Docket #0255 Date Filed: 08/24/2019

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
EMERGE ENERGY SERVICES LP, *et al.,*[1]	)	Case No. 19-11563 (KBO)
	)	(Jointly Administered)
Debtors.	)	**Objection Deadline: August 29, 2019 at 4:00 p.m.**
	)	**Hearing Date: September 5, 2018 at 10:00 a.m.**

OBJECTION OF THE SECURITIES AND EXCHANGE COMMISSION TO APPROVAL OF THE DISCLOSURE STATEMENT AND CONFIRMATION OF THE DEBTORS' JOINT CHAPTER 11 PLAN

The United States Securities and Exchange Commission ("Commission"), a statutory party to these proceedings[2] and the federal agency responsible for regulating and enforcing compliance with the federal securities laws, objects to approval of the Disclosure Statement ("Disclosure Statement") and confirmation of the Joint Plan of Reorganization ("Plan") for Emerge Energy Services LP ("Emerge Energy") and its Affiliated Debtors (collectively, the "Debtors") under Chapter 11 of the Bankruptcy Code, filed July 25, 2019. In support of its objection, the Commission respectfully states as follows:

[1] The other affiliated debtors in these cases are Emerge Energy Services GP LLC, Emerge Energy Services Operating LLC, Superior Silica Sands LLC, and Emerge Energy Services Finance Corporation.

[2] As a statutory party in corporate reorganization proceedings, the Commission "may raise and may appear and be heard on any issue[.]" 11 U.S.C. § 1109(a).

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INTRODUCTION

The Commission objects to approval of the Disclosure Statement and confirmation of the Plan because it would release the liability of, and permanently enjoin actions against, non-debtor third parties in contravention of Sections 524(e) and 1123(a)(4) of 11 U.S.C. §§ 101, *et seq*. (the "Bankruptcy Code").[3] As a general matter, nondebtor third party releases contravene Section 524(e) of the Bankruptcy Code, which provides that only debts of the debtor are affected by Chapter 11 discharge provisions. Such releases have special significance for public investors, such as Emerge Energy's Class 9 limited partnership unit holders (defined in the Plan as the "Old Emerge LP Equity Interests"), because they may enable nondebtors to benefit from a debtor's bankruptcy by obtaining their own releases with respect to past misconduct, including violations of the federal securities laws or breaches of fiduciary duty under state law.

While such releases may be allowed if parties expressly consent to them in exchange for consideration from each released party and the releases do not result in disparate treatment among similarly situated class members, those circumstances are not present here. Nor are there exceptional circumstances that would support non-consensual releases.[4] The Commission has similar concerns regarding an exculpation clause in the Plan that provides that the exculpated parties shall have no liability for any acts or omissions taken

[3] A court may disapprove a disclosure statement if the plan, on its face, does not meet the confirmation standards of Chapter 11. *In re Moshe*, 567 B.R. 438, 444 (Bankr. E.D.N.Y. 2017). In addition, the Debtors are seeking approval of the form of ballot and opt out from the release that contemplate the propriety of the release in question, so that an objection to the release at this stage of the case is proper.

[4] The SEC objects to the Releases only insofar as they apply to Class 9 Old Emerge LP Equity Interests and to the government because it appears that the prepetition noteholders have all consented to the Releases as part of the prepetition restructuring support agreement.

in connection with the restructuring, including certain prepetition conduct, but excluding actual fraud, gross negligence, or willful misconduct.

Thus, the release and exculpation provisions should be deleted from the Plan or the Plan should be amended to provide: (i) that class 9 Old Emerge LP Equity Interests be carved out of the release, or be required to "opt in" to the release rather than having to affirmatively "opt out" of the release; (ii) that the exculpation clause will be narrowly tailored to cover only estate fiduciaries and to exclude prepetition conduct; and (iii) that the government is carved out of the releases. If the Court is nonetheless inclined to approve the release in its current form, then the deceptively written "ballot" provided to class 9 Old Emerge LP Equity Interests should be modified to make clear to the class members that they are not entitled to vote on the Plan and that the Plan will strip their rights against third parties if they do not opt out of the release.

BACKGROUND

On July 15, 2019, the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. On July 25, 2019, the Debtors filed the Plan and Disclosure Statement.

Emerge Energy was formed in 2012 by Insight Equity Management Company LLC and its affiliated investment funds. On or about May 14, 2013, Emerge Energy completed its initial public offering to become a publicly listed limited partnership. From May 14, 2013 until May 31, 2019, the Emerge Energy common units were listed on the NYSE under the symbol "EMES." The common units continue to trade on the OTC Markets under the symbol "EMESQ." As of October 31, 2018, there were approximately 31 million units outstanding. (Disc. St. at 1)

Prior to the petition date, Emerge Energy and its affiliates entered into a restructuring support agreement with all of its privately-held prepetition noteholders and its prepetition secured revolving loan lenders. (Dkt.#14, Ex. B) Under the Plan, Class 9 Old Emerge LP Equity Interests are deemed to reject the Plan and are not entitled to vote. The Old Emerge LP Equity Interests will receive at most a de-minimis distribution of warrants equal to 5% of the reorganized debtors' equity, but only if the general unsecured creditors vote to accept the Plan. Plan at 27-28. Although deemed to reject the Plan and not entitled to vote, the Old Emerge LP Equity Interests will nonetheless be bound to a discharge or release of non-debtor third-party liability (the "Release") unless they affirmatively opt out of the Release. Plan at 13 & 17 (defining "Nondebtor Releasing Parties" and "Releasing Old Emerge LP Equity Holders").

The Release releases claims against: (a) the Debtors and the reorganized Debtors; (b) the creditors' committee and its members; (c) the debtor in possession financing lender; (d) the second lien notes agent and holders of second lien notes who vote in favor of the Plan or do not otherwise opt out of the Releases; (e) the holders of the old general partner equity interests, and each of the foregoing entities' "Related Persons," including their professionals, and current and former officers and directors. Plan at 16 & 17 (defining "Released Party" and "Related Persons"). The Release is for any and all claims and causes of action and a wide range of other obligations, but excludes claims arising from willful misconduct, actual fraud, and gross negligence. Plan at 52.

The exculpation provision provides that exculpated parties[5] shall have no liability to creditors and interests holders for acts or omissions taken in connection with

[5] "Exculpated Parties" is defined as "collectively: (a) the Debtors; (b) the Reorganized Debtors; (c) any Committee and the members thereof in their capacity as such; (d) the DIP Credit

prepetition restructuring efforts and the bankruptcy case, although actual fraud, willful misconduct, and gross negligence are carved out. Plan at 54-55.

DISCUSSION

I. The Release is not consensual and does not satisfy the standard to be approved as a nonconsensual release.

A. The Release is Not Consensual.

Section 524(e) of the Bankruptcy Code addresses the scope of a bankruptcy discharge and states, in relevant part, that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). The Bankruptcy Code contemplates that a discharge only affects the debts of those submitting to its burdens. *Gillman v. Continental Airlines (In re Continental Airlines),* 203 F.3d 203, 211 (3d Cir. 2000). Nonetheless, courts in this District have held that third party releases of non-debtors may be allowed if they are consensual. *See In re Washington Mutual, Inc*., 442 B.R. 314, 352 (Bankr. D. Del. 2011); *In re Zenith Electronics Corp*., 241 B.R. 92, 111 (Bankr. D. Del. 1999)); *see also In re Arrowmill Dev. Corp.*, 211 B.R. 497, 506-07 (Bankr. D.N.J. 1997) (court held that debtors must give creditors and interest holders an opportunity to individually consent to the release, apart from voting on the plan).

In the Commission's view, releases should be considered to be consensual only if the affected parties provide affirmative consent. Here, by contrast, the class 9 Old Emerge LP Equity Interest holders must affirmatively opt out of the Release. Bankruptcy courts in this Circuit have generally held that an opt-out mechanism is not sufficient to

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Agreement Agent; (e) DIP Credit Agreement Lenders; (f) the Prepetition Credit Agreement Agent; (g) the Prepetition Credit Agreement Lenders; (h) the Prepetition Notes Agent; (i) the Prepetition Noteholders; and (j) in each case, the respective Related Persons of each of the foregoing Entities." Plan at 9.

support a third party release, particularly with respect to those who do not return a ballot. *See Washington Mutual*, 442 B.R. at 355 ("[f]ailing to return a ballot is not a sufficient manifestation of consent to a third party release"); *In re Exide Techs*., 303 B.R. 48, 74 (Bankr. D. Del. 2003) (court found nondebtor releases consensual and binding only on creditors and interest holders voting to accept the plan); *cf. In re Spansion, Inc.*, 426 B.R. 114, 144-45 (Bankr. D. Del. 2010) (court found releases consensual only with respect to parties voting to accept the Plan, and unimpaired creditors deemed to have accepted the Plan). Thus, simply abstaining from voting or voting to reject a plan but failing to opt out of the releases does not constitute "consent." *But see In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013) (in nonpublic company case, nondebtor releases deemed consensual with respect to both impaired creditors who abstained from voting on the Plan, and those who voted to reject the plan and did not otherwise opt out of the releases).

Here, the Plan deems the consent of the Old Emerge LP Equity Interests to the Release to be established by silence or failure to opt out. This is inconsistent with basic contract principles. *In re SunEdison, lnc*., 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017) ("Courts generally apply contract principles in deciding whether a creditor consents to a third party release.") *citing In re Washington Mutual, Inc*., 442 B.R. at 352. The Restatement of Contracts makes clear that silence or failure to act cannot be deemed consent under the facts of this case.

Under the Restatement, silence can be deemed to be acceptance only:

(1)

> (a) Where an offeree takes the benefit of offered services with reasonable opportunity to reject them and reason to

> know that they were offered with the expectation of compensation.
> (b) Where the offeror has stated or given the offeree reason to understand that assent may be manifested by silence or inaction, and the offeree in remaining silent and inactive intends to accept the offer.
> (c) Where because of previous dealings or otherwise, it is reasonable that the offeree should notify the offeror if he does not intend to accept.
>
> (2) An offeree who does any act inconsistent with the offeror's ownership of offered property is bound in accordance with the offered terms unless they are manifestly unreasonable. But if the act is wrongful as against the offeror it is an acceptance only if ratified by him.

Restatement (Second) of Contracts, § 69; *see also Jacques v. Solomon & Solomon P.C.*, 886 F. Supp. 2d 429, 433 n.3 (D. Del. 2012) ("Merely sending an unsolicited offer does not impose upon the party receiving it any duty to speak or deprive the party of its privilege of remaining silent without accepting.").

None of the situations enumerated in the Restatement apply here. The Debtors cannot rely on the silence of the Old Emerge LP Equity Interest holders, who are not even entitled to vote on the Plan, as a manifestation of their acceptance of the Release.

B. The Non-Debtor Release does not satisfy the standard to be approved as a nonconsensual release because it is not: (i) fair to the releasing parties; (ii) necessary to the reorganization; and (iii) supported by the facts of this case.

The Third Circuit has held that allowing nonconsensual non-debtor releases is an "extraordinary remedy" that should be used only sparingly. *See In re Continental Airlines*, 203 F.3d at 212. In order to bind all of the affected parties without their consent, the Debtors would need to show that the impacted classes received fair consideration and that the Release is necessary to the Debtors' reorganization. *See id.* at

215;[6] *In re Spansion, Inc.*, 426 B.R. at 144-145. In particular, the Third Circuit in *Continental* focused on whether the releases were given in exchange for reasonable financial consideration, separate and apart from the consideration to which the class was entitled as creditors under the Plan. *In re Continental Airlines*, 203 F.3d at 215. Courts in Delaware consider a number of factors, including whether: "(i) the non-consensual release is necessary to the success of the reorganization; (ii) the releasees have provided a critical financial contribution to the debtor's plan; (iii) the releasees' financial contribution is necessary to make the plan feasible; and (iv) the release is fair to the non-consenting creditors, i.e., whether the non-consenting creditors received reasonable compensation in exchange for the release." *In re Spansion, Inc.*, 426 B.R. at 144-145. Here, the minimal contingent distribution to the Emerge Old LP Equity Interest Holders is simply a function of the mechanics of the Plan, not payments from each Released Party in exchange for the Release.

When applying the *Continental* factors to the facts of this case, it is clear that the Release contravenes Bankruptcy Code Section 524(e) and applicable Third Circuit law. There is no evidence that fair consideration was provided specifically in exchange for the

[6] In *Continental Airlines*, the Third Circuit rejected a plan provision that released and permanently enjoined shareholder lawsuits against present and former officers and directors who were not in bankruptcy. The court held that the release and injunctive provisions fell squarely into the Section 524(e) prohibition because they amounted to nothing more than a lockstep discharge of nondebtor liability. The Court held open the possibility that "there are circumstances under which [it] might validate a nonconsensual release that is both necessary and given in exchange for fair consideration," *Id*. at 214, n.11, but made this comment in light of releases and permanent injunctions issued in such extraordinary cases as *Robins*, *Manville*, and *Drexel*; *See Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694 (4th Cir. 1989); *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89 (2d Cir.1988); *Drexel Burnham Lambert Trading Corp. v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285 (2d Cir. 1992); *see also Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 143 (2d. Cir. 2005) (the Second Circuit held a "nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the plan. . . .").

release of claims against nondebtors or that all of the nondebtor Released Parties made contributions to the Plan. Indeed, "Released Parties" include not just the enumerated parties, but also, among others, those parties' current and former officers and directors, who may not have contributed anything to the Plan or restructuring. There has not been an adequate showing that all of these Released Parties have provided a critical financial contribution, or that the Release is fair to Old Emerge LP Equity Interests. Based on the above, it is the Commission's position that the Old Emerge LP Equity Interests should be carved out from the Release entirely, or they should only be bound by the Release if they opt in to the Release.

In addition, in the Commission's view, the exculpation clause in the Plan constitutes an impermissible non-debtor release and discharge since it limits the liability of various non-estate fiduciaries for conduct that occurred prior to the Chapter 11 case, and hence falls squarely within the scope of Section 524(e). Although actual fraud, willful misconduct, and gross negligence are carved out, the exculpation provision could still potentially release various non-scienter-based claims. *See Washington Mutual*, 442 B.R. at 350, *citing In re PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000)* (exculpations are limited to actions by estate fiduciaries in the bankruptcy case).

II. The Release results in disparate treatment of similarly situated class members in contravention of Section 1123(a)(4) of the Bankruptcy Code.

Section 1123(a)(4) of the Bankruptcy Code requires that a plan "[m]ust provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest." 11 U.S.C. § 1123(a)(4). Here, Old Emerge LP Equity Interest Holders who opt

out of the Release will receive the same consideration as Old Emerge LP Equity Interest Holders who fail to opt out of the Release. This is particularly troublesome because the class is deemed to reject the Plan and it's members have no financial incentive to scrutinize the Plan or Disclosure Statement. This constitutes unequal treatment of similarly situated class members under Section 1123(a)(4) of the Bankruptcy Code, which renders the Plan unconfirmable.

III. The "Ballot" provided to Class 9 is deceptive and should be modified.

If the Court is nonetheless inclined to approve the Release, then the Commission requests that the ballot provided to the class be modified. (Dkt.#247-2 at pp. 59-70) First, the title "ballot" given to the opt out form is misleading because it implies that the class members have the ability to vote to accept or reject the Plan. In the Commission's view, the title should reflect the realities of the situation and should state clearly that the class members are not entitled to vote on the Plan but that the Plan will strip their rights against third parties unless they read the form and opt out of the Release. The form should then state clearly what rights the class members are relinquishing if they do not opt out of the Release, rather than referring them to the Disclosure Statement. In addition, the language in bold in the first full paragraph on the second page of the ballot and similar language on the third page of the ballot threatening the class members that they will not receive a release from the Non-Debtor Releasing Parties if they opt out of the Release should be deleted or the Debtors should state clearly what claims the Non-Debtor Releasing Parties could conceivably have against the class members.

CONCLUSION

For all of the foregoing reasons, the Commission requests that the Release and exculpation provisions be deleted from the Plan, or the Plan should be amended to provide: (i) that class 9 Old Emerge LP Equity Interests be carved out of the Release, or be required to opt in to the release rather than having to affirmatively opt out of the Release; (ii) that the exculpation clause will be narrowly tailored to cover only estate fiduciaries and exclude prepetition conduct; and (iii) that the government is carved out of the Release.

Dated: August 24, 2019
New York, NY

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