnification, release, exculpation and injunction provisions.[410] The UST had previously objected to the initial plan, citing concern with the opt-out procedures for third party liability, the omission of a "carve out" for releases with respect to governmental authorities, and a lack of information as to who would serve as officers and

[405] The Court found that the solicitation and voting requirements satisfied Sections 1125(g) and 1126(b) of the Bankruptcy Code, Bankruptcy Rules 3017 and 3018, and relevant Local Bankruptcy Rules. Final Order, 320 at 6.
[406] Solicitation Materials, that is, the ballots and cash out election notice used to vote on the plan.
[407] Final Order, 320 at 6.
[408] Cash Management Motion, 11 at 2. Holders of 100% in aggregate principal amount of the Debtors' senior secured superpriority notes; and holders of over 71% in aggregate principal amount of the Debtors' senior secured notes voted to approve the plan during pre-petition solicitation.
[409] The Secured Notes Claims were allowed in the amount of $640 MM, the largest claim amount that was included in Guitar Center's plan for reorganization. *See supra* note 137.
[410] Final Order, 320 at 6.

directors of Guitar Center upon reorganization.[411] To address this objection, Guitar Center modified the language of the release provisions to allow parties to opt-out by formally or informally objecting to confirmation of the plan.[412] Guitar Center also filed a plan supplement with its amended plan that identified the persons who were to serve as directors and officers of Guitar Center once it reorganized.[413]

Here, the Court held that Guitar Center's classification of claims and interests in its plan met the requirements for confirmation outlined in the Bankruptcy Code.[414] The Court found that Guitar Center's amendments to the initial plan with respect to the release provisions met the requirements of Bankruptcy Code Section 1123(b)(3).[415] The Court held that these releases were negotiated at arms-length, in good faith, were essential to the overall plan, and approved the new language in the final order.[416] Further, the court was satisfied that Guitar Center had met the requirements for confirmation under the relevant sections of the Bankruptcy Code in providing the identities of the persons who would serve as its officers and directors upon reorganization.[417] While not expressly provided for in the amended plan, the final order included provisions that imposed the "carve out" requested by the UST.[418] This provision exempted governmental agencies from the plan's provisions that released or discharged liability outside of claims.[419]

Next, the Court addressed the contracts and leases section of the plan. The Court emphasized that Guitar Center had the sole discretion to reject leases because the brick-and-mortar leases were an integral part of their business and as such Guitar Center should be able to determine which stores are profitable. Additionally, the Court found that Guitar Center's determinations regarding the assumption of contracts and leases were based on and within Guitar Center's sound business judgement[420] and were necessary to the implementation of the plan.[421]

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[411] UST Objection, 200 at 12–17.
[412] Amended Plan, 286 at 30, 57, 21.
[413] Final Order, 320 at 7.
[414] The court held that the plan satisfied all applicable requirements of the Bankruptcy Code, thereby satisfying the requirements for confirmation in Section 1129(a)(1). *Id*. at 12.
[415] *Id.* at 16.
[416] *Id.*
[417] *Id.* at 13.
[418] *Id.* at 55–56.
[419] *Id.*
[420] Under section 363(c)(1) Unless the court orders otherwise, the debtor may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business. 11 U.S.C. §363(c)(1).

As outlined in the amended plan and by the landlord objections discussed above, the major concerns regarding the plan were the procedures for the disputed claims process and whether Guitar Center would pay back rent on the accepted leases. The Final Order adopted all the provisions from the initial plan and the amended plan with a few small changes. First, entry of the Final Order constituted a determination by the Court that Guitar Center had provided adequate assurance of future performance under the contracts and leases.[422] Next, the Court confirmed Guitar's Center plan to pay the cure amount to accepted leases but amended the plan so that Guitar Center could only amend the schedule of rejected leases after the entry of the Final order and with the consent of the landlords.[423] Moreover, if a lease was added to the schedule of rejected leases after the Effective Date, then a landlord would have 10 days to object to the proposed rejection date.[424] After, entry of the Final Order all of the objecting landlords withdrew their claims.

Furthermore, the Final Order approved of the New ABL Facility and the New First Lien Debt. The Court recognized that both the New ABL Facility and the New First Lien debt were necessary for Guitar Center, so they could have working capital on the Effective Date. On the Effective Date, Guitar Center was authorized, to enter the New ABL Facility and all liens from the New ABL facility were granted first priority status on the "ABL Priority Collateral"[425] subject to certain tax liens.[426] In addition, on the Effective date, Guitar Center was authorized to enter the New First Lien Debt and all liens from the New First Lien Debt were granted first priority status on the "Notes Priority Collateral"[427].[428]

Finally, the Final Order addressed the objections of the various taxing agencies. Specifically, the taxing agencies were worried that the New ABL Facility and the New First Lien debt were going to prime their tax liens. To address this concern, the Court modified the plan so that nothing in the plan or the Final Order discharged, released, precluded, or enjoined any

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[421] Final Order, 320 at 25.
[422] *Id.* at 26.
[423] *Id.*
[424] *Id.* at 29
[425] The ABL priority collateral included Guitar Center's account receivables, cash, deposit accounts, inventory, and the proceeds of each category just listed.
[426] Final Order, 320.
[427] The Notes Priority Collateral included Guitar Center's intellectual property, the proceeds that flow from the intellectual property and all other assets that are not in the ABL priority collateral.
[428] Final Order, 320.

liability to any Government Unit.[429] Moreover, nothing in the plan or the Final Order could stop a Government Unit from asserting or enforcing any liability.[430] Lastly, all priority tax claims and allowed secured tax claims were to be paid in the ordinary course of business by Guitar Center.[431]

The Final Order was the last step to confirming Guitar Center's plan for reorganization. Once the Court entered the Final Order, Guitar Center was set to move towards the Effective Date and emerge from chapter 11 with a clean slate.

Professional Fees

After the Court entered the Final Order, Guitar Center applied and the Court approved the various professional fees associated with the chapter 11 proceedings. Pursuant to Bankruptcy Code Section 327 Guitar Center was authorized to retain professionals to assist in their bankruptcy.[432] Furthermore, section 328 explains that the fees associated with professionals must be reasonable.[433] When the Court approved Guitar Centers fees it was essentially saying the fees incurred were reasonable under the terms of the bankruptcy.

Professionals	Fee associated with professional service
A&G Realty Partners, LLC- the real estate consultants that helped Guitar Center value their different leases.	$1,071,548.80
Hunton Andrews Kurth LLP- the co counsel for Guitar Center while there in bankruptcy	$282,707.40
KPMG- the accountants employed by Guitar Center to ascertain the potential tax liabilities associated with the reorganization of Guitar Center	$570,272.70
Milibank LLP- counsel to Guitar Center during their chapter 11 case	$3,696,194.93

429 *Id.* at 56.
430 *Id.*
431 *Id.*
432 The trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying put the trustee's duties under this title. 11 U.S.C. § 327.
433 The trustee, with the court's approval, may employ or authorize the employment of a professional person, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. 11 U.S.C § 328.

In total Guitar Center spent $5,620,723.83 on professionals during their Chapter 11 proceedings.

*The Final Decre*e

After the Effective Date, Guitar Center filed a motion seeking a final decree and closing the chapter 11 cases. The purpose of the Final Decree was to have the Bankruptcy Court state the case was finished and to discharge Guitar Center as debtor in possession.[434] It would also mean that no further quarterly fees would be due to the United States Trustee's Office. Moreover, Guitar Center desired to terminate Prime Clerk as the claims, noticing and administrative agent. The Court granted the motion and allowed Guitar Center to end its chapter 11 case.[435]

Epilogue

During their bankruptcy, Guitar Center was able to deleverage its balance sheet by approximately $500 million. This allowed Guitar Center to emerge from bankruptcy with a clean slate and new battle plan to reassert themselves as the largest music retailer in the United States. After the COVID 19 pandemic, many brick-and-mortar stores saw a massive uptick in sales. Many of these stores including Guitar Center, were showing 40% to 50% growth in a year.[436] Specifically, Guitar Center's customers found a renewed interest in guitars, amps and other musical instruments. Music industry experts forecasted 2022 to be the biggest year of guitar sales in history and projected Guitar Center sales to reach a record of $2.5 billion. [437] Guitar Center's approach to its chapter 11 case allowed it to quickly navigate through a reorganization and emerge ready to capitalize on surging consumer demand. The prepetition negotiations with key creditors paved the way to a smooth transition from an over leveraged position to promising future growth. This uptick in sales and favorable market forecast led Guitar Center to consider filing confidential paperwork for an initial public offering, less than a year after emerging from bankruptcy. However, Guitar Center is still relatively fresh out of bankruptcy, and it is likely the

[434] Section 350 of the bankruptcy code requires the court to close the case after the estate is fully administered and the trustee has been discharged 11 U.S.C. § 350.
[435] Final Decree (I) Closing Chapter 11 Case and (II) Terminating Prime Clerk LLC as Claims, Noticing, and Administrative Agent. Case 20-34656 (KRH). 410 at 5.
[436] *From Bankruptcy to IPO in a year? It's a Tune Guitar Center might play*, NPR, https://perma.cc/BT6N-4GJ3.
[437] *Id*.

company will let the dust settle before filing any IPO paperwork.[438] Guitar Center is still a privately held company today.[439]

[438] Guitar Center Stock- Can you purchase Shares?, Growing Savings, https://perma.cc/V8TV-3GPF.
[439] *Id*.