UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Case No. 09-cv-10506

In re Charter Communications, Inc., *et al.*

Debtors.

R^2 Investments, LDC

Appellant,

v.

Charter Communications, Inc., *et al.*

Appellees.

OPENING BRIEF FOR APPELLANT R^2 INVESTMENTS, LDC

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction to consider the debtors' joint plan of reorganization under 28 U.S.C. § 157(b)(2)(L). It entered an order confirming the plan on November 17, 2009. See R6.[1] Appellant R^2 Investments, LDC filed a timely notice of appeal on November 23, 2009. See R1; see also Fed. R. Bankr. P. 8002(a). This Court has jurisdiction to review a final order of confirmation under 28 U.S.C. § 158(a)(1). See *Silverman* v. *Tracar, S.A. (In re Am. Preferred Prescription, Inc.)*, 255 F.3d 87, 92 (2d Cir. 2001).

ISSUES PRESENTED

1. Whether the bankruptcy reorganization plan improperly extinguishes the equity interests of the public shareholders of debtor Charter Communications, Inc. (CCI) without establishing that those investments have no value.

2. Whether the deal cut by the debtors' chairman and controlling shareholder, Paul Allen—pursuant to which Allen becomes the only CCI equityholder to receive value in the debtors' reorganization—is invalid because:

   (a) it disregards the "absolute priority rule," 11 U.S.C. § 1129(b)(2)(B)(ii), in allowing Allen, by virtue of his position as CCI's controlling shareholder, to recover ahead of other shareholders and more senior creditors of CCI; and/or

   (b) it violates Delaware corporate law's "entire fairness" standard, made applicable by 11 U.S.C. § 1129(a)(3), by conferring an improper advantage on an insider without subjecting that transaction to exacting review.

[1] Citations to "R#" refer to the correspondingly numbered item in R2's record designations. Citations to "CD R#" refer to the correspondingly numbered item in the counter-designations.

3. Whether the plan of reorganization unjustifiably releases Allen, his affiliates, certain of debtors' bondholders, the debtors' directors and officers, and others from all potential lawsuits related to the debtors and the plan of reorganization, in the absence of "truly unusual circumstances," *Deutsche Bank AG* v. *Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 141, 143 (2d Cir. 2005).

PRELIMINARY STATEMENT

This appeal challenges the bankruptcy reorganization plan of Charter Communications, Inc. (CCI) and a set of its subsidiaries and affiliates (collectively, "the debtors"). The bankruptcy court aptly characterized the plan as "in all likelihood . . . among the most ambitious and contentious" "prearranged bankruptcies ever attempted." R7 (Confirmation Op.) 7. The debtors collectively run a healthy multimedia business that generates several billion dollars a year in revenue. While the debtors carried significant debt, they had been quite successful in managing those obligations through periodic refinancing and other financial strategies. Towards the end of 2008, however, the debtors found themselves, due to complications stemming from their multi-company corporate structure, unable to move cash to certain specific CCI subsidiaries that needed to make loan payments. They attempted to solve their structural problems with a carefully scripted trip in and out of bankruptcy.

The script was drafted by a select group of creditors (the "Crossover Committee") and by the debtors' chairman and controlling shareholder, Paul Allen. The debtors wanted the Crossover Committee to agree to invest new money in the enterprise, and they wanted Allen to refrain from actions that might have scuttled certain favorable loan arrangements and tagged the debtors with over a billion dollars of tax liability. They therefore encouraged Allen and the

Crossover Committee to discuss between themselves what the price of their cooperation would be, and the resulting terms became the basis for their bankruptcy reorganization plan.

The consequence of all this "calculated pre-bankruptcy planning" was a plan that, in the bankruptcy court's words, "test[ed] . . . the [bankruptcy] process itself" and "might even be called a gamble." R7 (Confirmation Op.) 14. The plan calls for the debtors to shed more than eight billion dollars of debt and emerge as a reorganized enterprise controlled by Allen and the Crossover Committee, whose members would invest approximately $1.6 billion in the refreshed venture. But certain creditors who were *not* invited to join the Crossover Committee, such as the holders of approximately $500 million in bonds issued by CCI, would have their debts eliminated for pennies on the dollar. And the fate of CCI's equityholders is worse still. With the notable exception of Allen—who walks away with $375 million of value; retains substantial voting power in the reorganized company; is absolved of all potential civil liability for his involvement with the debtors; and, the evidence indicates, saves over $1 billion in personal income taxes—the shareholders of CCI, including appellant R^2, would get nothing.

Needless to say, this plan did not receive unanimous approval of the classes of creditors and interestholders entitled to vote on it in the bankruptcy proceedings. So the bankruptcy court, at the debtors' request, resorted to the aptly named "cramdown" provision of the Bankruptcy Code, 11 U.S.C. § 1129(b). But the debtors' envelope-pushing plan does not, in fact, meet the statutory criteria for a cramdown. To be sure, it is an excellent deal for the debtors (who get rid of billions of dollars in debt) and their collaborators (who receive substantial value). It is not, however, the sort of "fair and equitable" plan that the Code requires.

For starters, a plan must allow equityholders to retain the value, if any, of their shares. See 11 U.S.C. § 1129(b)(2)(C). This plan, however, wipes out the investments of all of CCI's public shareholders without any proof that their shares are worthless, and in the face of considerable evidence to the contrary. Indeed, CCI occupied a unique and highly valuable position in the debtors' corporate structure: It held tax-eliminating net operating losses that were worth in excess of a *billion* dollars to the reorganized debtors. The bankruptcy court was legally required to value CCI independently before confirming a plan that left CCI shareholders with nothing.

Making matters worse, the plan *does* substantially benefit one, and only one, shareholder—Paul Allen—by as much as $1.4 billion. For multiple reasons, that preferential treatment is impermissible. First, at least $200 million of the $375 million Allen received directly under the plan was on account of his status as controlling shareholder, in plain violation of the "absolute priority rule," which forbids an equityholder from obtaining favorable treatment in bankruptcy on account of his position. See 11 U.S.C. § 1129(b)(2)(B)(ii). Second, Allen's deal was proposed by "means forbidden by law," 11 U.S.C. § 1129(a)(3), because Allen took advantage of his powerful position to divert as much of the debtors' resources as he could to himself, breaching Delaware law's requirement that insider dealings be "entirely fair" (a standard the bankruptcy court refused to apply).

Finally, the plan improperly exonerates Allen, all of his affiliates, the Crossover Committee, and all of the debtors' directors and officers from civil liability relating to their involvement with Charter. Such sweeping third-party releases—which preclude, among other things, the possibility of shareholder derivative suits or other legal actions—are highly disfavored under Second Circuit precedent, and there is no basis for them here.

This Court should reverse the bankruptcy court's confirmation order and remand with instructions to: conduct a proper standalone valuation of CCI and direct the payment of any excess value to CCI's shareholders; void the payment of $200 million to Allen in violation of the absolute priority rule (or at least to allow the presentation of competing plans); invalidate Allen's deal under the entire fairness doctrine; and strike the third-party releases.

STANDARD OF REVIEW

This Court reviews the bankruptcy court's findings of fact for clear error and its legal conclusions *de novo*. See, *e.g.*, *Cartalemi* v. *Karta Corp. (In re Karta Corp.)*, 342 B.R. 45, 51 (S.D.N.Y. 2006); see also, *e.g.*, *Lubow Machine Co.* v. *Bayshore Wire Prods. Corp. (In re Bayshore Wire Prods. Corp.)*, 209 F.3d 100, 103 (2d Cir. 2000).

STATEMENT OF THE CASE

The debtors filed for bankruptcy on March 27, 2009. See No. 09–11435 (Bankr. S.D.N.Y.), Dkt. #1. They submitted their proposed plan the same day. See No. 09–11435 (Bankr. S.D.N.Y.), Dkt. # 36. R^2 lodged an objection to the plan on July 13, 2009, as did other parties. See R8 (R^2's Objection); see also, *e.g.*, R10 (CCI Bondholder Trustee's Objection). The bankruptcy court held a bench trial to resolve these objections (as well as a related adversary complaint filed by certain creditors) over 19 hearing days between July 20 and October 1, 2009. See R24–R42. On October 15, 2009, the bankruptcy court issued an oral ruling confirming the plan. See R43 (10/15/09 Tr.). A written opinion, findings of fact, conclusions of law, and an order followed on November 17, 2009. See R6, R7. R^2 filed a timely notice of appeal on November 23, 2009. See R1; see also Fed. R. Bankr. P. 8002.

STATEMENT OF FACTS

1. The debtors in this case are a group of affiliated companies that sell cable video programming, high-speed Internet, telephone, and advanced broadband services to residential and commercial customers. See R113 (Disclosure Stmt.) 14. A diagram of the debtors' pre-

bankruptcy corporate structure, reproduced from the disclosure statement they filed with their bankruptcy petition, appears as Appendix A to this brief. As that diagram illustrates, CCI is the parent company of the group. It is the managing member of Charter Communications Holding Company, LLC ("Holdco"), which sits atop a ladder of other limited liability companies. See App. A; R113 (Disclosure Stmt.) 14–15. Towards the bottom of that ladder is Charter Communications Operating, LLC ("CCO"), which directly owns the debtors' operating subsidiaries. See App. A.

The diagram also illustrates Paul Allen's considerable equity stake in, and control of, the debtors prior to bankruptcy. Allen directly owned a 7% financial share, and an overwhelming 91% voting share, of CCI. See App. A; R113 (Disclosure Stmt.) 15. He was the Chairman of CCI's board of directors and had the power to appoint some of the other board members. See CD R95 (Allen Post-Trial Br.) 8. He also was (and still is) the 100% owner of Charter Investment, Inc. ("CII"), which owned 45% of Holdco. See App. A; R113 (Disclosure Stmt.) 15. An agreement with the debtors (often referred to as the "Exchange Agreement") gave him the right unilaterally to exchange that 45% interest in Holdco for a like share of CCI, which would have given him a majority financial share in CCI. See App. A; R113 (Disclosure Stmt.) 15.

Allen was not the only party with a financial stake in the debtors. R^2 and other investors owned the remaining equity in CCI, giving them collectively about a 93% financial share, but only a 9% voting share (less than a tenth of Allen's). See App. A; see also see also No. 09–11435 (Bankr. S.D.N.Y.), Dkt. # 684 (R^2's Stmt. of Ownership). CCI also carried a relatively small amount of debt: just under $500 million worth of bonds, some of which were owned by R^2. See App. A; see R113 (Disclosure Stmt.) 33; see also No. 09–11435 (Bankr. S.D.N.Y.), Dkt.

684 (R^2's Stmt. of Ownership).[2] But most of the overall enterprise's debt—over $20 billion of bonds and secured loans—was held by the limited liability corporations that sit beneath CCI and Holdco in the corporate structure. See App. A; R7 (Confirmation Op.) 9–10.

2. The Charter enterprise was, and remains, an "operationally sound business," with about $6.5 billion in revenue for 2008 alone. R7 (Confirmation Op.) 9; see R113 (Disclosure Stmt.) 14. But the collapse of the credit markets, combined with the enterprise's heavy debt load, began to cause problems in late 2008. See R7 (Confirmation Op.) 10–11. The debtors first encountered difficulties in November 2008, when organizational problems left certain subsidiaries unable to access sufficient cash to make interest payments on their debts. See *id.* at 14. The debtors ultimately made the payments by drawing $250 million on a different line of credit and then distributing funds to the debtor subsidiaries. See *ibid.* Such a distribution is permissible only if the entity making the distribution has a sufficient "surplus"—*i.e.*, enough assets in excess of its liabilities that the distribution will not affect its ability to pay off its own creditors. See *ibid.* The debtors' conclusion that such a surplus existed in November 2008 rested largely on an advisor's determination that the Charter enterprise, viewed as a whole, was then worth about $21.6 billion. See R17 (Debtors' Post-Trial Br. on Reinstatement) 30; R7 (Confirmation Op.) 39.

Making the November interest payments offered only a temporary fix for the debtors' structural problems. The debtors' longer-term solution was to eliminate a lot of their debt by reorganizing through a pre-arranged bankruptcy, a process in which a company devises a plan to renegotiate or pay off its debts (possibly at less than face value) *before* formally filing for

[2] R^2 participated independently in the bankruptcy court in its capacity as a shareholder of CCI, and this brief is submitted in that capacity. R^2's bond interests are represented by the Law Debenture Trust Company of New York, which has filed a separate brief in its related appeal, No. 09-cv-10566. R^2 incorporates by reference the arguments made in that brief.

bankruptcy protection. As with any reorganization plan, of course, any value beyond what is owed to creditors must be distributed to equityholders. See generally COLLIER BANKRUPTCY MANUAL ¶ 1.03[4] (Henry J. Somner & Lawrence P. King eds., 3d ed. rev. 2002). Unless all groups of creditors and investors are willing to go along with the plan, the plan can be confirmed only if the bankruptcy court "cram[s] down" the plan against the dissenters' objections. See *ibid*; 11 U.S.C. § 1129(b).

Lazard Frères & Co. LLC, a longstanding advisor to Charter during Allen's tenure as chairman and controlling shareholder, set the debtors' bankruptcy strategy in motion. See R7 (Confirmation Op.) 11. Lazard identified two sticking points to a reorganization. The first was that the debtors would need some of the enterprise's existing creditors to agree to trade their debt for equity (*i.e.*, stock) in the reorganized company, and to invest additional money in the company. See *id.* at 12. Lazard therefore encouraged the creditors whose cooperation it deemed necessary—namely, those creditors holding bonds issued by particular mid-level companies in the debtors' corporate structure—to form the Crossover Committee (whose professional fees and expenses would be paid by the debtors) to represent their joint interests in the reorganization. See *id.* at 12 & n.7.

The second sticking point was Allen. At Lazard's suggestion, Allen "demanded . . . the right to receive substantial compensation in exchange for his cooperation" with a reorganization. *Id.* at 9. In theory, Allen could dramatically (and perhaps fatally) impair the proposed plan in two independent ways.[3] First, it was a condition of the debtors' primary loan agreement that

[3] Substantial evidence introduced at trial indicated that Allen's threat to scuttle the reorganization was hollow. As described in greater detail below, *infra* at 27–29, substantial evidence shows that forcing the company into a liquidation scenario would have caused Allen to face *personal* tax liability of approximately $1 billion, and Allen therefore had no intention of pulling the trigger.

Allen (or entities under his control) retain at least 35% voting control of CCI. See *id.* at 20–21. Had Allen refused to retain such control, the lenders could have prevented the debtors from "reinstating" that loan on its original terms following the bankruptcy. See *ibid.*; see also *id.* at 52. Without reinstatement, the debtors would have had to replace the credit facility, and the prevailing market conditions would have forced them to accept a higher interest rate. See *id.* at 52. Second, Allen was in position to cause the debtors considerable tax-related harm. CCI had, over time, built up well over a billion dollars' worth of "net operating losses," or "NOLs," that could be used to offset future income and thereby reduce future tax liability. See *id.* at 53. Allen claimed to have the power to destroy a large portion of those NOLs: Because the reorganization would eliminate a great deal of the Charter enterprise's debt, it would generate "cancellation of debt" (or "COD") income that would flow up the debtors' corporate structure to the two owners of Holdco: CII (Allen's affiliate) and CCI. See R12 (Debtors' Post-Trial Br.) 20; CD R95 (Allen Post-Trial Br.) 15 n.9; CD R12 (Degnan Decl.). Any COD income received by CCI would reduce the debtors' NOLs. See R12 (Debtors' Post-Trial Br.) 20; CD R95 (Allen Post-Trial Br.) 15 n.9; CD R12 (Degnan Decl.). During the run-up to the bankruptcy, Allen threatened to maximize the hit that the NOLs would take by getting rid of CII's investment in Holdco and forcing *all* the COD income to go straight to CCI. See R89 (1/20/2009 e-mail) (documenting Allen's threat to exchange his interest in Holdco for an interest in CCI); R12 (Debtors' Post-Trial Br.) 20; CD R95 (Allen Post-Trial Br.) 15 n.9; CD R12 (Degnan Decl.). That maneuver, if actually carried out, would have cost CCI over one billion dollars. See (R7 Confirmation Op.) 50.

Lazard's strategy for getting past these sticking points was to get the members of the Crossover Committee together with Allen and allow them to hammer out among themselves how much of the enterprise's value each should receive in return for their cooperation. The eventual "agreement among Mr. Allen and certain members of the Crossover Committee . . . bec[ame] the foundation of [the] pre-negotiated plan" that debtors' board of directors (which included Allen himself, as well as directors he had appointed) subsequently approved. R7 (Confirmation Op.) 13. The salient features of that plan, as revised and presented to the bankruptcy court for confirmation, were as follows:

- Members of the Crossover Committee would receive considerable recoveries, including substantial control over the reorganized enterprise. Some committee members would receive stock, plus the option to purchase additional stock; others would receive full value for their bonds. See R113 (Disclosure Stmt.) 24–26, 44–47. Certain committee members would get the right to appoint directors to CCI's reconstituted board. See R7 (Confirmation Op.) 7.
- Allen—who held only equity interests (*i.e.*, stock) in CCI—would receive approximately $375 million in cash, bonds, warrants, and stock in the reorganized debtors. See R7 (Confirmation Op.) 51; R113 (Disclosure Stmt.) 26–27. Roughly $175 million of that was to pay off a $25 million claim he had against the debtors and to buy out his interest in one of the debtor subsidiaries. See R7 (Confirmation Op.) 51. The remaining $200 million was payment for maintaining 35% equity voting control of CCI (to allow for continuation of the favorable loans), and a 1% share of Holdco (to avoid the tax penalty he might otherwise have caused). See *id.* at 51.
- Allen, his affiliates, the debtors' directors and officers, and bondholders on the Crossover Committee were awarded prospective immunity against any potential lawsuit by a

creditor or shareholder concerning their involvement with the debtors. See R22 (Reorganization Plan) 61.

- The CCI bondholders—who were not on the Crossover Committee, and were thus not at the negotiating table—would receive a payment of less than a third (32.7%) of the value of their bonds. See R7 (Confirmation Op.) 29.
- CCI shareholders other than Allen would get nothing. Their shares would be eliminated, and they would receive neither cash nor stock in the reorganized enterprise. See R113 (Disclosure Stmt.) 33.

3. The debtors' plan was the only reorganization option presented to the creditors and shareholders during the bankruptcy. Although the Bankruptcy Code permits parties other than debtors to propose plans, any such competing proposals generally must wait until the expiration of an exclusive 120-day debtor-only window. See 11 U.S.C. § 1121(b). That window never expired here, because the debtors presented their pre-arranged plan on the first day of the bankruptcy and put it quickly to a vote. See *id.* § 1126. The plan was not ratified by unanimous approval. See *id.* § 1129(a)(8). To the contrary, CCI's bondholders (who held over 99% of the claims against CCI) voted overwhelmingly to reject the plan—fully 82.5% of the bonds that voted expressed opposition. See CD R83 (Sullivan Aff.) Ex. A. And CCI's equityholders (including R^2) were deemed to have rejected the plan because they were to receive no value whatsoever. See R22 (Reorganization Plan) 25, 43; 11 U.S.C. § 1126(g). Twelve other classes at the various debtor entities also voted against or were deemed to reject the plan. Nevertheless, the bankruptcy court ultimately permitted the debtors to cram down the plan despite the dissenters' "foreseeable, strenuous objections." R7 (Confirmation Op.) 14; see also 11 U.S.C. § 1129(b)(1).

A cramdown is permissible under the Bankruptcy Code only when a plan satisfies certain specific requirements, including that it is "fair and equitable," "does not discriminate unfairly," does not pay anyone more than they are owed, and pays everyone in proper order (*i.e.*, more senior creditors first). See 11 U.S.C. § 1129(b); see generally 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4] (15th rev. ed.). The dissenting voters, including R^2, argued that this plan did not meet those criteria. They pointed to, among other things, problems with the debtors' assessment of their value at the time of the reorganization. Despite having valued the collective enterprise at $21.6 billion in November 2008 (thereby permitting the distribution of $250 million to the debtor subsidiaries), the debtors claimed in March 2009 that it was worth only $15.4 billion. See R7 (Confirmation Op.) 15; see also *id.* at 17 (recognizing "that conflicting indications of value were offered by Charter itself"). As a result (and as the bankruptcy court correctly observed), "[b]illions of notional dollars [had] disappeared"—*i.e.*, were unavailable for distribution to creditors and shareholders—even though "the markets h[ad] stabilized and . . . no corporate event h[ad] taken place that would explain any sharp decline in value." *Id.* at 17. More troubling still, the debtors had valued the various Charter entities only collectively, and had not analyzed the value of each debtor individually. See R113 (Disclosure Statement) Ex. D (valuation analysis); see also R7 (Confirmation Op.) 79. The dissenters argued that the law required such individualized valuations and that, in their absence, the plan's choices about how much the creditors and shareholders of each particular debtor should get paid were fundamentally arbitrary. See *ibid.*

The objectors also strongly opposed the deal that Allen was getting. They argued that compensating Allen for retaining a 35% share of CCI improperly allowed him to recover hundreds of millions of dollars "on account of" his equity investment, ahead of CCI's bondholder creditors (who got less than one-third of the value of their bonds) and other shareholders (who got nothing at all). 11 U.S.C. § 1129(b)(2)(B)(ii); see R7 (Confirmation Op.) 78–79. And they argued that Allen's deal was subject to, and could not withstand scrutiny under, the "entire fairness" standard for insider transactions under Delaware law, such that the plan had been proposed by "means forbidden by law" and therefore was not confirmable under 11 U.S.C. § 1129(a)(3). See R7 (Confirmation Op.) 63–64.

The objectors further argued that the broad releases granted to Allen, his affiliates, the debtors' directors and officers, and the Crossover Committee were unjustified and improper. R7 (Confirmation Op.) 58. They were joined in that objection by the U.S. Trustee and the Securities and Exchange Commission. See *id.* at 58 n.27

The bankruptcy court conceded that the debtors' plan was "creative," "ambitious," and a risky attempt "to obtain significant restructuring benefits" for its proponents. *Id.* at 7, 8, 14, 61. Nevertheless, it sided with the debtors, the Crossover Committee, and Allen, and confirmed the plan. This appeal (and the related appeals) followed.

SUMMARY OF ARGUMENT

The bankruptcy court correctly observed that the plan in this case was a high-stakes "gamble" by its proponents. R7 (Confirmation Op.) 14. The debtors hoped to shed massive amounts of debt while preserving for the reorganized companies significant tax advantages that had accrued to CCI over the past several years. The Crossover Committee sought to obtain control over a set of companies far more valuable than the plan admitted. And Allen worked to extract hundreds of millions of dollars for refraining from harming an enterprise he controlled. To achieve those ends, the debtors knowingly precipitated litigation that would constitute—again, in the bankruptcy court's own words—"a test of the [bankruptcy] process itself." *Ibid.*

The debtors should lose their gamble. For starters, they have cut CCI's public shareholders entirely out of the reorganization without any lawful justification. To push shareholders aside, the law requires a plan's proponents first to prove that the shares in question have no value. See 11 U.S.C. § 1129(b)(2)(C). But the debtors never proved that here, because they presented no analysis of CCI's standalone value from which a fair price for its shares could have been derived. All they offered was a valuation of the Charter companies *viewed collectively*, which reveals nothing about the value of CCI *by itself*, or of its shares. There is considerable evidence that, properly viewed on an individualized basis, CCI's assets (including north of a billion dollars' worth of NOLs) far exceed its debts, meaning that its shares have substantial value.

Furthermore, Allen took improper advantage of his "position of strength" as controlling shareholder. R7 (Confirmation Op.) 8. To begin with, the "absolute priority rule" prohibits giving a priority recovery to a shareholder in a reorganization "on account of" his equity position, 11 U.S.C. § 1129(b)(2)(B)(ii)—which is exactly what this plan does by paying Allen to keep a 35% interest in CCI. Additionally, Allen's insider deal—which was approved by a board on which he sits, and pays him off not to harm a company he directs—is subject to "entire fairness" review, and plainly fails that exacting standard.

Finally (and adding insult to injury), the plan grants Allen and his affiliates—along with the Crossover Committee and the debtors' directors and officers—broad releases from liability for their dealings with Charter. Those broad releases, which lack any compelling justification, exceed the bankruptcy court's authority and violate Second Circuit law.

ARGUMENT

I. THE PLAN UNLAWFULLY DENIES RECOVERY TO CCI'S PUBLIC SHAREHOLDERS.

A. The plan suffers from a fundamental legal defect: it does not even consider whether CCI's equityholders, such as R^2, are entitled to a recovery on their investments because CCI actually had substantial net worth as an individual entity. Reorganizing through bankruptcy does not automatically entitle a company to wipe out its preexisting equityholders. Rather, a court can cram down a contested plan only if it is "fair and equitable," 11 U.S.C. § 1129(b)(1), and a "fair and equitable" plan is one that tries first to pay off all the company's debts to creditors, and then distributes any remaining value to equityholders. See *id.* § 1129(b)(2)(C)(i) (guaranteeing that in a reorganization, a debtor's interestholders will receive, if possible, "the value of such interest" on "the effective date of the plan"); see also 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][a][ii] ("Holders of debt traditionally contract for repayment of principal and interest, but no more; after that, the residual goes to equity.").

Accordingly, to obtain confirmation of a reorganization plan that completely extinguishes equity interests, the plan's proponents must prove that the debtor is insolvent—*i.e.*, that there is no value left once the creditors have had their turn. See, *e.g.*, *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 441 (1968); *N.W. Vill. Ltd. P'ship* v. *Franke (In re Westpointe, L.P.)*, 241 F.3d 1005, 1007 (8th Cir. 2001); 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][a][ii] ("Eliminated classes may . . . insist on . . . an evidentiary showing that there is insufficient reorganization value for the eliminated class after payment to the senior classes."). Proof of insolvency must take the form of a "going-concern" valuation of the reorganized company—an estimate of "the present worth of [its] future anticipated earnings"—as of the day the plan would take effect. *TMT Trailer Ferry*, 390 U.S. at 442–43; see also *Assocs. Commercial Corp.* v. *Rash (In re Rash),* 90 F.3d 1036, 1053 n.23 (5th Cir. 1996) (*en banc*) ("In Chapter 11 cases, a going-concern valuation of the reorganized debtors is a necessary step in applying the 'fair and equitable' standard to . . . a class of interests in a cram down.") (emphasis omitted), *rev'd on other grounds*, 520 U.S. 953 (1997); 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][a][ii]. If the company's debts exceed its going-concern value, then it is insolvent, and equityholders may be shut out of the plan; otherwise, the company is solvent, and equityholders must be allowed to recoup what remains of their investment. See, *e.g.*, *TMT Trailer Ferry*, 390 U.S. at 441–42; *In re Johns-Manville Corp.*, 68 B.R. 618, 636–37 (Bankr. S.D.N.Y. 1986).

The debtors in this case have frozen out CCI's public shareholders without ever conducting a proper going-concern valuation of CCI to determine its solvency. The only going-concern valuation presented in connection with the plan was a *combined* valuation of *all* of the debtors, without any analysis of CCI's solvency as a standalone entity. See R113 (Disclosure Statement) Ex. D (valuation analysis); R34 (8/24/09 Tr.) 120:5–7 ("[Q.] [Y]ou didn't separately value CCI from other entities in your valuation, right? A. We did not."). That blended valuation was neither legally nor factually sufficient to prove that the CCI shareholders' investments were worthless.

B. The law is crystal clear: what matters is the solvency of CCI *itself*. The shares at issue are shares of CCI, not of any of the other Charter companies. If CCI alone had filed for bankruptcy protection, there would be no question that the shareholders' recovery would be based solely upon CCI's financial condition. See, *e.g.*, *TMT Trailer Ferry*, 390 U.S. at 442; *In re Johns-Manville Corp.*, 68 B.R. at 636–37. That fact does not change merely because other Charter entities filed for bankruptcy simultaneously with CCI. The bankruptcy court consolidated these related cases "for *procedural purposes only*." No. 09–11435, Dkt. # 64 at 23 (emphasis added). It is black-letter law that such "joint administration" does not affect claimants' *substantive* rights against individual estates. Fed. R. Bankr. P. 1015(b); see *id.* advisory committee's note; *Bunker* v. *Peyton (In re Bunker)*, 312 F.3d 145, 153 (4th Cir. 2002) ("Under joint administration the estate of each debtor remains separate and distinct."); *Woburn Assocs.* v. *Kahn (In re Hemingway Transp., Inc.)*, 954 F.2d 1, 11 (1st Cir. 1992) ("[J]oint administration is designed in large part to promote procedural convenience and cost efficiencies which do not affect the substantive rights of claimants or the respective debtor estates.").

If the debtors wanted the bankruptcy court substantively to disregard their corporate independence and treat them as a single entity, they could have asked it to apply a separate doctrine of bankruptcy law, called "substantive consolidation," that would have allowed precisely that. See generally *In re Owens Corning*, 419 F.3d 195, 205–12 (3d Cir. 2005) (describing substantive consolidation); *Union Sav. Baking Co.* v. *Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.)*, 860 F.2d 515, 518 (2d Cir. 1988) (same); see also *Reider* v. *FDIC (In re Reider)*, 31 F.3d 1102, 1109 (11th Cir. 1994) (distinguishing between joint administration and substantive consolidation). But they never did so. See R7 (Confirmation Op.) 79 n. 46. And it is doubtful that they would have succeeded had they tried. Precisely because substantive consolidation "vitally affect[s] substantive rights," courts employ it only "sparingly." *Augie/Restivo*, 860 F.3d at 518 (internal quotation marks omitted).

The bankruptcy court, for its part, offered no legal justification for permitting the debtors to shirk their burden to provide a standalone valuation of CCI. The bankruptcy court acknowledged that "no motion seeking substantive consolidation of these chapter 11 cases was ever presented" to it. R7 (Confirmation Op.) 79 n.46. But it failed to explain how, in that circumstance, the debtors were entitled to treat themselves as a single entity for valuation purposes. The only portion of its opinion that even touches on the consolidation issue is a single sentence noting that the plan *dissenters* did not present an expert opinion as to whether substantive consolidation would be appropriate here. See *id.* at 79–80. But again, it was the debtors' burden—not the dissenters'—to establish the proper valuation. And *nobody*, including the debtors, asked for substantive consolidation, and yet the debtors wrongly acted as if it had been ordered.

C. From a factual standpoint, the amalgamated valuation proved nothing about the standalone solvency of CCI. Just because the companies' *combined* liabilities exceed their *combined* value does not establish that any particular company's *individual* liabilities exceed its *individual* value. Indeed, the debtors themselves have argued in this case that at least two of the debtor entities—CC VIII and CCO—were solvent, even while asserting that the Charter entities as a whole were not. See R12 (Debtors' Post-Trial Br.) 68, 84.

What is more, there is powerful evidence that CCI was, in fact, solvent. Nearly all of the Charter group's $21.7 billion debt was held by companies other than CCI. See R113 (Disclosure Stmt.) 16, 18–19. CCI itself had liabilities of less than $500 million (roughly 2% of the total), made up entirely of bond debt ($497,489,463) and miscellaneous creditor claims ($971,207). See *id.* at 32–33. And CCI had substantial assets to offset those liabilities. First of all, it had the ability to pass *all* of those debts through to other Charter entities: it held a "mirror note" that entitled it to reimbursement from Holdco in an amount equal to the bond debt, as well as a management agreement that entitled it to reimbursement from CCO (which, the debtors assert, was fully solvent) for at least the miscellaneous creditor claims. See CD R70 (CCI 2008 10-KA) at 52, 54–55; R12 (Debtors' Post-Trial Br.) 77–78 & n.115, 84; see also R113 (Disclosure Stmt.)

Ex. E at vi (valuing the mirror note at $83 million even on the assumption that Holdco was insolvent). Furthermore, the debtors themselves have made clear that, as among the various Charter entities, it was CCI specifically that owned the NOLs that could be used to offset future tax liability:

- The debtors acknowledged in the bankruptcy court that "the public disclosures of CCI report the NOL (as belonging to CCI)." R12 (Debtors' Post-Trial Br.) 4. A 2007 filing with the SEC, for example, states that "Charter," a term defined to refer exclusively to CCI, "had approximately $7.9 billion of federal tax net operating losses" that it could "use[] to offset" any "future taxable income." R115 (CCH 2007 10-K) 13; see also *id.* at 1.
- The debtors represented in a letter to the Internal Revenue Service, in which they sought favorable tax treatment, that CCI "had available [NOL] carryforwards of approximately $8.7 billion," which were "attributable to losses at [Holdco]" and had been "allocated to [CCI] based on the terms of [Holdco's] operating agreement." R106 (4/6/09 Ltr. to IRS) 3. The letter further represented that CCI was a "a loss corporation, as defined in [Internal Revenue] Code § 382(k)(1)," *id.* at 14, meaning that it was a corporation "entitled to use a net operating loss carryover or having a net operating loss" for a particular tax year, 26 U.S.C. § 382(k)(1); see also R59 (7/21/09 IRS ruling) 4.
- The debtors structured their reorganization specifically to avoid NOL-related tax consequences *at CCI*. Representing to the bankruptcy court that a change in corporate ownership "limits the amount of taxable income that can be offset by a corporation's NOLs" in the tax years following such a change, the debtors sought immediately after filing their bankruptcy petition to restrict trading of CCI stock. No. 09–11435, Dkt. # 10 at 10; see also R113 (Disclosure Stmt.) 23–24. And one of primary motivations for the Allen deal, as

explained by Allen himself, was the concern that, without Allen's cooperation, income "allocated to CCI in a restructuring would reduce *its* NOLs." CD R95 (Allen Post-Trial Br.) 15 n.9 (emphasis added).

The bankruptcy court briefly opined that CCI, as a standalone entity, lacked legal rights in the NOLs. See R7 (Confirmation Op.) 30, 69, 77–78 & n.43. According to the bankruptcy court, (1) NOLs "[g]enerally" belong not to a parent corporation that actually pays taxes but instead to "the operating entity that generated" the losses; and (2) the plan opponents had failed to prove that the parent company in this case, CCI, "had any rights to . . . harvest the value" of the NOLs. See *id.* at 69, 76. That reasoning is mistaken several times over.

First and foremost, it impermissibly shifts the burden of proof away from the debtors. Shareholders and others objecting to the plan bear no burden to prove anything about CCI's value, including what value it might derive from NOLs. It is the debtors, as the plan proponents, who must prove that CCI lacked sufficient value to distribute to shareholders. See *TMT Trailer Ferry*, 390 U.S. at 442; *In re Westpointe*, 241 F.3d at 1007; 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][a][ii]. The bankruptcy court's belief that there was not enough evidence in the record to allocate the NOLs therefore required the plan's *rejection*, not its confirmation.

Second, the bankruptcy court erred in its view that NOLs typically are owned by operating subsidiaries, rather than their parents. It based that view upon two inapplicable cases. See *Official Comm. of Unsecured Creditors* v. *PSS Steamship Co. (In re Prudential Lines Inc.)*, 928 F.2d 565 (2d Cir. 1991); *Nisselson* v. *Drew Indus., Inc. (In re White Metal Rolling & Stamping Corp.)*, 222 B.R. 417 (Bankr. S.D.N.Y. 1998) (cited at R7 (Confirmation Op.) 68–69, 77–78). Those cases hold that when a subsidiary would by default pay its own taxes, it does not relinquish its right to offset its individual tax liability with any losses it may individually generate merely by agreeing to consolidate its tax return with its parent's. See *In re Prudential Lines Inc.*, 928 F.2d at 567, 571; *In re White Metal Rolling & Stamping Corp.*, 222 B.R. at 420, 424. This case, however, does *not* involve subsidiaries that would by default pay their own taxes; instead, the subsidiaries here are limited liability corporations and partnerships that are "disregarded" for tax purposes and simply pass any profits and losses they generate along to their parents. See R106 (4/6/09 Ltr. to IRS) 2–3 & n.4; see also 26 C.F.R. § 301.7701–2. The logic of the consolidated-return cases—that the subsidiary has an inherent right use its losses exclusively for its own benefit—therefore does not apply. Moreover, even in the consolidated-return context, parents and subsidiaries may alter the default allocation of NOLs by explicit agreement. See *In re Prudential Lines Inc.*, 928 F.2d at 570; *In re White Metal Rolling & Stamping Corp.*, 222 B.R. at 420. And the debtors here have an agreement that does just that: as they explained to the IRS, $8.7 billion of NOLs "attributable to losses at [Holdco] . . . were allocated to [CCI] based on the terms of [Holdco's] operating agreement." R106 (4/6/09 Ltr. to IRS) 3; see also R12 (Debtors' Post-Trial Br.) 4 (acknowledging that "the public disclosures of CCI report the NOL (*as belonging to CCI*)") (emphasis added).

Third, and finally, the bankruptcy court's opinion simply ignores the debtors' repeated admissions—to the IRS, the SEC, and others—that the NOLs properly belong to CCI. The debtors cannot have it both ways. They cannot rely on CCI's ownership of the NOLs when convenient (*e.g.*, when filing with the SEC or seeking favorable treatment from the IRS) but deny that ownership when it poses a problem for their bankruptcy strategy (*e.g.*, in assessing CCI's standalone value). See, *e.g.*, *New Hampshire* v. *Maine*, 532 U.S. 742, 749 (2001) ("Where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position.") (internal quotation marks and alterations omitted).

If the debtors' own statements regarding NOL ownership are to be believed, then the NOLs are assets of CCI, and considerable value should have been available to the shareholders in the reorganization. See 11 U.S.C. § 1129(b)(2)(C)(i). And it was undisputed that the NOLs' *cash* value was *at least* \$1.14 billion to the reorganized debtors. R.6 (Findings and Conclusions) 16.[4] That value alone would have made CCI highly solvent and left hundreds of millions of dollars for CCI's shareholders. CCI's noteholders received a 32.7% recovery on a claim just under \$498 million, leaving approximately \$335 million in debt unpaid. Had \$1.14 billion in NOLs been properly attributed to CCI, the bondholders could have been paid off in full with at least \$800 million left over for the shareholders.

In any event, if the debtors could somehow switch positions now and deny that CCI owned the NOLs, the fact remains that they did not present *any* going-concern valuation of CCI, with or without NOLs, that justified giving the shareholders nothing at all. Nothing in the bankruptcy court's opinion could or did make up for that evidentiary gap. And because filling the gap would make a critical difference in how value is distributed among the different claimants, the confirmation order must be reversed and the case remanded with instructions to conduct the proper standalone valuation of CCI and distribute the excess equity to CCI's shareholders.

[4] The \$1.14 billion figure represents the cash value (*i.e.*, net benefit) of only those NOLs that Allen refrained from destroying. CCI held still more NOLs, which the bankruptcy court did not attempt to value but which also should have been properly attributed to CCI in a stand-alone valuation.

II. THE PLAN'S SUBSTANTIAL PAYMENTS TO A SINGLE INSIDER SHAREHOLDER—PAUL ALLEN—VIOLATE THE BANKRUPTCY CODE.

In sharp contrast to CCI's public shareholders, who receive nothing under the plan, CCI's major insider shareholder, Paul Allen, walks away with about $375 million, plus complete immunity from any suit relating to the Charter companies. See R7 (Confirmation Op.) 9 n.2, 58; R22 (Debtors' Plan) 60–61. For several independent reasons, that highly preferential treatment was impermissible. Allen should not be paid ahead of the other shareholders and creditors of CCI, and he should not have been able to negotiate an insider deal while shielding it from the exacting scrutiny the law imposes on such arrangements.[5]

A. The Allen Deal Violates the Absolute Priority Rule by Redirecting Money to Allen "on Account of" His Equity Interest in CCI.

Compensating Allen ahead of other shareholders and creditors of CCI violates the "absolute priority rule," which prohibits a shareholder from leveraging his equity position in a debtor to cut in line ahead of creditors and other shareholders. The rule dictates that if there is a class of creditors that is not paid in full and objects to the plan, then "the holder of any . . . interest that is junior to the claims of such class will not receive or retain under the plan on account of such . . . interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii); see also *ibid.* (setting forth a limited exception, not relevant here). Here, Allen's equity interest in CCI is indisputably "junior" to the claims of an objecting class of impaired creditors, the CCI bondholders. See R7

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[5] For reasons explained more fully below, Allen's unlawful insider deal precluded consideration of reorganization plans that would have provided the CCI equityholders, including R^2, with at least some recovery. The entire fairness doctrine required that the equityholders be represented in discussions with Allen, and that doctrine as well as the absolute priority rule required that any deal for Allen maximize the value available for the debtors' other creditors and equityholders. Had any of that happened, then Allen—who, the evidence indicates, was already getting over a billion dollars in tax benefits from the reorganization, see *infra* at 27–29—might well have left enough value in the estate (or even contributed additional value in return for his considerable tax and voting-control benefits) for the equityholders. At a minimum, these defects rendered the plan (which left CCI equityholders with nothing) unconfirmable as a matter of law.

(Confirmation Op.) 9; 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][a][i] ("[D]ebt comes before equity with respect to the debtor's assets."). And, as explained below, his substantial recovery arises directly "on account of" that junior equity interest.

1. There is no dispute that the plan awards Allen $200 million for his agreement to retain 35% voting control of CCI, in order to maintain compliance with the terms of the debtors' primary loan agreement. See R7 (Confirmation Op.) 27 & n.15, 52, 78–79; accord R12 (Debtors' Post-Trial Br.) 68; CD R95 (Allen Post-Trial Br.) 61. The source of Allen's voting control before the bankruptcy was his equity investment in CCI. See R113 (Disclosure Stmt.) 15 (describing Allen's ownership stake in CCI). And the terms of the loan agreement are quite clear that Allen must maintain "Equity" voting control, not merely his seat on the Board or some other form of involvement. R7 (Confirmation Op.) 40–41 (quoting exhibit JPX2 (credit agreement)). Compensating Allen for retaining equity voting control therefore plainly constitutes a payment "on account of" his pre-bankruptcy equity position, in violation of the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B)(ii); see also *Motorola, Inc.* v. *Official Comm. of Unsecured Creditors* (*In re Iridium Operating LLC)*, 478 F.3d 452, 463 (2d Cir. 2007) (absolute priority rule applies to "a settlement presented for approval as part of a plan of reorganization"). Under the rule, "if old equity's new interest under the plan results *in any significant way* from its old status, the plan may not be confirmed." *Coltex Loop Cent. Three Partners, L.P.* v. *BT/SAP Pool C Assocs., L.P. (In re Coltex Loop Cent. Three Partners, L.P.)*, 138 F.3d 39, 43 (2d Cir. 1998) (emphasis added). A "significant" connection exists here between the plan's payments to Allen and the preexisting equity position he is being paid to preserve. See CD R95 (Allen Post-Trial Br.) 62 (acknowledging that Allen is receiving compensation for "retaining an equity interest in Charter").

The bankruptcy court's contrary conclusion is untenable. It opined, with only minimal discussion, that the Allen deal satisfies the absolute priority rule because Allen "is not obtaining a recovery 'on account of' his equity interest in CCI," but instead "on account of his cooperation with respect to maintaining requisite voting power within CCI." R7 (Confirmation Op.) 78. But there is no daylight between those two statements. The "voting power" he is getting paid for "maintaining" *is* his "equity interest in CCI."

Nor does anything change if Allen's payment is characterized as compensation "on account of . . . his agreement[] to cooperate to enable the senior debt to be reinstated." *Id.* at 27 n.15. That is yet another way of saying the same thing. Allen's ability to preserve the debtor's preexisting loan agreements comes from his voting power, and that voting power comes from his equity. "[A] causal relationship between holding the prior claim or interest and receiving or retaining property is what activates the absolute priority rule." *Bank of Am. Nat'l Trust & Sav. Assoc.* v. *203 N. LaSalle St. P'ship*, 526 U.S. 434, 451 (1999). Focusing only on the final link in the causal chain (between the preservation of the loan and the payment to Allen) does not make the previous links (between Allen's old equity and his ability to preserve the loan) go away. See *id.* at 450 (rejecting the view that application of the absolute priority rule requires compensation directly "'in exchange for'" a prior interest); see also *In re Coltex*, 138 F.3d at 43 ("If Congress had intended to modify [the statutory phrase 'on account of'] with the addition of the words 'only,' 'solely,' or even 'primarily,' it would have done so. For [a] court to add such modifiers would work a significant and unwarranted change in the meaning and consequence of the statute.").

2. Even putting aside the direct and immediate connection between Allen's compensation and his preexisting equity, the plan still runs afoul of the absolute priority rule

because Allen's mere *status* as a prior equityholder creates a presumption of impropriety. The absolute priority rule exists to address "the danger inherent in any reorganization plan proposed by a debtor . . . that the plan will simply turn out to be too good a deal for the debtor's owners." *LaSalle*, 526 U.S. at 444. The Supreme Court has accordingly acknowledged the possibility that the rule might bar *any* transaction that lets a prior equityholder cut in line, regardless of the situation. See *id.* at 451–54. And it has said that even if such transactions are *sometimes* permissible, they are limited to a very narrow set of circumstances. See *id.* at 451–58. In particular, the old equityholder must supply "new value" to the estate, and it must supply that value "at a price that . . . provide[s] the greatest possible addition to the bankruptcy estate." *Id.* at 446, 453. Neither condition is satisfied here.

To begin with, the "value" that Allen is supposedly providing—preservation of an existing loan agreement—is not "new." For an equityholder to "'participate in a plan of reorganization'" ahead of creditors and other shareholders, he must "'make a fresh contribution'" of "new capital" that will help the debtor make a go of it upon emerging from bankruptcy. *Id.* at 445 (quoting *Case* v. *L.A. Lumber Prods. Co.*, 308 U.S. 106, 121–22 (1939)); see also *S. Pac. Transp. Co.* v. *Voluntary Purchasing Groups, Inc.*, 252 B.R. 373, 389 (E.D. Tex. 2000) (requiring a "post-petition contribution . . . that . . . is new"); *In re Cypresswood Land Partners, I*, 409 B.R. 396, 438 (Bankr. S.D. Tex. 2009) (requiring "a contribution that is new capital"). There is nothing "fresh" about Allen's "contribution" here. Rather than *giving* the debtors an infusion of new value, Allen is simply agreeing not to *deprive* the debtors of value that they already have by walking away from CCI. The self-dealing concern that animates the absolute priority rule is surely at its highest when an owner is being paid simply to refrain from causing harm. See *LaSalle*, 526 U.S. at 444.

Furthermore, even assuming Allen's preservation of the status quo could somehow be considered "new value," the record fails to justify the amount that Allen is getting paid for providing it. In order to smoke out cases of unfair "favoritism," the absolute priority rule requires an old equityholder "to demonstrate [his] payment of top dollar" for what he is getting under the plan. *Id.* at 456, 457. Allen and the debtors, therefore, had to show that this was the best deal that could have been made under the circumstances. See *id.* at 453 (transaction must provide "greatest possible addition to the bankruptcy estate"). The bankruptcy court fundamentally misunderstood this requirement when approving Allen's settlement, concluding that the deal need not "be the best the debtor could have obtained." R7 (Confirmation Op.) 49. That error alone requires reversal.

What is more, "in the absence of a competing plan of any sort," the debtors could not possibly show that the Allen deal achieved "top dollar" for the estate. *LaSalle*, 526 U.S. at 457.[6] Allen and the Crossover Committee worked out this deal behind closed doors, then the debtors pushed it through immediately upon the opening of their exclusive plan-presentation window. There was never an opportunity for anyone else to propose a plan that would have paid Allen less (or nothing at all) to see whether he might still go along with it.

There is substantial evidence that Allen had powerful reasons to cooperate with the restructuring even *without* any added financial incentives. The bankruptcy court's opinion

[6] *LaSalle*, like this case, involved a plan proposed during a debtor's exclusive 120-day window. See 526 U.S. at 438. In invalidating that plan as a violation of the absolute priority rule, the Supreme Court's decision repeatedly identifies the absence of "competing plans" as a reason why the plan was not properly market-tested. See *id.* at 456–57. Although the Court ultimately declined to decide whether competing plans are always a prerequisite for market-testing, see *id.* at 458, competing plans are the only method of market-testing that might be available here. Since the CCI equityholders, and others, were shut out of the pre-bankruptcy negotiations, post-bankruptcy proposal of competing plans is the only realistic means of subjecting Allen's deal to the requisite market pressure.

simply ignored the testimony of numerous witnesses that failure of the reorganization plan would have *cost* Allen well over $1 billion in tax liability from a liquidation. See, *e.g.*, R36 (8/31/09 Tr.) 217:16–17 (testimony from CCI board member that "in the event of a freefall bankruptcy, [Allen] would have a large tax liability"); R38 (9/2/09 Tr.) 186:16–17 (testimony from president of Allen's investment company that "there were scenarios that had the potential to create large tax liabilities for Mr. Allen"); see also R90 (1/27/09 e-mail) 1 (stating that Allen could in certain circumstances "get a tax bill for abt 1.5bb"); R91 (1/28/09 e-mail) 2 (stating that "[d]oing a deal with [Charter] would enable [Allen] to avoid" "a potential $1+ billion tax liability"); R94 (2/8/09 e-mail) 1 (stating that deal avoided approximately $1 billion liability for Allen). For either that reason, or some other, Allen might have been willing to accept the less-than-onerous burden of maintaining 35% voting control of CCI for far less than the hundreds of millions of dollars he was paid. It is not inconceivable that Allen would have been willing, if pressed, to *contribute* to the estate to ensure confirmation of this basic plan of reorganization. In addition to perhaps saving $1 billion in taxes, Allen stood to receive an equity stake in Holdco, paired with substantial influence over the reorganized debtors by virtue of his 35% voting stake in CCI—all of which is highly valuable.[7]

The point is, nobody knows. And neither self-serving statements by representatives of Allen and the debtors, nor post hoc judicial analysis, can compensate for the absence of an actual market test and hard data. "[T]he best way to determine value is exposure to a market," not "determination . . . by a judge in bankruptcy court." *LaSalle*, 526 U.S. at 457. The creditors accordingly should have been able to market-test Allen's willingness to cooperate by proposing,

[7] All of this was briefed at length before the bankruptcy court, R9 (R^2 Post-Trial Br.) 39–41; R11(CCI Bondholder Trustee's Post-Trial Br.) 20–21, 31–32. R12 (Debtors' Post-Trial Br.) 18–21; CD R95 (Allen Post-Trial Br.) 38–39. But there is no mention of it anywhere in the court's findings of fact, conclusions of law, or confirmation opinion.

and voting on, reorganization plans that presented a *range* of possible payoffs to Allen (including, perhaps, no payoff at all), and then seeing what Allen would accept. See *id.* at 457–58; *id.* at 457 n.28 ("[T]he Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests.").

Allen's compensation was not subject to a real market test in his pre-bankruptcy discussions with the Crossover Committee. For one thing, those insider negotiations were not "fair" in any meaningful sense, so the price they arrived at cannot be trusted. See *infra* Part II.B. For another, the best that such negotiations could accomplish was to bargain Allen down to a price that was acceptable to the Crossover Committee. But that is not the same thing as the lowest price possible, which is what the absolute priority rule demands. See *LaSalle,* 526 U.S. at 453 (old equityholder's contribution must "provide the greatest possible addition to the bankruptcy estate"). $200 million is not the best price possible just because the Crossover Committee may have been willing to participate in a plan that paid Allen as much as, say, $400 million; Allen may well have agreed to much less or nothing at all.

Without competition from other parties, who might have proposed plans driving a harder bargain than the Crossover Committee did, there is no assurance that the debtors got the maximum value they could from Allen. See *id.* at 457–58 (courts administering the absolute priority rule should "disfavor . . . decisions untested by competitive choice"). For that reason, as well as the reasons previously stated, the Allen deal does not satisfy the absolute priority rule, and the plan should not be permitted to stand on its current terms.

B. The Allen Deal Cannot Satisfy Delaware Law's "Entire Fairness" Standard for Insider Transactions.

The Allen deal is additionally flawed because it violates the Delaware corporate-law requirement that transactions involving insiders be "entirely fair." *Kahn* v. *Tremont Corp.,* 694

A.2d 422, 429 (Del. 1997). A reorganization plan cannot be confirmed unless it "has been proposed in good faith *and not by any means forbidden by law*"—including applicable state law. 11 U.S.C. § 1129(a)(3) (emphasis added); see also *Koelbl* v. *Glessing (In re Koebl)*, 751 F.2d 137, 139 (2d Cir. 1984) ("[S]ection 1129(a)(3) requires that the proposal of the plan comply with all applicable law, not merely the bankruptcy law.") (citing 5 COLLIER ON BANKRUPTCY ¶ 1129.02, at 1129-13 (15th ed. 1984)). Delaware law, which applies here because the debtors are Delaware corporations, generally forbids any "transaction involving self-dealing by a controlling shareholder," or a director, unless the insider can demonstrate that the transaction was "entirely fair" to the other stakeholders. *Kahn*, 694 A.2d at 428, 429 (Del. 1997); see also *Weinberger* v. *UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain."); see also R105 (CCI 2008 10-K) (CCI incorporated in Delaware). The bankruptcy court, however, subjected this remarkable accommodation to the far more lax "business judgment" rule. R7 (Confirmation Op.) 49. The bankruptcy court was wrong to reject the entire fairness standard, and Allen's deal—which allowed a director and controlling shareholder to insist upon a plan giving himself hundreds of millions of dollars—cannot meet that higher standard.

1. The bankruptcy court improperly allowed the debtors to dodge entire fairness review altogether based on its erroneous conclusion that the standard had no application to these proceedings. Neither of its proffered reasons for reaching that conclusion has merit.

The bankruptcy court first opined that "the 'entire fairness' standard does not apply in light of the record showing that" (1) the negotiations for the deal "were initiated by Lazard for the benefit of the enterprise, not by Mr. Allen for his benefit," and (2) the deal "was approved by independent members of Charter's board." See R7 (Confirmation Op.) 64. Neither fact matters under Delaware law. Proposal of the deal by Lazard—a long-time advisor to the Allen-controlled debtors—hardly shows impartiality. See *infra* at 33. Moreover, the circumstances surrounding the initiation of an insider transaction are simply a factor to be considered *under* entire fairness review; they are not a reason to avoid applying that exacting standard altogether. See, *e.g.*, *Mills Acquisition Co.* v. *Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1988) ("'Fair dealing' focuses upon the actual conduct of corporate fiduciaries in effecting a transaction, *such as its initiation*, structure, and negotiation.") (emphasis added). Nor is it relevant that board members unaffiliated with Allen voted to approve the deal. The independent directors never created a formal independent committee, or retained their own impartial professional advisors. See *infra* at 33–34. And in any event, "[e]ntire fairness remains applicable *even when* an independent committee *is* utilized because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny." *Kahn*, 694 A.2d at 428 (emphasis added).

The bankruptcy court further opined that "even if the 'entire fairness' standard were applicable, the plain language of section 1129(a)(3) does not require that the Plan's contents comply 'in all respects with the provisions of all nonbankruptcy laws and regulations' because it 'speaks only to the proposal of a plan.'" R7 (Confirmation Op.) 64 (quoting *In re Buttonwood Partners, Ltd.*, 111 B.R. 57, 59 (Bankr. S.D.N.Y. 1990); *In re Gen. Dev. Corp.*, 135 B.R. 1002, 1007 (Bankr. S.D. Fla. 1991)). But here that is truly a distinction without a difference: The "proposal" of a plan that hinges on an impermissible sweetheart deal for an insider is *necessarily* improper.

Even if it were possible to separate the "proposal" of this plan from its "contents," that would not save it. Unlike in the cases cited by the bankruptcy court, which merely involved challenges to substantive plan provisions, the problem in this case *is* with how the plan was proposed. Compare *In re General Dev. Corp.*, 135 B.R. 1002 (challenging plan provision as violating state-law restriction on municipal ownership of stock); *In re Buttonwood Partners Ltd.*, 111 B.R. 57 (challenging plan provision as inconsistent with federal banking law). The debtors arrived at this plan by insisting that Allen get a piece of the action, giving Allen free rein to extract as much as he could in discussions with the Crossover Committee, and then rubber-stamping the outcome of those discussions. An objection that this proposal process was not "entirely fair" is precisely the sort of state-law argument that courts routinely address during plan confirmation. See, *e.g.*, *In re Koelbl*, 751 F.2d at 139 (addressing argument that debtor's former employee had violated state-law duty of loyalty by structuring reorganization plan to transfer ownership of debtor to himself); *In re Bush Indus.*, 315 B.R. 292, 296, 303–07 (Bankr. W.D.N.Y. 2004) (addressing argument that plan was premised on pre-filing agreement that compensated insiders in violation of board's and controlling shareholder's state-law fiduciary duties). It should have been addressed here.

2. Allen's deal could not possibly survive scrutiny under the entire fairness standard. For a transaction to be "entirely fair," it must result from "fair dealing" and arrive at a "fair price." *Weinberger*, 457 A.2d at 711. The Allen deal satisfied neither requirement. To achieve their restructuring goals, the debtors believed that they needed Allen to do two things: (1) retain a 35% voting interest in CCI (to avoid violating the loan agreement), and (2) retain an interest in Holdco (to avoid depleting CCI's NOLs). See *supra* at 8–9; see also R7 (Confirmation Op.) 51. Even putting aside the evidence that the reorganization saved Allen over $1 billion in taxes, one

might think that Allen's ability to retain equity in and control of the company—both of which Allen otherwise stood to lose in bankruptcy—*already* provided Allen with significant value and would require no additional compensation. See, *e.g.*, R29 (7/29/09 Tr.) 209:11–44, 211:10–13 (testimony that Allen wanted even *more* control of the debtors than he wound up getting). But Allen managed to extract *hundreds of millions of dollars* (plus broad releases of liability for himself and his affiliates) in return for his cooperation.

Procedurally, the deck was stacked in Allen's favor from the get-go. At a meeting of CCI's entire board (including Allen and the other interested directors) on December 10, 2008, Charter's long-time financial advisors from Lazard proposed that the company should pay Allen as part of any restructuring. See R38 (9/2/09 Tr.) 174:5–20; R39 (9/10/09 Tr.) 20:1–25. Until then, not even *Allen's own representatives* had concluded that such a payment "was appropriate." See R38 (9/2/09 Tr.) 174:9–13 (testimony of Allen's chief negotiator that Lazard's proposal was "the moment it crystallized" for him). Lazard's proposal thus slanted the playing field considerably by taking the idea of *not* paying Allen entirely off the table. Compare *Valeant Pharm. Int'l* v. *Jerney*, 921 A.2d 732, 746 (Del. Ch. 2007) (criticizing a spin-off transaction initiated by a suggestion to directors, officers, and management that "bonuses would be appropriate," recognizing that "[t]he seed of that suggestion fell on fertile ground").

The procedural inequities continued when, despite Allen's direct financial interest in Lazard's proposal, the board declined to appoint a special committee of disinterested directors (*i.e.*, a committee that would exclude Allen himself and directors appointed by him) to pursue the proposal—a dramatic departure from its past practice for negotiating with Allen. See R26 (7/22/09 Tr.) 123:25–125:2, 245:14–246:20. In the absence of such a functioning special committee, the disinterested directors lacked legal and financial advisors who were truly independent of the entire board, and instead allowed Lazard to retain its lead advisory role throughout the process. See R26 (7/22/09 Tr.) 123:25–125:2; R71 (12/10/08 board minutes) 8. And that process essentially consisted of the board and Lazard encouraging Allen and the Crossover Committee to hash out a deal themselves, without anyone in the room asserting the separate interests of CCI's public shareholders or any other party to the restructuring. See R25 (7/21/09 Tr.) 72:12–73:9 (Lazard's chief restructurer classifying role as that of "mediators" between Allen and the Crossover Committee); see also *id.* at 168:3–169:4. The board did intervene at one point to *assist* Allen: The company successfully suggested that it could help Allen step up the pressure on the discussions by allowing him to give only five days' notice, rather than the contractually required ten days' notice, of his purported threat to deplete the debtors' NOLs by converting his interest in Holdco into shares of CCI. See R38 (9/2/09 Tr.) 39:24–25, 151:11–17. Once that screw was suitably tightened, Allen ensured still-greater pressure by threatening that he would fire CCI's board if it refused to accede to his demands. See R92 (e-mail among Crossover Committee members) ("If they did not reach agreement with us, they would fire the board."); R96 (same) ("Paul . . . still says he has the power to fire the board.").

Substantively, there is no support for the notion that the hundreds of millions of dollars that Allen received constituted a "fair price" for what he was asked to do. In this context, the concept of "fair price" requires that directors have "commit[ted] themselves, inexorably, to obtaining" as low a price for Allen's cooperation as was "reasonably available to the share-holders under all the circumstances." *Mills Acquisition Co.*, 559 A.2d at 1280. And where a bilateral negotiation is infected by unfair process (as this one was), and the "pricing terms" reached "cannot be justified by reference to reliable markets or comparison to substantial and dependable precedent transactions" (as these cannot), "the burden of persuading the court of the fairness of the terms will be exceptionally difficult." *Valeant Pharm.*, 921 A.2d at 748. Neither the debtors nor Allen can carry that burden here. As noted above, it is far from clear that Allen required, or deserved, *any* payment for agreeing to retain his interests in CCI. The mere fact that he was ultimately successful in extracting compensation does not prove that it was "fair," from the perspective of the minority shareholders and other stakeholders, for him to demand it. Indeed, there is ample evidence that Allen's threat to pull out of Holdco, and thereby reduce the debtors' NOLs, was simply a bluff for the purpose of increasing his compensation. R38 (9/2/09 Tr.) 150:22–151:2 (testimony by Allen's negotiator and fellow interested director that he was "very careful to explain to some of the board members . . . that our intent was not to follow through with the exchange, but we were primarily giving notice to bring the [Crossover Committee] to the table"). It is hardly "fair" to pay Allen any price for such a maneuver.

And even if there were *something* Allen did that deserved compensation, there is no reason to believe that he had to get as much as he did. As previously discussed, there is considerable record evidence that Allen would have accepted much less. See *supra* at 27–29. Neither Allen nor the debtors has met the burden of showing that what he managed to extract was entirely fair.

3. The bankruptcy court's legal errors are fatal to its confirmation order. Because it declined to apply the entire fairness standard, the bankruptcy court analyzed the deal under the more relaxed business-judgment "standards applicable to approval of bankruptcy settlements" under Bankruptcy Rule 9019. R7 (Confirmation Op.) 28; see also *id.* at 48–49. That analysis was inadequate. The bankruptcy court deemed the deal procedurally fair simply because it involved an agreement among parties with "divergent economic interests" (in that Allen and the

Crossover Committee each wanted to acquire as much of the debtors' value as they could for themselves). *Id.* at 57. But "fair dealing" review under Delaware law would also require consideration of (among other things) Allen's advantageous insider status, the circumstances under which the deal was proposed, Allen's hardball tactics, and the complete absence of a minority-shareholder representative from the negotiating table. See *Weinberger*, 457 A.2d at 710 (entire fairness requires "utmost good faith" and "most scrupulous inherent fairness"). And the bankruptcy court deemed the deal substantively fair simply because the price Allen demanded was less than the damage he could have done by refusing to go along with the reorganization. See R7 (Confirmation Op.) 52–53. But even if that reasoning—which, taken to its logical conclusion, suggests it would be "fair" to pay an insider $999,999,999 to keep him from causing $1 billion of harm—suffices under Rule 9019, the "fair price" requirement under Delaware law demands consideration of whether the debtors could have secured Allen's restraint at a better price. See *Mills Acquisition Co.*, 559 A.2d at 1280. This Court should accordingly reverse the bankruptcy court's plan-confirmation order—or, at the very least, remand for application of the proper standard.

III. THE PLAN IMPROPERLY SHIELDS NONDEBTORS—INCLUDING ALLEN AND HIS AFFILIATES—FROM LIABILITY TO CHARTER'S CREDITORS AND SHAREHOLDERS FOR ANYTHING RELATING TO THE DEBTORS

The debtors' plan violates the Bankruptcy Code in yet another way by including "third-party" releases that exempt Allen (along with his representatives, his affiliates, and even his spouse and immediate family), CCI's directors and officers, and bondholders on the Crossover Committee from "any and all Causes of Action" by a creditor or shareholder "arising from or related in any way to the Debtors." R22 (Reorganization Plan) 60–61. There is no authorization in the Bankruptcy Code, except in asbestos cases, for a court to approve a plan shielding nondebtors from potential liability. See 11 U.S.C. § 524(e), (g); *Bank of N.Y. Trust Co., N.A.* v. *Official Unsecured Creditors Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 251–53 (5th Cir. 2009); *Resorts Int'l, Inc.* v. *Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995); *Landsing Diversified Props.-II* v. *First Nat'l Bank & Trust Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600-02 (10th Cir. 1990) amended by *Abel* v. *West*, 932 F.2d 898 (10th Cir. 1991). And even though the Second Circuit (in conflict with other Circuits)[8] has occasionally permitted such releases outside the asbestos context, it recognizes that they are a "device that lends itself to abuse," and thus are "proper only in rare cases" that present "circumstances that may be characterized as unique." *In re Metromedia*, 416 F.3d at 141–42. This is not such a case.

The Second Circuit requires, "at minimum," that a nondebtor release be "*itself* important" to the plan—that is, that the extinguishing of claims *directly* accomplish a plan goal. *In re Metromedia*, 416 F.3d at 143. It has, for example, approved nondebtor releases when the nondebtors are making a substantial contribution to the plan in settlement of the released claim. See *SEC* v. *Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992). Nondebtor releases might also be appropriate where a nondebtor's substantial contribution to the plan would be "'manifestly impossible'" without the releases. See, *e.g.*, *In re Karta Corp.*, 342 B.R. at 55 n.1 (approving releases where nondebtor would be unable "to devote any financial resources towards the organization" if it had "to defend State Court lawsuits and to pay out relatively substantial amounts of money") (internal quotation marks omitted).

[8] R^2 respectfully reserves the right to challenge the Second Circuit's rule that third-party releases are *ever* permissible outside the asbestos context.

But there is no suggestion here that any of the released nondebtors would have been *unable* to participate in the plan without the releases. There is no record evidence whatsoever that the releases were critical to the Crossover Committee's participation in Charter's reorganization; likewise, there is nary a mention of why releasing CCI's directors and officers was "itself important" to the plan. Indeed, the bankruptcy court focused its attention almost entirely on whether the releases were important *to Allen* (together with his affiliated "CII Settlement Claim Parties"), and those reasons were severely lacking. See R7 (Confirmation Op.) 60-62. The primary rationale behind the releases—that they were necessary for Allen to cooperate with the reorganization, see R7 (Confirmation Op.) 58–62—hardly presents a "unique" circumstance. *Any* nondebtor in a position of power could potentially hold up *any* reorganization plan by demanding a similarly broad release. See, *e.g.*, *In re Karta Corp.*, 342 B.R. at 55. In Allen's case, there is evidence that, if pressed, he might have abandoned his demand for them: in trial testimony, his chief negotiator stopped short of calling the releases a "showstopper," and left open the possibility that Allen would have agreed to cooperate even without them. See R38 (9/2/09 Tr.) 86:22–88:8. Nor is Allen paying to settle the released claims—to the contrary, he is the one *getting paid* under the plan. The releases are simply a cherry on top of the hundreds of millions of dollars he already is receiving. The value of the releases, Allen claims, is that they allow him and his affiliates to avoid "nuisance suits" (a characterization made without explaining the nature of the potential claims or the likelihood of their success). CD R95 (Allen Post-Trial Br.) 11. But that hardly makes them integral to the plan. If Allen had instead demanded, say, free cable television for life, on the view that it would be valuable and essential for him to avoid the nuisance of annual contracts and monthly bills, such lifetime service would not have been "*itself* important" to the plan.

The absence of any substantial importance of the releases to the plan is further demonstrated by their unjustifiable breadth. A "necessary corollary" of the unique-circumstances requirement is that nondebtor releases "bear a reasonable relationship to the protection of the estate and go no further than necessary to protect those interests." *In re Karta Corp.*, 342 B.R. at 57. The Second Circuit has recently emphasized that bankruptcy courts in fact lack the power to grant broader releases, because "a bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that *directly affect* the *res* of the bankruptcy estate." *Johns-Manville Corp.* v. *Chubb Indemnity Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52, 66 (2d Cir. 2008) (emphasis added), rev'd on other grounds *sub nom. Travelers Indem. Co.* v. *Bailey*, 129 S. Ct. 2195 (2009); see also *In re Metcalfe & Mansfield Alternative Invs.*, 421 B.R. 685, 695 (Bankr. S.D.N.Y. 2010) (finding *Johns-Manville* "persuasive with respect to the jurisdictional issue"). All that the record contains, and that the bankruptcy court relied on, are a few passing suggestions that the debtors have indemnification agreements requiring them to cover at least *some* of the nondebtor releasees for *some* of the released claims. See R7 (Confirmation Op.) 60; R32 (8/17/09 Tr.) 62:25–63:9; R61 (Doody Affidavit) ¶ 40. In fact, the bankruptcy court conceded that no such indemnification agreement applies to the Crossover Committee. See R6 (Findings and Conclusions) ¶ 46 (no "identity of interest" between debtors and the Crossover Committee). It is also inconceivable that *every* possible claim a creditor or shareholder might bring against Allen or his affiliates, CCI's directors and officers, or any other released nondebtors would "directly affect" the debtors' estates. In any event, the burden of proof is plainly on the debtors, and the mere suggestion of a direct effect on the estate is not enough to sustain the comprehensive releases that the plan here contains.

Because those releases are unsupportable, they must be stricken from the plan.

CONCLUSION

For the foregoing reasons, this Court should reverse the bankruptcy court's confirmation order and remand with instructions to: conduct a proper standalone valuation of CCI and direct the payment of the excess value to CCI's shareholders; void the payment of $200 million to Allen in violation of the absolute priority rule (or at least to allow the presentation of competing plans); invalidate Allen's deal under the entire fairness doctrine; and strike the third-party releases bestowed on Allen and his affiliates. At a minimum, this Court should direct the bankruptcy court to conduct such further proceedings as are necessary to correct the serious errors in its confirmation analysis.

Dated: March 24, 2010

Respectfully submitted,

By: /s/ Lawrence S. Robbins

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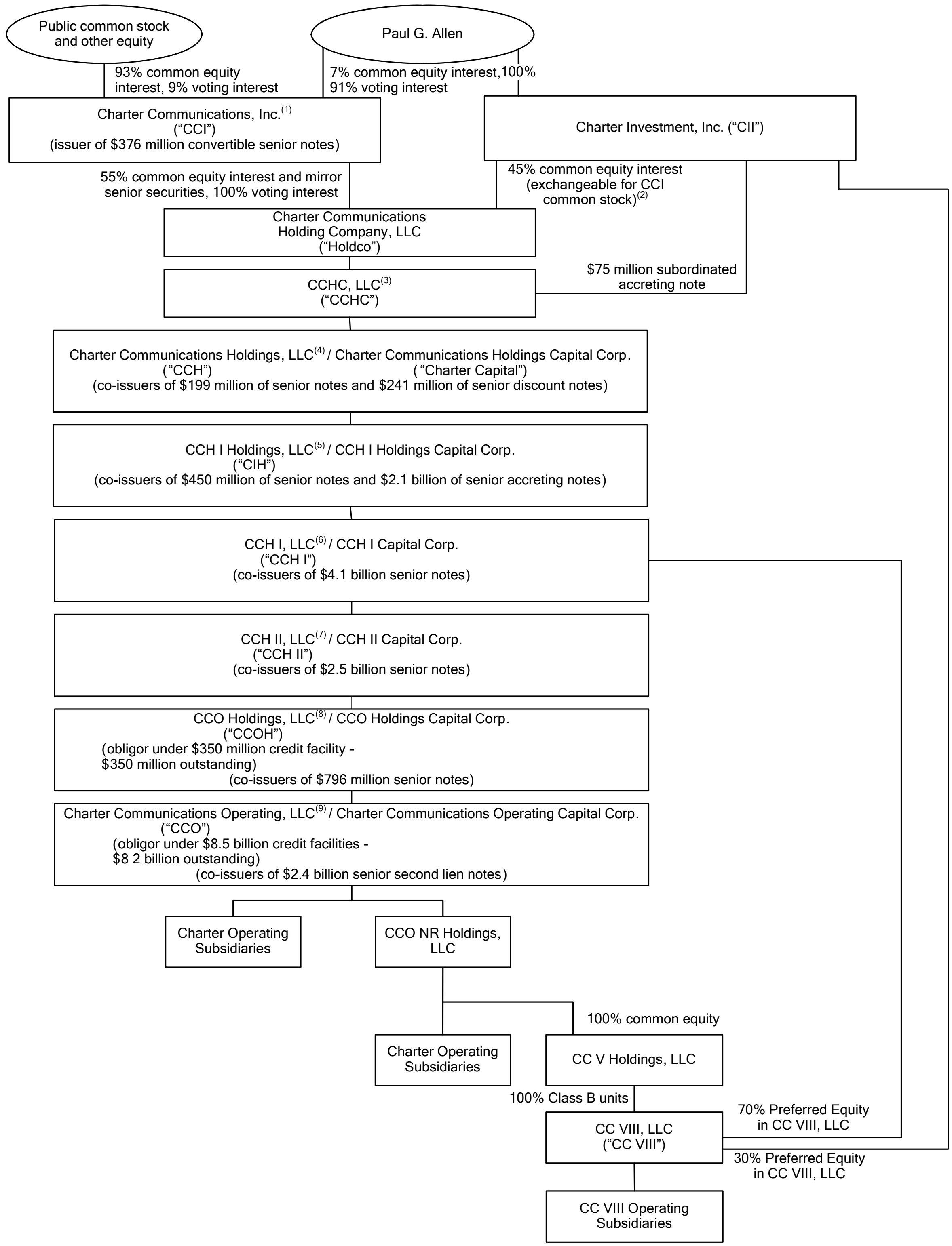
APPENDIX A

Pre-Petition Corporate Organizational and Capital Structure



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CERTIFICATE OF SERVICE

I hereby certify that on March 24, 2010, I filed and served the foregoing brief to be filed by CM/ECF, and additionally caused copies to be sent by Federal Express to the Court and first class mail to the following:

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