Docket #0182 Date Filed: 06/24/2024

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: ProSomnus, Inc., *et al.*, [1] Debtors.	Chapter 11 Case No. 24-10972 (JTD) (Jointly Administered) **Re: Docket Nos. 87 and 88**

REPLY OF DEBTORS IN SUPPORT OF MOTION OF DEBTORS FOR ENTRY OF ORDER (I) APPROVING DISCLOSURE STATEMENT AND FORM AND MANNER OF NOTICE OF DISCLOSURE STATEMENT HEARING, (II) ESTABLISHING SOLICITATION AND VOTING PROCEDURES, (III) SCHEDULING CONFIRMATION HEARING, (IV) ESTABLISHING NOTICE AND OBJECTION PROCEDURES FOR CONFIRMATION OF PLAN, AND (V) GRANTING RELATED RELIEF

The above-referenced debtors and debtors-in-possession (the "**Debtors**") hereby file this reply (the "**Reply**") in support of and in response to the objection filed by the Office of the United States Trustee for the District of Delaware (the "**UST**") [Docket No. 164] (the "**Objection**") to approval of: (i) the Debtors' proposed disclosure statement [Docket No. 87] (as amended on June 24, 2024 [Docket No. 179] and as may be further amended, modified, or supplemented from time to time, and together with all exhibits and schedules thereto, the "**Disclosure Statement**")[2] for the *Joint Chapter 11 Plan of Reorganization of ProSomnus, Inc. and its Debtor Affiliates* [Docket No. 86] (as amended on June 24, 2024 [Docket No. 177] and as may be further modified, amended, or supplemented from time to time, and together with all exhibits and schedules thereto, the "**Plan**") and (ii) the motion to approve the Disclosure Statement and related procedures for soliciting and

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number are: ProSomnus, Inc. (8216), ProSomnus Holdings, Inc. (3855), and ProSomnus Sleep Technologies, Inc. (0766). The location of the Debtors' principal place of business and the Debtors' mailing address is 5675 Gibraltar Dr., Pleasanton, California 94588.
[2] Capitalized terms not defined herein shall have the meanings ascribed to such terms in the Motion.

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tabulating votes to accept or reject the Plan [Docket No. 88] (the "**Motion**"). For the reasons set forth below the Debtors respectfully request that the Court overrule the Objection and grant the relief requested in the Motion.

Preliminary Statement

1. As set forth in the Disclosure Statement, the Debtors engaged in an extensive prepetition marketing and restructuring process, but unfortunately were unable to obtain a feasible third-party offer that could provide sufficient liquidity to consummation. As the Debtors were unable to access debt or equity markets to obtain additional third-party funding either, the Debtors engaged in negotiating a comprehensive restructuring with their existing noteholders. This culminated in the prepetition execution of the Restructuring Support Agreement with the holders of a majority in aggregate principal amount of existing secured noteholders (the "**Restructuring Support Agreement**").

2. On May 24, 2024, the Debtors filed their initial Plan and Disclosure Statement, which were the products of substantial, good faith, arms' length negotiations among the Debtors and the existing secured noteholders holding approximately (i) 100% of the issued and outstanding Senior Secured Convertible Notes, (ii) 100% of the issued and outstanding Senior Secured Convertible Exchange Notes, (iii) 94.95% of the issued and outstanding Subordinated Secured Convertible Notes, (iv) 100% of the issued and outstanding Subordinated Secured Convertible Exchange Notes, and (v) 100% of the Bridge Notes (collectively, the "**Sponsoring Noteholders**") pursuant to the terms of the committed Restructuring Support Agreement. Critically, in accordance with the Restructuring Support Agreement, the proposed Plan provides for 100% recoveries for *all* creditors except the existing secured noteholders.

3. The primary issues raised in the Objection concern the scope of the releases under the Plan and are confirmation issues, premature at the Disclosure Statement phase, and should be considered – if at all – at the confirmation hearing. The other basis for the Objection is a purported lack of "adequate information" as required by section 1125 of title 11 of the United States Code (the "**Bankruptcy Code**"). However, the UST is the *only* party that has filed an objection to the Disclosure Statement. Notwithstanding that the UST will not vote on the Plan, the UST argues that the Disclosure Statement lacks sufficient information to determine whether to vote on the Plan.

4. As detailed above, the Disclosure Statement is supported by the Sponsoring Noteholders, as well as supported by the lack of objection by any other party in interest in these Chapter 11 Cases. Notwithstanding, since filing the initial versions of the Disclosure Statement and Plan, the Debtors have worked diligently and constructively to address the comments received to the Disclosure Statement, Plan, and Motion from the UST. While the Debtors have incorporated many of the UST's informal comments into the amended Plan, amended Disclosure Statement, and revised proposed form of order approving the Motion [Docket No. 181] (the "**Proposed Order**") filed contemporaneously herewith, they were not able to consensually resolve all of the UST's comments, which have since been formalized in the Objection.

5. Accordingly, Debtors respectfully request that the Court: (a) overrule the Objection; (b) approve the Disclosure Statement as containing adequate information as required by section 1125 of the Bankruptcy Code and generally complying with other applicable provisions of the Bankruptcy Code and the Local Rules of Bankruptcy Practice and Procedure of the United States Bankruptcy Court for the District of Delaware (the "**Local Rules**"); and (c) approve the Motion, including the proposed confirmation schedule.

<u>Reply</u>

I. The Disclosure Statement provides adequate information and satisfies the applicable standards for approval under Section 1125 of the Bankruptcy Code.

6. The Disclosure Statement provides adequate information to all holders of impaired claims and interests as required by section 1125 of the Bankruptcy Code. Under section 1125 of the Bankruptcy Code, a plan proponent must provide parties voting on the plan with "adequate information" to make an informed judgment as to the plan. In particular, section 1125 includes a limited definition of "adequate information":

> [I]nformation of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of such claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan . . . and in determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information.

11 U.S.C. § 1125.

7. The adequacy of information in a disclosure statement is determined on a case-by-case basis according to the facts and circumstances of each case. *See* 11 U.S.C. § 1125(a)(1) ("'adequate information' means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records . . . that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan[.]" 11 U.S.C. § 1125(a)(1)"); *see also Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414, 417 (3d Cir. 1988) ("From the legislative history of § 1125 we discern that adequate information will be determined by the facts and circumstances of each case."); *First Am. Bank of N.Y. v. Century Glove, Inc.*, 81 B.R. 274, 279 (D. Del. 1988)

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(noting that adequacy of disclosure for a particular debtor will be determined based on how much information is available from outside sources); S. Rep. No. 95- 989, at 121 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5907 ("the information required will necessarily be governed by the circumstances of the case").

8. Courts acknowledge that determining what constitutes "adequate information" under section 1125 of the Bankruptcy Code is within the broad discretion of the court. *See, e.g., Texas Extrusion Corp. v. Lockheed Corp. (In re Texas Extrusion Corp.)*, 844 F.2d 1142, 1157 (5th Cir. 1988) (the determination of what is adequate information "is largely within the discretion of the bankruptcy court."); *In re PC Liquidation Corp.*, 383 B.R. 856, 865 (E.D.N.Y. 2008) ("[W]hat constitutes 'adequate disclosure' in any particular situation is determined on a case-by-case basis, with the determination being largely within the discretion of the bankruptcy court."); *In re River Village Assocs.*, 181 B.R. 795, 804 (E.D. Pa. 1995) (same).

9. In construing section 1125, courts have articulated certain categories of information that generally should be included in a disclosure statement. *See In re Phoenix Petroleum*, 278 B.R. 385, 393, n.6 (E.D. Pa. 2006) (*citing In re Metrocraft Pub. Servs., Inc.*, 39 B.R. 567, 568 (Bankr. N.D. Ga. 1984)); *In re Scioto Valley Mort. Co.*, 88 B.R. 168, 170-71 (Bankr. S.D. Ohio 1988) (listing various categories of information). But courts acknowledge that disclosure of all the information suggested in these cases is not always necessary. *See Phoenix Petroleum*, 278 B.R. at 393 ("[I]t is ... well understood that certain categories of information which may be necessary in one case may be omitted in another; no one list of categories will apply in every case.").

10. As set forth in the Motion, the Disclosure Statement is thorough and includes more than sufficient information for voting parties to make an informed judgment regarding the Plan. Nevertheless, the UST asserts that the Disclosure Statement cannot be approved because: (a) it

does not include financial projections, (b) it contains "scant information about causes of actions against insiders and other entities," which, according to the UST, "would help creditors determine how much value, if any, the Debtors are leaving behind, and whether any causes of action will be subject to liens held by the Debtors' secured creditors," and (c) it fails to provide certain information relating to the releases and their scope contained in the Plan. All of these objections should be overruled for the reasons set forth herein or because they have been directly addressed through revised documents.

11. First, the only parties entitled to vote in these Chapter 11 Cases are the existing secured noteholders. With one exception, every voting creditor is a Sponsoring Noteholder that has signed onto the thoroughly-negotiated Restructuring Support Agreement. Thus, the creditors in the voting classes, *the only impaired creditors in these Chapter 11 Cases*, already consented by a large majority to their treatment under the Plan. Further, the Debtors' amended documents address the information that had been forthcoming at the time of the original filing on May 24, 2024, including but not limited to the projections. Accordingly, under the facts and circumstances of these Chapter 11 Cases, there are no additional disclosures necessary.

12. Finally, as stated above, the Objection presents issues that are premature objections to the confirmability of the Plan as opposed to the adequacy of the Disclosure Statement. The Court should not determine such objections at present as it would circumvent the well-settled rule that plan confirmation objections are not the proper subject of a disclosure statement hearing. *See, e.g., In re Cardinal Congregate I*, 121 B.R. 760, 764 (S.D. Ohio 1990) ("Where objections relating to confirmability of a plan of reorganization raise novel or unsettled issues of law, the Court will not look behind the disclosure statement to decide such issues at the hearing on the adequacy of

the disclosure statement.”). The UST, like all other parties in interest, will have the opportunity to object to the Plan at the appropriate time.

13. The Debtors submit that the Disclosure Statement provides ample information that constitutes “adequate information,” and, therefore, meets the requirements of section 1125 of the Bankruptcy Code.

II. The Solicitation Procedures provide appropriate notice to parties in interest and should be approved.

14. While the UST does not articulate any express objection to the timing or method of solicitation proposed, the UST asserts that the proposed releases in the Plan are too broad, and that certain of the “Releasing Parties” under the Plan will not receive adequate notice of those releases. *See* Objection, ¶ 29. The scope and propriety of the releases in a plan are issues for courts to consider in connection with confirmation, not at the disclosure statement hearing. Notably, other than to categorically state that the Plan is not confirmable on account of the releases, the UST provides no argument supporting the position that release-related objections are appropriately considered at a hearing to consider approval of a disclosure statement.

A. The Voting Deadline is fair and reasonable under the circumstances of these Chapter 11 Cases.

15. The Debtors have proposed to commence solicitation on June 28, 2024, or as soon as practicable thereafter, with a Voting Deadline of July 19, 2024, which leaves voting parties with approximately three weeks to cast their votes. As detailed above, the only creditors that will be solicited here are the existing prepetition secured noteholders, comprising of eleven unique parties, ten of which are Sponsoring Noteholders who have already committed to support the Plan through the Restructuring Support Agreement, and one voting party (a Sponsoring Noteholder) that holds its securities through a nominee. Accordingly, any concerns regarding delayed transmission of

ballots or an inability to timely identify beneficial holders are misplaced, and the Voting Deadline should be approved.

16. More specifically, there are exactly three Holders of Claims in Class 1, all of whom are Sponsoring Noteholders who (i) through their counsel, have provided substantial comments to the Plan and Disclosure Statement, and (ii) are bound under the Restructuring Support Agreement to support the Plan. While one of these Sponsoring Noteholders holds its securities through DTC (and is therefore being solicited through its nominee), this is not a case where the nominee will need to spend significant time and engage third party proxy agents to ensure that all beneficial holders can receive appropriate solicitation materials. This impacts exactly one beneficial Holder of a Class 1 Claim and, as noted above, that creditor is already intimately familiar with these Chapter 11 Cases, the Plan, and the Disclosure Statement.

17. Similarly, there are exactly eight Holders of Claims in Class 2. With one exception, all such Holders are Sponsoring Noteholders. Importantly, none of these Class 2 Holders hold their notes through nominees. Thus, the claim that "[m]any of [the Class 1 and Class 2 claimants] hold their notes through nominees, and therefore the identity of the beneficial owners of the notes are unknown to the Debtors"[3] is incorrect. There is only one Class 1 Holder that holds its notes through a nominee, and the Debtors not only know this creditor's identity, but have been in frequent contact with its counsel in these Chapter 11 Cases.

18. The UST also incorrectly asserts that "[i]n all instances, the solicitation packages will not be sent directly to the beneficial holders."[4] It is true that for the single Holder that holds its securities through DTC, the Debtors will send the Solicitation Package to the nominee. Per the Debtors' Voting Agent, it is securities-industry standard practice for securities held at DTC to send

[3] *See* Objection, n.5.
[4] *See id*.

solicitation materials with beneficial holder ballots and master ballots to the DTC participants of record, even if there is only a small number of beneficial holders known by the debtor. Regardless, the other ten Holders of Class 1 and Class 2 Claims will receive Solicitation Packages directly.

19. In sum, the Debtors believe that the Voting Deadline is reasonably calculated under the unique circumstances of these Chapter 11 Cases to ensure that all voting parties have an adequate opportunity to cast an informed vote to accept or reject the Plan.

B. The proposed deadline for filing the Plan Supplement should be approved.

20. Local Rule 3016-2 allows the Court to set a deadline for filing the Plan Supplement based on the facts and circumstances of the case before it.[5] Here, the Court should approve the Debtors' proposed Plan Supplement deadline of July 19 for the same reasons that the July 19 Voting Deadline is appropriate in this case: (i) there are only eleven parties that will be voting; and (ii) ten of those voting parties are Sponsoring Noteholders holding nearly 98% of the voting claims who have been (and will continue to be) actively involved in the negotiation and drafting of the Plan Supplement documents. Thus, contrary to the UST's assertion, the vast majority of the parties that will be affected by the contents of the Plan Supplement will not need additional time to "review, analyze and formulate objections to the provisions of the Plan Supplement."[6]

III. The Plan is not patently unconfirmable.

21. The UST claims that the Plan is "patently unconfirmable" because, according to the Objection, the Plan contains non-consensual third-party releases and an allegedly-impermissible opt-out framework. Because the UST's argument is both legally and factually incorrect, the Court should overrule the Objection.

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[5] Local Rule 3016-2 provides, in full—

The plan proponent must file any plan supplement on or before seven (7) days prior to the earlier of (a) the deadline for submission of ballots to vote to accept or reject a plan, or (b) the deadline to object to confirmation of the plan, ***unless otherwise ordered by the Court.***

[6] *See* Objection, ¶ 42.

22. A proposed plan is patently unconfirmable only if "it is obvious at the disclosure statement stage that a later confirmation hearing would be futile." *In re Am. Cap. Equip., LLC*, 688 F.3d 145, 154 (3d Cir. 2012). Therefore, a bankruptcy court should approve a disclosure statement that otherwise complies with Section 1125 unless the disclosure statement "describes a plan of reorganization which is so fatally flawed that confirmation is impossible[.]" *In re Cardinal Congregate I*, 121 B.R. 760, 764 (Bankr. S.D. Ohio 1990); *see also In re Unichem Corp.*, 72 B.R. 95, 98 (Bankr. N.D. Ill. 1987), *aff'd*, 80 B.R. 448 (N.D. Ill. 1987) (courts should disapprove the adequacy of a disclosure statement on confirmability grounds "where it is readily apparent that the plan accompanying the disclosure statement could never legally be confirmed"). "Only where the disclosure statement *on its face* relates to a plan that cannot be confirmed" is it appropriate to dismiss a proposed plan prior to the solicitation of votes; "otherwise, confirmation issues are left for later consideration." *In re Dakota Rail, Inc.*, 104 B.R. 138, 143 (Bankr. D. Minn. 1989) (emphasis in original).

23. But despite acknowledging that there are differing views among Courts in this District regarding the scope of permissible releases and the appropriateness of an opt-out mechanism like the one proposed by the Debtors,[7] the UST asserts that the releases in the Plan and the Debtors' proposed opt-out mechanism render the Plan "patently" unconfirmable. This sweeping assertion ignores the nuanced law in this area and the fact-specific analysis that courts must undertake with the benefit of proper, robust briefing in connection with confirmation. *See In re Copy Crafters Quickprint, Inc.*, 92 B.R. 973, 980 (Bankr. N.D.N.Y. 1988) ("[C]are must be taken to ensure that the hearing on the disclosure statement does not turn into a confirmation hearing, due process considerations are protected and objections are restricted to those defects that

[7] *See* Objection, ¶ 41 ("Not all decisions from this District have required affirmative consent for third party releases…").

could not be cured by voting."); *In re Monroe Well Service*, 80 B.R. 324, 333 (Bankr. E.D. Pa. 1987) (Courts must be cautious "not to convert the disclosure statement hearing into a confirmation hearing, and to insure due process concerns are protected. Furthermore, the objections considered must be limited to defects [in the plan] which could not be overcome by creditor voting results and must also concern matters upon which all material facts are not in dispute or have been fully developed at the disclosure statement hearing.").

24. Importantly, the UST's recitation of precedent completely disregard's this Court's own previous ruling in *Mallinckrodt*,[8] where certain creditors also claimed that releases contained in the proposed plan rendered the plan "patently unconfirmable" and, therefore, the Court could not approve the related disclosure statement for solicitation. This Court disagreed, explaining that such issues were properly considered at confirmation.[9]

25. The Debtors submit that the same result should apply here. The Court should consider the releases in connection with confirmation (with the assistance of fulsome briefing from all parties in interest), against the backdrop of a completed solicitation process. Because there is no legal or factual basis, at this stage of the proceedings, from which the Court can conclude that the Plan is "patently unconfirmable," the Objection should be overruled.

[8] *See* Hr'g Tr. at 13:8–14:10, *In re Mallinckrodt PLC, et al.,* Case No. 20-12522 (JTD) (Bankr. D. Del. June 16, 2021), Docket No. 2930.
[9] *Id*.

Conclusion

WHEREFORE, the Debtors respectfully request that the Court overrule the Objection, grant the relief requested the Motion, and provide the Debtors with such other and further relief as may be just and proper.

Dated: June 24, 2024
Wilmington, Delaware

Respectfully submitted,

POLSINELLI PC

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