

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
FORT LAUDERDALE DIVISION

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In re:)	Chapter 11 Cases
)	
TOUSA, INC., <u>et al.</u> ,)	Case No. 08-10928-JKO
)	
Debtors.)	Jointly Administered
)	

OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF TOUSA, INC., ET AL., TO DEBTORS’ MOTION FOR ORDER APPROVING THE DEBTORS’ DISCLOSURE STATEMENT AND ESTABLISHING SOLICITATION AND VOTING PROCEDURES WITH RESPECT THERETO

The Official Committee of Unsecured Creditors (the “Committee”) of TOUSA, Inc., et al. (collectively, the “Debtors”), by and through its undersigned counsel, hereby files this objection (the “Objection”) to the Debtors’ Motion for Order Approving the Debtors’ Disclosure Statement and Establishing Solicitation and Voting Procedures with Respect Thereto [D.E. #1954] (as supplemented by D.E. # 2014, the “Disclosure Statement Motion”). In support of this Objection, the Committee respectfully submits as follows:

PRELIMINARY STATEMENT¹

1. The Debtors assert that the Plan and related Disclosure Statement accomplish two primary objectives: (i) facilitating the Debtors’ emergence from chapter 11 and (ii) preserving the claims set forth in the Committee Action for the Debtors’ unsecured creditors. Disclosure Statement at 3. The Disclosure Statement, however, describes a Plan that is patently unconfirmable, significantly prejudices prosecution of the Committee Action and makes it likely

¹ All capitalized terms used, but not otherwise defined herein, shall have the meanings ascribed to such terms in the Disclosure Statement for Joint Plan of TOUSA, Inc. and Its Affiliated Debtors and Debtors in Possession Under Chapter 11 of the Bankruptcy Code [D.E. # 2012] (the “Disclosure Statement”) or the Joint Plan of TOUSA, Inc. and Its Affiliated Debtors and Debtors in Possession Under Chapter 11 of the Bankruptcy Code [D.E. # 2013] (the “Plan”), as applicable.

that if the Committee Action is successful, the Debtors' unsecured creditors will not enjoy the fruits of such victory.

2. The Plan is patently unconfirmable because, contrary to applicable law, it contemplates distributions being made to creditors that do not have Allowed Claims. The Plan is premised on the Claims of the First Lien Revolver Lenders, First Lien Term Lenders and Second Lien Term Lenders (collectively, the "Prepetition Secured Lenders"), which are the subject of the Committee Action and the Objection to Bank Claims, being "Provisionally Allowed" for purposes of voting on the Plan and receiving distributions thereunder. There is no legal support, however, in the Bankruptcy Code or case law for provisionally allowing a disputed claim for the purpose of receiving distributions under a chapter 11 plan. Indeed, the Debtors clearly state in the Disclosure Statement that "[o]ne of the key concepts under the Bankruptcy Code is that only claims and equity interests that are 'allowed' may receive distributions under a chapter 11 plan." Disclosure Statement at 61. As the Prepetition Secured Lenders do not have Allowed Claims, they are not entitled to receive distributions on account of their Claims under the Plan.

3. Despite the Debtors' assertions in the Disclosure Statement, the Plan does not maintain "the status quo of the relative rights, claims and defenses of all parties to the Committee Action" Disclosure Statement at 57. Rather, the proposed Plan and related Disclosure Statement contain terms that seek to strip the Debtors' unsecured creditors of significant rights and remedies related to the Committee Action and otherwise including, but not limited to, the following:

- The Plan contemplates that the Debtors and not the Committee will select the Litigation Trustee and the members of the Litigation Trust Committee that will be responsible for administering the Litigation Trust and overseeing the continued prosecution of the Committee Action. There is no justification for the Debtors, who waived the right to prosecute the claims underlying the Committee Action and whose officers and directors may have liability associated with the July Recapitalization, to have any input in the

selection of the Litigation Trustee or the members of the Litigation Trust Committee. These rights should belong solely to the Committee.

- The Debtors propose to fund the Litigation Trust with a \$3 million loan to, among other things, complete the prosecution of the Committee Action, enforce any judgment entered in connection therewith, litigate valuation issues and perform any other duties and obligations as may be set forth in the Litigation Trust Agreement.² This funding is woefully (and purposely) inadequate. The Committee submits that the Litigation Trust must be funded with no less than \$20 million.
- The Plan provides that the Litigation Trust must repay the fees and expenses incurred by the Committee during the pendency of the Chapter 11 Cases in connection with the investigation and prosecution of the Committee Action out of the proceeds of the Litigation Trust Causes of Action. There is no legal basis to require proceeds of such actions to be used to repay allowed administrative expenses.
- The Plan presupposes that the Prepetition Secured Lenders are successful in defending the Committee Action by, among other things, providing the Second Lien Lenders with all of the stock in New TOUSA and the right to select all of the members of the New Board and management for New TOUSA and the Reorganized Debtors. The Committee, as the fiduciary representative for the Debtors' unsecured creditors which have a contingent interest in 100% of the New TOUSA Stock, should have an equal voice in the selection of the New Board and management.
- The terms of the New Notes (as defined below) ensure that, if the Litigation Trust is successful in prosecuting the Committee Action, the Debtors' unsecured creditors will be unable to realize on any remedy ordered. Indeed, the New Notes, drafted by the Debtors, provide that an event of default will occur if (i) Permitted Investors (which is undefined in the term sheets for the New Notes) fail to own at least 50.1% of the voting equity interests in New TOUSA, (ii) a majority of the seats on the New Board at any time are occupied by persons who were neither (A) nominated by the New Board or (B) appointed by directors so nominated or (iii) there is any change of control (or similar event, however denominated) with respect to New TOUSA or any other Reorganized Debtor (collectively, (i) – (iii) above, a “Change of Control”). To the

² As discussed in more detail below, as of the date hereof, the Committee has not seen a draft of the Litigation Trust Agreement and reserves its rights to object to the terms thereof.

extent the Committee Action is successful, it is evident that a Change of Control would occur, triggering an event of default which would result in, among other things, acceleration of principal and interest on the New Notes and the right of the lenders under the New Notes to setoff amounts held with any agent against outstanding obligations.

- The terms of the New Notes also provide for mandatory and optional prepayments of outstanding obligations. In order to ensure the preservation of the Committee Action and available remedies, any amounts paid in connection with the New Notes prior to the conclusion of the Committee Action must be paid into escrow or the recipients of any payments must be required to post a letter of credit for the benefit of the Litigation Trust for at least 115% of the amounts provisionally paid in respect of the New Notes.
- Schedules G-1 and G-2 to the Disclosure Statement contain illustrative exhibits regarding intercompany loan agreements and net intercompany claim balances for each of the Debtors. To date, the Debtors have not been able to certify the accuracy or completeness of such information. Despite the Debtors' inability to verify these amounts, the Debtors propose to treat intercompany claims equally with claims of third party creditors. The Debtors' conduct in failing to keep accurate intercompany claim records was inequitable and resulted in injury to third party creditors because it has impeded the establishment of claims by the Debtors against their affiliates. Accordingly, intercompany claims should be equitably subordinated to the claims of third parties.

The foregoing provisions evidence (i) a lack of (a) fundamental fairness to unsecured creditors and (b) good faith in the filing of the Plan as is required under Bankruptcy Code section 1129(a)(3) and (ii) that the Plan does not adequately meet the Debtors' objective of preserving the status quo with respect to the Committee Action.

4. The Plan is patently unconfirmable because it violates Bankruptcy Code section 524(e) by the inclusion of third party releases and overly broad exculpation provisions that are tantamount to releases. In order for a plan that contains third party releases to be confirmed, the plan proponent is required to demonstrate extraordinary circumstances warranting the non-debtor releases and that such releases are fair and necessary. Here, the Debtors cannot demonstrate any

circumstances warranting the release of third parties. Indeed, many of the parties for which the Debtors seek to obtain releases (officers, directors, Second Lien Lenders, and various professionals) have been identified by the Committee and/or the Debtors as potentially having liability to the Debtors' estates in connection with the failed Transeastern joint venture and/or the July Recapitalization. Moreover, additional potential claims against the proposed released parties may be uncovered in connection with the prosecution of the Committee Action. Accordingly, any plan proposed by the Debtors that contemplates the release of potentially culpable parties cannot be confirmed.

5. In addition to the Plan being patently unconfirmable and failing to protect the interests of unsecured creditors in the Committee Action, the Disclosure Statement does not provide "adequate information" as defined in Bankruptcy Code section 1125. The Disclosure Statement fails to satisfy the requirements of Bankruptcy Code section 1125 because, among other things, it (i) does not include material information and critical documents regarding the formulation of the Plan and the business operations, governance and financing of New TOUSA and the Reorganized Debtors and (ii) contains convoluted, confusing language with a number of mistakes and/or inaccuracies that make it impossible for hypothetical investors typical of the Debtors' various unsecured creditors to make an informed judgment about the Plan.

6. For the foregoing reasons and as set forth below, the Disclosure Statement Motion must be denied.

OBJECTION

I. The Plan Is Patently Unconfirmable

7. Courts routinely hold that, if a plan is not confirmable as a matter of law, the related disclosure statement should not be approved. *In re Atlanta West VI*, 91 B.R. 620, 622 (Bankr. N.D. Ga. 1988) ("A court may refuse to approve a disclosure statement when it is

apparent that the plan which accompanies the disclosure statement is not confirmable.”); *see also In re Criimi Mae, Inc.*, 251 B.R. 796, 799 (Bankr. D. Md. 2000); *In re Market Square Inn, Inc.*, 163 B.R. 64, 68 (Bankr. W.D. Pa. 1994); *In re 266 Washington Assos.*, 141 B.R. 275, 288 (Bankr. E.D.N.Y. 1992), *aff’d*, 147 B.R. 827 (E.D.N.Y. 1992); *In re Curtis Ctr. Ltd. P’ship*, 195 B.R. 631, 638 (Bankr. E.D. Pa. 1996) (finding that a court should disapprove a disclosure statement where the plan it describes is patently unconfirmable); *In re United States Brass*, 194 B.R. 420, 422 (Bankr. E.D. Tex. 1996) (holding that disapproval of a disclosure statement may be appropriate where it describes a plan that is so fatally flawed that confirmation is impossible); *In re Cardinal Congregate I*, 121 B.R. 760, 764 (Bankr. S.D. Ohio 1990) (same). “Allowing a facially nonconfirmable plan to accompany a disclosure statement is both inadequate disclosure and a misrepresentation.” *In re Dakota Rail, Inc.*, 104 B.R. 138, 143 (Bankr. D. Minn. 1989) (citing *In re Pecht*, 57 B.R. 137, 139 (Bankr. E.D. Va. 1986)).

8. Courts should not approve a disclosure statement and engage in the “wasteful and fruitless exercise of sending the disclosure statement to creditors . . . when the plan is unconfirmable on its face.” *In re Atlanta West VI*, 91 B.R. at 622. Indeed, “such an exercise in futility only serves to further delay a debtor’s attempts to reorganize.” *Id.* Moreover, as a matter of public policy and judicial economy, a disclosure statement should not be approved unless it is conceivable that the plan may be confirmed. *In re Franklin Indus. Complex*, 386 B.R. 5, 9 (Bankr. N.D.N.Y. 2008) (adjourning a disclosure statement hearing until contingencies implicated in the plan could be resolved).

9. In the instant case, the Debtors are seeking approval of a disclosure statement for a plan of reorganization that (i) provides for distributions to be made to creditors that do not have allowed claims, (ii) unfairly prejudices the rights of unsecured creditors and (iii) contains broad release and exculpation provisions that are not supported by the law or the facts of these cases.

These provisions make the Plan patently unconfirmable. Accordingly, the Disclosure Statement cannot be approved.

A. *There Is No Basis Under the Bankruptcy Code or Other Applicable Law to Make Distributions on Account of Disputed Claims*

10. The Prepetition Secured Lenders' claims have been challenged by both the Committee in the Committee Action and by certain of holders of the Debtors' Senior Notes and Subordinated Notes in connection with the Objection to Bank Claims. *See Official Committee of Unsecured Creditors of TOUSA, Inc. v. Citicorp North America, Inc., et al.*, Adv. Proc. No. 08-01435 (Bankr. S.D. Fla. 2008); *Objection to Claims of Pre-Petition Lenders* [D.E. # 82].

Notwithstanding these challenges, the Debtors propose to make distributions on account of the Prepetition Secured Lenders' Disputed Claims by artificially classifying such claims as "Provisionally Allowed." Specifically, the Plan provides for the following distributions to be made to the Prepetition Secured Lenders on account of their "Provisionally Allowed" secured claims:³

- The First Lien Term Lenders and the First Lien Revolver Lenders (together, the "First Lien Lenders") will receive: (i) with respect to their alleged secured claims at TOUSA, their Pro Rata share of the New Term Notes and New Revolver Notes (together, the "New First Lien Notes"), respectively, in respect of the TOI Transfer Consideration and (ii) with respect to their alleged secured claims at the Subsidiary Debtors, (a) their Pro Rata share of the New First Lien Notes transferred by New TOUSA to the respective Subsidiary Debtor on account of the "book value"⁴ of the respective Subsidiary Debtor and (b) after the Effective Date, an amount equal to all reasonable and documented out-of-pocket fees

³ In addition, the Plan provides that to the extent the Second Lien Lenders are deemed to have a deficiency claim against TOUSA, they will receive their Pro Rata share of all assets available for distribution by the TOI Plan Administrator upon liquidation of all unencumbered assets of TOUSA. The Plan also provides for the Prepetition Secured Lenders' to have potential unsecured claims, including deficiency claims, against the Subsidiary Debtors.

⁴ As discussed below, the Debtors have not included a specific valuation of any Debtor in connection with the Disclosure Statement, which makes it impossible for creditors to determine the value of the consideration they are to receive under the Plan.

and expenses related to the defense of the Litigation Trust Causes of Action (the “Defense Costs”).

- The Second Lien Lenders will receive: (i) with respect to their alleged secured claims at TOUSA, their Pro Rata share of all assets available for distribution by the TOI Plan Administrator upon the liquidation of all collateral securing TOUSA’s obligations under the Second Lien Credit Agreement, including any proceeds from the TOI Causes of Action to the extent that such proceeds are subject to an Allowed, perfected security interest; and (ii) with respect to their claims at the Subsidiary Debtors, (a) their Pro Rata share of 100% of the New TOUSA Stock allocated to the applicable Subsidiary Debtor, (b) their Pro Rata share of the New Second Lien PIK Notes (collectively with the New First Lien Notes, the “New Notes”) and (c) after the Effective Date, Defense Costs.⁵

11. The law is well-settled that only allowed claims are entitled to distributions under a chapter 11 plan. *In re Insilco Techs., Inc.*, 480 F.3d 212, 216 (3d Cir. 2007) (holding that “[t]he concept of an ‘allowed claim’ lies at the heart of the bankruptcy process, for only those who possess allowed claims are entitled to distribution”); *In re Johns*, 37 F.3d 1021, 1023, n1. (3d Cir. 1994) (“An ‘allowed claim’ is one that will serve as the basis for distribution”); *In re Dixon*, 218 B.R. 150, 151 (B.A.P. 10th Cir. 1998) (“distribution under confirmed plan may be made only to creditors whose claims have been allowed”); *In re Milit, Inc.*, 231 B.R. 604, 606 (Bankr. W.D. Tex. 1999) (“only allowed claims receive distributions from the bankruptcy estate, and many other creditor protections are keyed to the concept of allowed claims”) (citing 4 Collier on Bankruptcy, 502.01 (15th ed. 1996)); *In re Macias*, 195 B.R. 659, 660-61 (Bankr. W.D. Tex. 1996) (holding that a secured creditor that has a disputed claim is not entitled to any distribution under a chapter 13 plan and noting the same principle would apply with respect to any chapter of the Bankruptcy Code). Indeed, Bankruptcy Rule 3021 expressly provides that “after a plan is

⁵ The Plan provides that the Defense Costs incurred by the First Lien Lenders will be paid into escrow while the Defense Costs incurred by the Second Lien Lenders will be distributed to such lenders, subject to disgorgement. The Disclosure Statement fails to discuss the rationale for this distinction (other than the obvious that the Second Lien Lenders demanded this proposed treatment) or the procedures to be used to ensure disgorgement.

confirmed, distribution shall be made to creditors whose claims have been allowed” Fed R. Bankr. P. 3021; *see also In re Conroe Forge & Mfg. Corp.*, 82 B.R. 781, 785 (Bankr. W.D. Pa. 1988) (noting that “Bankruptcy Rule 3021 provides that distribution pursuant to a Chapter 11 plan is authorized only with respect to *allowed* claims. The amount of [the lender’s] claim has not been determined and could depend on many factors including, *inter alia*, the terms of a proposed plan, whether or not the plan is accepted, and whether or not the case suffers conversion to a Chapter 7.”) (emphasis in original).

12. Even where the proposed “plan specifically provides for payments on a creditor’s claim, the creditor is not entitled to distributions without an allowed claim.” *In re Reichenbach*, No. 03-03148, 2004 WL 1718090 (Bankr. N.D. Iowa May 5, 2004) (creditor not entitled to distribution, even though plan provided for payment of his claim, because the claim was not allowed); *In re Griggs*, 306 B.R. 660, 664 (Bankr. W.D. Mo. 2004) (same); *In re Walters*, 219 B.R. 520, 523 n.1 (Bankr. W.D. Ark. 1998) (same). In addition, the Bankruptcy Code is replete with references to the fact that only allowed claims are entitled to be satisfied by the bankruptcy estate. *See, e.g.*, 11 U.S.C. § 502(a) (defining all timely filed proofs of claim as allowed, “unless a party in interest ...objects”); *Id.* § 506 (discussing payment of allowed secured claims); *Id.* § 507 (setting priorities among allowed unsecured claims).

13. As the Prepetition Secured Lenders’ claims are the subject of colorable objections, they must be classified as disputed claims and cannot receive distributions unless and until they are allowed. Accordingly, the Debtors’ proposed distribution scheme violates the Bankruptcy Code and other applicable law rendering the Plan patently unconfirmable.

B. The Plan Has Not Been Proposed in Good Faith

14. Bankruptcy Code section 1129(a)(3) provides that in order for a court to confirm a plan of reorganization, the plan must be “proposed in good faith and not by any means

forbidden by law.” 11 U.S.C § 1129(a)(3); *In re Natural Land Corp.*, 825 F.2d 296, 298 (11th Cir. 1987) (“Section 1129 forbids a court from accepting a reorganization plan which has not been proposed in good faith.”). The term “good faith” faith is not defined in the Bankruptcy Code. Courts, however, have defined “good faith” to mean “alternatively that (1) the plan be consistent with the objectives of the Bankruptcy Code; (2) the plan be proposed with honesty and good intentions and with a basis for expecting that reorganization can be achieved; or (3) there was fundamental fairness in dealing with creditors.” *In re Lernout & Hauspie Speech Prods. N.V.*, 308 B.R. 672, 675 (D. Del. 2004) (citations omitted). “According to the good faith requirement of section 1129(a)(3), the court looks to the debtor’s plan and determines, in light of the particular facts and circumstances, whether the plan will fairly achieve a result consistent with the Bankruptcy Code. The plan “must be ‘viewed in light of the totality of the circumstances surrounding confection’ of the plan [and] ... the bankruptcy judge is in the best position to asses the good faith of the parties’ proposals.” *In re Madison Hotel Assocs.*, 749 F.2d 410, 425 (7th Cir. 1984) (citations omitted); *see also In re McCormick*, 49 F.3d 1524, 1526 (11th Cir. 1995) (holding that “[t]he focus of a court’s inquiry is the plan itself, and courts must look to the totality of the circumstances surrounding the plan”); *In re University Creek Plaza, Ltd.*, 176 B.R. 1011, 1018-19 (S.D. Fla. 1995) (noting that “[t]he bankruptcy judge is in the best position to assess the good faith of the parties’ proposals”); *In re SM 104 Limited*, 160 B.R. 202, 244 (Bankr. S.D. Fla. 1993) (holding that “[i]n evaluating good faith, the bankruptcy court must look to the totality of the circumstances surrounding the development and proposal of the plan.”).

15. As noted above, the Debtors have proposed the Plan with two primary objectives: (i) to facilitate the Debtors’ emergence from chapter 11 and (ii) to preserve the claims set forth in the Committee Action for the Debtors’ unsecured creditors. While the Debtors’ goals are laudable, the Plan, as drafted, is ill-conceived and evidences a failure to act with fairness to the

Debtors' unsecured creditors. Based on the totality of the facts and circumstances, the Plan has not been proposed in good faith as required by Bankruptcy Code section 1129(a)(3).

1. The Plan Does Not Adequately Preserve Unsecured Creditors' Rights and Remedies with Respect to the Committee Action and, Thus, Has Not Been Proposed in Good Faith

16. The Committee acknowledges that it is in the best interests of the Debtors' estates and their creditors for the Debtors to emerge from chapter 11 as soon as possible. The need to emerge from chapter 11, however, must be balanced against the rights of the Debtors' unsecured creditors and the pending challenges to the validity and enforceability of the Prepetition Secured Lenders' claims and liens. In order to satisfy the good faith requirement of Bankruptcy Code section 1129(a)(3) and ensure fundamental fairness to unsecured creditors, material modifications to the Plan are necessary. These modifications include the following:

- The Committee must have sole authority to select the Litigation Trustee and the members of the Litigation Trust Committee.
- The Litigation Trust must be adequately funded.
- The Litigation Trust should not be required to repay the reasonable and actual costs and expenses associated with the pre-Effective Date investigation and prosecution of the Committee Action. Indeed, the provision regarding repayment of pre-Effective Date fees is an attempt to circumvent the requirements of the Bankruptcy Code that require all allowed administrative expense claims to be paid in full, in cash. *See, e.g., In re Miami Optical Export, Inc.*, 101 B.R. 383, 385 (Bankr. S.D. Fla. 1989) (finding that 1129(a)(9)(A) requires payment of administrative expenses on the effective date of the plan).
- All potential claims arising out of the July Recapitalization and all chapter 5 causes of action should be transferred to and prosecuted by the adequately funded Litigation Trust for the benefit of unsecured creditors. *See In re Fogarty*, 114 B.R. 788, 793 (Bankr. S.D. Fla. 1990) ("A debtor may bring avoidance actions after confirmation of a debtor's plan of reorganization but only if recoveries from such actions benefit unsecured creditors.") (citation omitted).

- The Committee and the Second Lien Lenders should jointly select the members of the New Board and determine new management and otherwise be equally represented in the corporate governance of New TOUSA and the Reorganized Debtors.
- Pending the final outcome of the Committee Action, the corporate governance documents for New TOUSA and the Reorganized Debtors must contain provisions to protect the interests of unsecured creditors as the contingent holders of 100% of the New TOUSA Stock. The governance documents must prevent or limit, absent Bankruptcy Court order or approval of board members appointed by the Committee, among other things: (i) disposal of material assets of New TOUSA and the Reorganized Debtors, (ii) the sale of all or substantially all of the assets of, or liquidation, dissolution, or recapitalization of New TOUSA or any of its subsidiaries, (iii) taking any action that results in a change of control of New TOUSA or a subsidiary; (iv) the incurrence of indebtedness, issuance of any bonds, debentures or notes or incurrence any other debt obligations by New TOUSA or its subsidiaries; (v) the declaring or payment of any distribution on the capital stock of New TOUSA or any of its subsidiaries; (vi) the issuance of additional equity in New TOUSA or the Reorganized Debtors prior to the completion of the Committee Action; and (vii) any other major corporate event that could ultimately impair the unsecured creditors' contingent equity ownership of New TOUSA.
- The terms of the New Notes must be modified to ensure that if the Committee Action is successful, no event of default shall occur in connection with any actions taken in connection therewith including, without limitation, a Change of Control.
- Any amounts to be paid in connection with the New Notes should (i) be placed in escrow⁶ or (ii) be subject to disgorgement and secured by a letter of credit.⁷
- SEC registration rights must be provided to the Litigation Trust and/or the holders of Litigation Trust Interests to ensure that the

⁶ Bankruptcy courts routinely require sale proceeds to be escrowed in circumstances where the property is subject to competing claims. *See, e.g., In re Eagle Pine Prods.*, 284 B.R. 784, 786-87 (Bankr. E.D.N.C. 2001) (permitting sale of property but requiring a disputed lien to attach to the proceeds rather than permit payment); *In re Surplus Furniture Liquidators, Inc.*, 199 B.R. 136, 145 (Bankr. M.D.N.C. 1995) (same); *In re Olympia Holdings Corp.*, 129 B.R. 679, 681 (Bankr. M.D. Fla. 1991) (same).

⁷ The letter of credit approach was adopted in *In re SI Restructuring, Inc. (Wooley v. Faulkner)*, 542 F.3d 131 (5th Cir. 2008). Secured creditors, confident that they would prevail in pending claims litigation, sought cash distributions to reinvest in a new opportunity. *Id.* With the consent of the debtors, the court permitted distributions only after the creditors posted a letter of credit in the entire amount of the payment to be disbursed. *Id.*

New TOUSA Stock distributable to holders of unsecured claims is freely transferable.

- Remedies in respect of the Committee Action should be implemented upon a ruling from the Bankruptcy Court, not following the entry of a Final Order.
- The release provisions in the Plan must be stricken and the exculpation provisions must be modified as set forth in section I.C., below.
- All documents in the Plan Supplement, including without limitation the Litigation Trust Agreement, must be in form and substance acceptable to the Committee.

17. Absent the foregoing modifications, the interests of the Debtors' unsecured creditors are not adequately preserved and the Plan cannot be deemed to have been filed in good faith.

2. The Treatment of Intercompany Claims Under the Plan Evidences a Lack of Good Faith

18. The Plan and Disclosure Statement provide for Intercompany Claims to be treated as General Unsecured Claims and, thus, entitle Debtor entities to receive their pro rata share of cash and Litigation Trust Interests on account of such claims.⁸ The Debtors propose to treat

⁸ The Plan and Disclosure Statement provide the following treatment for the claims of (a) the Subsidiary Debtors against TOUSA; (b) TOUSA against the Subsidiary Debtors; and (c) the Subsidiary Debtors against each other. Specifically, the Plan and Disclosure Statement provide as follows:

- Intercompany Claims of TOUSA against a Subsidiary Debtor will be deemed to be General Unsecured Claims against the applicable Subsidiary Debtor. As such, TOUSA will be entitled to receive Litigation Trust Interests on account of such Intercompany Claims.⁸ Plan at 12, 23.
- Intercompany Claims of Subsidiary Debtors against TOUSA will be deemed to be General Unsecured Claims against TOUSA. As such, the Subsidiary Debtors will be entitled to receive their Pro Rata share of the proceeds of the liquidation of the unencumbered assets of TOUSA. Plan at 7, 18.
- Intercompany Claims of Subsidiary Debtors against other Subsidiary Debtors will be separately classified from General Unsecured Claims against the applicable Subsidiary Debtor. These Subsidiary Intercompany Claims "shall be reinstated, subject to a post-emergence adjustment after the closing of the Litigation Trust, such that each Allowed Subsidiary Intercompany Claim (if any) will be reduced to the amount obtained by multiplying the allowed amount of any such Claim multiplied by the percentage of actual recovery on account of all other General Unsecured Claims against the applicable Subsidiary Debtor." Plan at 25.

Intercompany Claims equally with claims of third parties notwithstanding the fact that, historically, the Debtors failed to keep accurate records of intercompany transactions.⁹ The Debtors' inability to determine with precision whether any Debtor is a net debtor or net creditor with respect to any other Debtor makes it inequitable to treat Intercompany Claims *pari passu* with claims of third parties. Accordingly, in order for the Debtors to satisfy the good faith requirement of Bankruptcy Code section 1129(a)(3), Intercompany Claims must be equitably subordinated to the claims of other unaffiliated creditors under the Plan. *See In re Chase & Sanborn Corp.*, 55 B.R. 451 (Bankr. S.D. Fla. 1985).

19. In *Chase & Sanborn*, the liquidating trustee (appointed by Chase & Sanborn's creditors) filed post-confirmation adversary proceedings to equitably subordinate intercompany claims filed against Chase & Sanborn by two of its affiliated debtors. The two affiliated debtors were (i) Alberto Duque ("Duque"), the owner of the equity in Chase & Sanborn, and (ii) Columbian Coffee, Inc. ("Columbian Coffee"). Available records indicated that Duque, who was an insider of, and owed a fiduciary duty to, Chase & Sanborn, had "co-mingled the credit and assets of several entities which he controlled, including [Chase & Sanborn] and Columbian Coffee, and used those assets to serve his individual purpose without any regard for the interests of unaffiliated creditors of the respective entities." *Id.*

⁹ Schedule G-1 to the Disclosure Statement purports to be "[a] list of the documented loans presently outstanding between Subsidiary Debtors that may give rise to allowed Subsidiary Intercompany Claims." Disclosure Statement at 84. Schedule G-2 sets forth a list of net intercompany account balances, which the Debtors assert may form the basis for the allocation and treatment of Intercompany Claims under the Plan. Disclosure Statement at 84. Notably, the Disclosure Statement does not contain any discussion regarding the circumstances upon which the "Intercompany Loan Agreements" came into existence or the diligence performed by the Debtors to ensure the accuracy of the amounts set forth on Schedule G-1 or G-2. Moreover, there is inadequate disclosure regarding (i) why the intercompany balances on Schedule G-2 are provided on a net basis as opposed to on a debtor-by-debtor basis and (ii) the accuracy of intercompany balances. Indeed, based on Schedule G-2, it is impossible for the Debtors' creditors to determine which Debtor entity the "net account balances" are assertable against.

20. Chase & Sanborn was a net creditor of Duque and other affiliated entities. The Court was unable to determine, however, with any precision how much Chase & Sanborn was owed because Duque had “failed to maintain or preserve an adequate financial record which would enable an independent auditor to certify . . . with acceptable precision that Chase & Sanborn occupied a net creditor situation on the date of bankruptcy with any *individual* affiliate, including Duque.” *Id.* at 454 (emphasis in original).

21. The Court stated that Duque’s commingling of funds and failure to keep adequate financial records was inequitable conduct that “resulted in an injury to the creditors of Chase & Sanborn because it impeded, if not prevented, the establishment of claims against the individual entities.” *Id.* In equitably subordinating Duque’s claims against Chase & Sanborn to the claims of all third party creditors, the Court stated further that “[i]t would be completely inequitable to permit Duque to benefit at the expense of the unaffiliated creditors of Chase & Sanborn from the consequences of his own inequitable conduct.” *Id.* The Court also equitably subordinated the claims of Columbian Coffee against Chase & Sanborn on similar grounds. In so holding, the Court stated that Columbian Coffee also had a fiduciary obligation to Chase & Sanborn and, therefore, its claims “are subjected to rigorous scrutiny and where any of [its] contracts or engagements is challenged the burden is on [the fiduciary] not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.” *Id.* at 454-55 (quoting *Pepper v. Litton*, 308 U.S. 295, 306 (1939)).

22. The facts of Chase & Sanborn are substantially similar to the facts of these cases. TOUSA, as the ultimate shareholder of the Subsidiary Debtors, managed and commingled the credit and assets of the Subsidiary Debtors, but “failed to maintain or preserve an adequate financial record.” Accordingly, TOUSA cannot certify with any precision which Debtors are net creditors, as of the Petition Date, of any individual Debtor affiliate. Thus, absent the Debtors

proving the inherent fairness of treating Intercompany Claims *pari passu* with claims of third party creditors, all Intercompany Claims must be equitably subordinated to the claims of such creditors.

C. *The Release and Exculpation Provisions Render the Plan Unconfirmable*

23. The Plan contains broad release and exculpation provisions for non-debtor third parties that violate applicable law. Specifically, as to non-Debtor parties, the Plan releases, waives, and discharges:

all claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities whether direct or derivative, liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise that are based in whole or in part on any act, omission, transaction, event or other occurrence taking place on or prior to Effective Date in any way relating to the Debtors, the [C]hapter 11 [C]ases, the Plan, or the [D]isclosure [S]tatement, that could have been asserted at any time, past or present or future by or on behalf of the Debtors, or their estates against (a) the current and former members of the Committee and the advisors and attorneys for the Committee, in each case in their capacity as such, (b) the Second Lien Agent, the Second Lien Restricted Lenders and all other holders of the Second Lien Claims and their respective agents, advisors, and professionals in each case in their capacity as such, (c) the Debtors' agents, advisors and professionals employed as of the Petition Date or retained or employed during the Chapter 11 Cases, in each case in their capacity as such, except solely to the extent that any such agent, advisor or professional has executed a tolling agreement with the Debtors preserving the Debtors' rights to pursue certain causes of action (the "Identified Actions") and (d) the Exculpated Parties (all parties identified in subsections (a) through (d), above, the "Plan Releasees").

Plan at 50; Disclosure Statement at 125-26.

24. While the Plan purports to require only the Debtors' estates and their successors, including the Litigation Trust, to release non-debtor third parties, the Plan also contains overly broad exculpation provisions that in essence require third parties to release the Plan Releasees for prepetition and postpetition acts. Indeed, the proposed exculpation provisions would relieve all of the Plan Releasees, plus the Debtors' current and former officers, directors, employees, advisors and representatives, from "any liability to any other entity for any prepetition or

postpetition act taken or omitted to be taken in connection with or related to formulating, negotiating, preparing, disseminating, implementing, administering, confirming or effecting the consummation of the Plan, the Disclosure Statement or any contract, instrument, release or other agreement or document created or entered into in connection with the Plan or any other prepetition or postpetition act taken or omitted to be taken in connection with or in contemplation of the restructuring of the Debtors.” Plan at 50; Disclosure Statement at 127. As drafted, this exculpation could be read to grant broad releases to entities that have potential liability associated with, among other things, the Debtors’ entry into the failed Transeastern joint venture and the July Recapitalization.

25. The Bankruptcy Code does not authorize the release and permanent injunction of claims against non-debtors. *See* 11 U.S.C. § 524(e) (“Except as provided in subsection (a)(3)...discharge of a debt of a debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.”). Courts in this Circuit, however, have held that a debtor can obtain confirmation of a plan of reorganization containing a non-debtor release if the debtor “demonstrate[s] that unusual circumstances exist, and that the non-debtor release is fair and necessary.” *See, e.g., In re Transit Group, Inc.*, 286 B.R. 811, 816 (Bankr. M.D. Fla. 2002) (noting also that “releases [are] the exception, not the norm” and an extraordinary reason for the release must be shown). In order to meet the forgoing test, courts in this Circuit have utilized the following factors: (i) whether an identity of interest exists between the debtor and the third party releasees; (ii) whether the releasees made a substantial contribution of assets to the reorganization; (iii) whether the injunction is essential to reorganization, namely the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (iv) whether the impacted class(es) overwhelmingly vote to accept the plan; (v) whether the plan provides for the payment of all or

substantially all the claims of the class(es) affected by the injunction; (vi) whether the plan provides for claimants to choose not to settle to recover in full; and (vii) whether the Bankruptcy Court made a record of specific factual findings that supports its conclusions. *Id.* There has been no showing that the release and exculpation provisions satisfy the standards for such provisions espoused in this Circuit. Accordingly, the release and related injunction provisions must be severed from the Plan and the exculpation provision must be modified materially in order for the Plan to be confirmed.¹⁰

26. In addition, the Plan seeks to prevent the Debtors, their estates, New TOUSA, the Reorganized Debtors, and the Litigation Trust from pursuing any “claim, obligation, suit, judgment, damages, demand, debt, right or other cause of action” against “any of the current or former representatives, directors, and officers of the Debtors to the extent that such claim exceeds the available insurance proceeds (taking into account payment of defense costs and other obligations) under any applicable D&O Liability Insurance Policy” (the “D&O Injunction Provision”) Plan at 50; Disclosure Statement at 126. The Plan and Disclosure Statement provide no information on the impact that the D&O Injunction Provision may have on the enforceability

¹⁰ The Committee submits that the following modifications are necessary to the exculpation provision:

The Exculpated Parties shall neither have, nor incur any liability to any entity for any ~~prepetition~~ ~~or~~ postpetition act taken or omitted to be taken in connection with, or related to formulating, negotiating, preparing, disseminating, implementing, administering, confirming or effecting the consummation of the Plan, the Disclosure Statement or any contract, instrument, release or other agreement or document created or entered into in connection with the Plan ~~or any other prepetition or postpetition act taken or omitted to be taken in connection with or in contemplation of the restructuring of the Debtors;~~ *provided, however,* that the foregoing provisions of this exculpation shall have no effect on the liability of any entity that results from any such act or omission that is determined in a Final Order to have constituted gross negligence, ~~or~~ willful misconduct ~~or~~ fraud; *provided further,* that each Exculpated Party shall be entitled to rely upon the advice of counsel concerning his, her or its duties pursuant to, or in connection with, the Plan; *provided still further,* that the foregoing exculpation shall not apply to any contingent Claims or to any Causes of Action that ~~is~~ (i) are expressly set forth in and preserved in the Litigation Trust, (ii) constitutes all or part of a Defensive Claim (solely to the extent required for defense of a Litigation Trust Cause of Action) ~~and~~ or (iii) is are expressly set forth in and preserved by the Plan, any Plan Supplement or related documents or Article VIII.F. hereof.

of the D&O Liability Insurance Policies. Absent a written opinion from Debtors' counsel that such injunction does not adversely affect enforcement of the D&O Liability Insurance Policies, the D&O Injunction Provision must be stricken from the Plan.

II. The Disclosure Statement Does Not Provide Adequate Information to Allow Creditors to Make an Informed Judgment When Voting on the Plan

27. A disclosure statement can be approved only if contains adequate information. Bankruptcy Code section 1125 defines "adequate information" as "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 a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan...." 11 U.S.C. § 1125(a)(1).

28. The importance of full and adequate disclosure as required by Bankruptcy Code section 1125 should not be minimalized. Courts repeatedly hold that "[t]he importance of full disclosure is underlaid by the reliance placed upon the disclosure statement by the creditors and the court. Given this reliance, we cannot overemphasize the debtor's obligation to provide sufficient data to satisfy the Code standard of adequate information." *Kunica v. St. Jean Fin., Inc.*, 233 B.R. 46, 54 (S.D.N.Y. 1999) (citing *Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414, 417 (3d Cir. 1988), *cert. denied*, 488 U.S. 967 (1988)); *In re 680 Fifth Avenue Assocs.*, 209 B.R. 314 (Bankr. S.D.N.Y. 1997) (same); *In re Loinel Corp.*, 722 F.2d 1063, 1070 (2d Cir. 1983) (holding that the key to the plan of reorganization is disclosure).

29. The legislative history to Bankruptcy Code section 1125 reveals that the broad standards established by Congress for determining what constitutes adequate information were designed to permit a case-by-case determination of the adequacy of a disclosure statement. S. Rep. No. 95-989 at 121 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5907; *In re Ferretti*, 128 B.R. 16, 18 (Bankr. D.N.H. 1991). Ultimately, what constitutes adequate information in any

particular instance must be determined based on the facts and circumstances presented by each case. *In re Brandon Mill Farms, Ltd.*, 37 B.R. 190, 191 (Bankr. N.D. Ga. 1984); *In re Atlanta West VI*, 91 B.R. at 622; *In re Colorado Mountain Express, Inc. v. Aspen Limousine Serv., Inc.* (*In re Aspen Limousine Serv., Inc.*), 193 B.R. 325, 334 (D. Colo. 1996); *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 694, 696 (4th Cir. 1989). A disclosure statement should, however, set forth all the factors presently known to the plan proponent that bear upon the success or failure of the proposed plan. *In re Scioto Valley Mortgage Co.*, 88 B.R. 168, 170 (Bankr. S.D. Ohio 1988).

30. The Disclosure Statement in its current form is both facially and fundamentally deficient. The Debtors need to revise the Disclosure Statement to respond to and address the following issues:

A. Valuation

- (i) According to the Disclosure Statement, in determining the consolidated Enterprise Value of New TOUSA and the Reorganized Debtors, Lazard utilized the following methodologies: (a) Discounted Cash Flow Analysis; (b) Comparable Company Analysis; and (c) Precedent Transaction Analysis. Despite the utilization of three valuation methodologies, Lazard discloses that its valuation is “predominantly based on the Discounted Cash Flow Analysis due to inherent limitations in the Comparable Company Analysis and the Precedent Transaction Analysis caused by the current operating and market environment in the homebuilding industry.” Disclosure Statement at 144. The Disclosure Statement fails to state how much weight was afforded to the Discounted Cash Flow Analysis as compared to the Comparable Company Analysis and the Precedent Transaction Analysis. In addition, although the Debtors provide that under the Comparable Companies Analysis, (y) observed enterprise values and equity values are commonly expressed as multiples of EBITDA and (z) equity values are periodically expressed as a multiple of tangible book value of equity, there is no disclosure regarding (A) the multiples Lazard used in its Comparable Companies Analysis; (B) whether Lazard used multiples of EBITDA and tangible book value in its analysis; or (C) the weight given to the EBITDA and tangible book value analyses to the extent both were used. Moreover, the Disclosure Statement insufficiently explains why “the current operating and market environment in the homebuilding industry” impose “inherent

limitations” on the Comparable Company Analysis and the Precedent Transaction Analysis, both of which, traditionally, are methodologies used in performing valuations.¹¹ Disclosure Statement at 144.

- (ii) The Plan provides that the First Lien Lenders will receive their Pro Rata share of that portion of the New First Lien Notes transferred to TOUSA from New TOUSA as the TOI Transfer Consideration. Plan at 15. The Disclosure Statement fails to disclose, however, the value of the operating assets and the Encumbered Assets of TOUSA that will be transferred in exchange for the TOI Transfer Consideration. Similarly, the Disclosure Statement does not ascribe a value to the TOI Transfer Consideration. Values for each of the foregoing must be disclosed in order for the Disclosure Statement to have adequate information.
- (iii) The Plan provides that each Second Lien Lender will receive its Pro Rata share of all assets available for distribution upon liquidation of all collateral securing TOUSA’s obligations under the Second Lien Credit Agreement that is not transferred to New TOUSA. Plan at 16. In addition, the Plan provides that holders of unsecured Claims will receive their Pro Rata share of all assets available for distribution upon the liquidation of all unencumbered assets of TOUSA. Plan at 16. The Disclosure Statement, however, fails to disclose with any specificity (i) the collateral that is not being transferred to New TOUSA, (ii) the unencumbered assets of TOUSA or (iii) the value of each of the foregoing. Absent adequate disclosure regarding the asset values, it will be impossible for creditors of TOUSA to estimate their potential recoveries under the Plan.
- (iv) The plan contemplates a complex structure, involving numerous contingencies and 39 separate plans with many claims asserted against multiple Debtors. Plan at 19. The valuation contained in the Disclosure Statement, however, was performed on a consolidated basis. Disclosure Statement at 141. The Debtors should be required to value each Debtor separately for purposes of its “plan.”
- (v) The Disclosure Statement does not include an estimated range of recoveries for unsecured creditors, leaving unsecured creditors with no basis upon which to evaluate distribution scenarios under the Plan. At a minimum, the Disclosure Statement must “give an estimate of what they think those numbers are” and “should give a range so people know what they’re voting for.” *See In re Loral Space & Comm’ns, Ltd.*, Chapter 11 Case No. 03-41710 (RDD), (Bankr. S.D.N.Y. Dec. 6, 2004) Transcript of Hearing, December 6, 2004 at 104.

¹¹ The Committee continues to analyze the valuation methodologies and financial projections underlying the Plan. Accordingly, at this time, the Committee takes no position as to the proper methodology for valuing Enterprise Value and reserves all rights related thereto.

- (vi) The Plan provides that the percentage of total assets available for distribution to creditors of each Subsidiary Debtor will be based on the book value of such Subsidiary Debtor's assets. Plan at 28. Schedule F to the Disclosure Statement [D.E. #2019] purports to provide the book valuation of each Subsidiary Debtor. The Disclosure Statement, however, states that the valuation information on Schedule F is for "illustrative purposes only." Disclosure Statement at 59. As the book value of the Subsidiary Debtors' assets will form the basis for the allocation of New Notes and New TOUSA Stock to each Subsidiary Debtor, absent the disclosure of true valuations for each Subsidiary Debtor, creditors lack sufficient information to determine with any accuracy their projected recoveries at each Subsidiary Debtor.¹²
- (vii) The Disclosure Statement provides an enterprise value range for the Debtors, on a consolidated basis, of between \$349 million and \$448 million. Disclosure Statement at 142. The Debtors provide an equity value range for New TOUSA of between \$184 million and \$283 million. As the Plan contemplates potential deficiency claims with respect to the Prepetition Secured Lenders' Claims, the Debtors must establish midpoint valuation numbers on which the deficiency claims, if any, will be based. The Debtors must disclose these midpoint valuations in the Disclosure Statement.
- (viii) Schedule F contains terms that are undefined making it impossible for creditors to understand the values described in each category. Specifically, the Debtors must define and explain (a) Fixed Assets; (b) Prepaid & Other; (c) Investments in JVs; and (d) Intercompany Receivable Allowance. The Debtors should also be required to disclose whether any of the items included on Schedule F will be written down further and what the impact of such write-downs may be on asset allocation and, thus, recovery allocations.
- (ix) Schedule F provides that the book value of the Debtors, on a consolidated basis, exceeds \$4 billion as compared to the enterprise value range of between \$349 million and \$448 million. The Debtors should be required to explain this vast difference and why the stated book value is an appropriate metric to allocate recoveries.
- (x) Schedule F attributes over \$11 million of goodwill to Newmark Homes, L.P. However, the Disclosure Statement does not explain why Newmark Homes, L.P., unlike any of the other Debtors, maintains goodwill as an asset.

¹² To the extent that the Court determines that book value is an appropriate metric for allocation of New TOUSA Stock and New Notes among the Debtors, the Debtors must use book values as of December 31, 2008 or such other date which will accurately reflect the Debtors' anticipated pre-Effective Date write-downs and provide a more appropriate allocation of value among the Subsidiary Debtors.

B. Intercompany Claims

- (i) The treatment of Intercompany Claims is ambiguous throughout the Plan and Disclosure Statement. For example, the Disclosure Statement provides that “Intercompany Claims could be based upon net account balances.” Disclosure Statement at 84. Without accurate intercompany balances, or at least estimates or ranges upon which creditors can rely, creditors cannot accurately determine the available assets for distribution at each Debtor.
- (ii) Schedules G-1 and G-2 purport to show intercompany balances that are documented in intercompany loan agreements and net intercompany balances for each Debtors, respectively. However, the amounts on Schedules G-1 and G-2 do not correspond to the intercompany balances on Schedule F. For example, on Schedule G-1, TOUSA Homes Mid-Atlantic Investment, LLC shows an intercompany balance of \$7,114,674, but Schedule F reflects no intercompany receivables due to TOUSA Homes Mid-Atlantic Investment, LLC. In fact, on Schedule G-2, not a single Debtor shows a net intercompany balance of \$0, but on Schedule F, 28 Debtors have intercompany receivables of \$0. The Disclosure Statement must clarify the correlation between Schedules G-1, G-2, and F.
- (iii) The Debtors do not provide for the satisfaction of postpetition intercompany claims under the Plan. Disclosure must be made why the Debtors are deferring allocation and satisfaction of such claims which impact the value of each Debtor and, thus, creditor recoveries. Absent allocation of postpetition intercompany claims in connection with the Plan process, certain Debtors will be inappropriately overvalued, while others will be inappropriately undervalued.
- (iv) The Debtors have not allocated ownership of the 2007 Tax Refund which may impact the value of one or more Debtors. Disclosure must be made why the Debtors are not properly allocating such ownership.

C. Disclosures Regarding Potential Litigation Recoveries

- (i) The Plan provides that (a) the Plan Administrator will liquidate the TOI Causes of Action for the benefit of TOUSA’s creditors; (b) the Operating Causes of Action, which includes chapter 5 causes of action shall become assets of the Reorganized Debtors; (c) the Litigation Trustee will prosecute the Litigation Trust Causes of Action; and (d) certain Causes of Action will be released pursuant to the Plan. Plan at 30, 43-44, 50, 51. The Disclosure Statement fails to disclose, however, the nature of any such causes of action and the probability that such causes of action will result in a recovery for creditors. *See In re Malek*, 35 B.R. 443, 444 (Bankr. E.D. Mich. 1983) (all pending or contemplated litigation of whatever nature must be described in detail). Given the Debtors’ failure to list each cause of action with specificity, it is impossible to determine which Debtor’s estate is entitled to the proceeds of such causes of action and the impact on creditor recoveries.

- (ii) The Plan and Disclosure Statement provide that holders of Class 5 Claims of the Subsidiary Debtors (other than Class 5E) will only receive Litigation Trust Interests on account of their Claims. Plan at 22-25; Disclosure Statement at 80-85. These holders should also receive their Pro Rata share of proceeds available on account of unencumbered assets at the applicable Subsidiary Debtors which include proceeds from causes of action (including chapter 5 causes of action) belonging to the applicable Subsidiary Debtor and unencumbered assets.
- (iii) The Plan provides that none of the Debtors, their estates, New TOUSA, the Reorganized Debtors, or the Litigation Trust will pursue any claims against any current or former representative, director, and officer of the Debtors to the extent such claims exceed available insurance proceeds under any applicable D&O Liability Insurance Policy. Plan at 50. The Disclosure Statement does not contain any information as to the existence or extent of such policies. The Disclosure Statement must set forth with clarity any risks to the availability of insurance proceeds and the extent such proceeds have already been disbursed.
- (iv) Under the Plan, the Litigation Trustee and the TOI Plan Administrator are charged with determining “each Debtor’s ownership and share in the proceeds” of the Litigation Trust Causes of Action and TOI Causes of Action, respectively. Plan at 30, 44. The Plan and Disclosure Statement do not explain how such allocation will be made. In addition, the Litigation Trustee should be designated as the fiduciary for the interests of unsecured creditors and should have the right to be heard with respect to all post-Effective Date matters impacting the rights of such creditors.

D. Prepetition Secured Lenders’ Claims

- (i) The Disclosure Statement fails to explain how adequate protection liens granted pursuant to the Cash Collateral Order will be allocated among the Debtors in the event that the collateral held by the Prepetition Secured Lenders is determined to have decreased in value during the period set forth in the Cash Collateral Order. To the extent the Prepetition Secured Lenders are entitled to additional liens on the Debtors’ assets, the Debtors must disclose (a) the extent of diminution of the Prepetition Secured Lenders’ collateral since entry of the Cash Collateral Order and (b) which entity or entities will be subject to additional liens.
- (ii) The Plan contemplates that various claims will be asserted against the Debtors by the Prepetition Secured Lenders. These claims include, (a) certain contingent and unliquidated claims, including those arising under Bankruptcy Code section 502(h), (b) claims sought by the First Lien Lenders in the CitiGroup Complaint, (c) indemnification claims, and (d) claims for default interest. Plan at 4-5, 6, 11, 36; Disclosure Statement at 49. The Disclosure Statement fails to disclose, the basis for such claims, the estimated allowed amounts of such claims and how the successful assertion of such claims will impact recoveries for other creditors. In addition, the Debtors fail to disclose how disgorgement related to claims against any individual Debtors would

impact claims assertable against other Debtors. The Debtors should also be required to disclose that deficiency claims and indemnification claims, if any, cannot be asserted against those Debtors for which it is determined that the Prepetition Secured Lenders' Claims and liens must be avoided.

- (iii) The Plan and Disclosure Statement provide that the First Lien Lenders will only be entitled to default interest "until that point in time" that is determined that they are undersecured. These provisions should be revised to make clear that the applicable time period is the date as of which the First Lien Lenders are deemed to be undersecured, not when a judgment is entered making such ruling.
- (iv) The Disclosure Statement must provide information regarding the existence of an intercreditor agreement among the First Lien Revolver Agent, the First Lien Term Agent and the Second Lien Agent and the effect such agreement may have on, among other things, (a) voting on the Plan and (b) distributions under Plan. For example, the Debtors should be required to disclose (y) whether the Second Lien Lenders can vote in favor of the Plan if the First Lien Lenders vote to reject the Plan and (z) the effect the intercreditor agreement will have on distributions and the estates if the claims and liens of the First Lien Term Lenders are avoided but the claims and liens of the First Lien Revolver Lenders are not avoided (or vice versa).
- (v) In the Committee Action, the Committee seeks, among other things, to equitably subordinate the claims of the Prepetition Secured Lenders. The Disclosure Statement fails to describe the impact of the successful prosecution of such claims on creditor recoveries.
- (vi) The Disclosure Statement must disclose the principal amounts to be issued in respect of the New Notes.
- (vii) The Plan provides that a portion of the interest on the New First Lien Notes will be held in trust by the Litigation Trustee. *See, e.g.*, Plan at 20, 21 (describing a portion of interest payments being held in trust). As currently drafted, the Disclosure Statement is not clear as to what percentage, if any, of interest accruing on the New First Lien Notes will be held in trust.

E. Post-Effective Date Administration

- (i) The Disclosure Statement provides that the Debtors will appoint the TOI Plan Administrator with input from the Second Lien Lenders and the Committee. Disclosure Statement at 89. As the Second Lien Lenders and unsecured creditors will be the beneficiaries of the services provided by the TOI Plan Administrator, the Second Lien Lenders and the Committee should jointly select the Plan Administrator, with input from the Debtors.
- (ii) There is no disclosure with respect to how the TOI Plan Administrator will be governed or why it is not subject to a plan administration agreement and an

oversight committee similar to the Litigation Trustee (*i.e.*, the Litigation Trust Agreement and Litigation Trust Committee).

F. Plan Mechanics and Distributions

- (i) The Plan and Disclosure Statement define New TOUSA Stock as “equity interests in New TOUSA. Plan at 9; Disclosure Statement at 11. The Disclosure Statement must disclose the amount of stock to be authorized and issued under the Plan and the par value of such equity interests. The Disclosure Statement should also disclose whether there will be different classes of stock and, if so, how such stock will be allocated.
- (ii) The Disclosure Statement must contain an explanation as to why TOUSA is being liquidated and New TOUSA is being formed as the new corporate parent.
- (iii) The Plan provides that distributions to holders of claims in Classes Subsidiary Debtors – 5C (Subordinated Noteholders) and Subsidiary Debtors - 5D (PIK Note Claims) are to be placed into escrow, while other creditors receive their distributions outright. Plan at 24. The Disclosure Statement must disclose the reason and authority therefore and why the Debtors have not structured the Plan to provide for 37 series of Litigation Trust Interests with sub-series allocated in respect of (a) Senior Note Claims -- Subseries A, (b) General Unsecured Claims—Subseries B and (c) Subordinated Note Claims/PIK Note Claims-Subseries C, respectively, with distributions made on account of Subseries C interests only after Claims in respect of Subseries A interests have been paid in full. This structure would enable all creditors legally entitled to receive distributions under the Plan to receive such distributions timely.
- (iv) The Disclosure Statement provides that distributions of Litigation Trust Interests among Class 5 Claims will be determined pro rata with reference to all allowed Class 5 Claims against the applicable Subsidiary Debtor. Disclosure Statement at 84. Class 5-E Subsidiary Intercompany Claims should not be included in this calculation because such claims will be equitably subordinated and otherwise will not receive Litigation Trust Interests.
- (v) The Disclosure Statement does not specify whether New TOUSA will be a private company or a public company upon emergence. In the event the New TOUSA Stock is distributed to holders of unsecured claims based on the outcome of the Committee Action, the Disclosure Statement fails to state how New TOUSA, if privately held, will comply with the limitations for a company to qualify as a private company.
- (vi) The Plan provides that the Senior Note Claims, Subordinated Note Claims and PIK Note Claims are “only entitled to recover one satisfaction” for such claims. Plan at 23-24. The Disclosure Statement needs to clarify the meaning of these provisions and state that it does not impede the rights of the holders of such Claims to assert the full amount of their Claims at, and obtain a

recovery from, each Debtor that is liable on account thereof. Similarly, the Plan provides that “in no case shall a holder of a Secondary Liability Claim receive more than one satisfaction of its Allowed Secondary Liability Claim.” Plan at 34. The purpose and effect of such language is unclear and also must be clarified.

- (vii) The Plan provides that the Debtors “reserve the right to effectuate the [dilution or cancellation of the New TOUSA Stock] by issuing one or more classes of securities to the holders of the Second Lien Claims or the Litigation Trust.” Plan at 46. The Debtors must disclose the types of securities to be issued, the impact of the securities on other securities to be issued under the Plan, and the impact of the securities on the terms of the New Notes.

G. Additional Miscellaneous Disclosures Required

- (i) As set forth in the Disclosure Statement, Second Lien Restricted Lenders are entitled to the following benefits: (a) consultation rights with respect to selection of the TOI Plan Administrator; (b) payment of out-of-pocket fees and expenses; (c) releases; and (d) exculpation. Disclosure Statement at 89, 78, 125-26; 126-27. The identities of the Second Lien Restricted Lenders must be disclosed in the Disclosure Statement and the legal authority to provide for the payment of their fees and expenses must be disclosed.
- (ii) The Solicitation Packages must be distributed at least 60 days before the Voting Deadline to give the nominees sufficient time to compile the individual ballots and prepare the Master Ballot.
- (iii) The Disclosure Statement should clearly set forth the meaning and effect of the following definitions: (a) Estate Bank Defenses (Plan at 5); and (b) Defensive Claims (Plan at 4).
- (iv) Article VIII.A of the Plan is titled “Compromise and Settlement.” Plan at 124. The Disclosure Statement, however, does not disclose the nature of any such compromise or settlement in the Plan or the basis thereof. The Disclosure Statement must be modified to include this information.
- (v) The Plan and Disclosure Statement provide that all Claim objections must be filed by the Confirmation Hearing. Plan at 3; Disclosure Statement at 103. The Debtors must accurately disclose by which date Claim objections must be filed in light of the provisions of Local Rule 3007-1(B), which require all Claim objections to be filed no later than 40 days prior to the Confirmation Hearing. The Committee respectfully submits that notwithstanding Local Rule 3007-1(B), the deadline to object to unsecured claims should be extended to a reasonable time following completion of the Committee Action and the associated claims reconciliation process should be lead by the properly funded Litigation Trust.
- (vi) The Disclosure Statement must provide an easily identifiable list of “Released Claims.” While the term is referenced twice in the Disclosure Statement,

there is no clear definition other than “any causes of action released pursuant to the Plan.” Disclosure Statement at 59, 108.

- (vii) The Plan and Disclosure Statement contemplate that Retained Professionals shall file final fee applications for the period from the effective date of their respective retention through the Confirmation Date. Plan at 14; Disclosure Statement at 64. The Disclosure Statement provides that for periods subsequent to the Confirmation Date for which a Retained Professional is entitled to be compensated by the Debtors’ estates, the Debtors “may” pay such Retained Professionals or other parties in the ordinary course of business. Disclosure Statement at 64. There is no disclosure, however, with respect to the criteria that the Debtors will use in determining whether to pay such parties or remedies available in the event that a dispute arises in connection with a request for payment.
- (viii) As the documents to be contained in the Plan Supplement will contain terms material to the governance of New TOUSA and may impact votes on the Plan as well as potential Plan objections, the Plan Supplement documents must be filed well in advance of the currently contemplated 5 Business Days prior to the Voting Deadline. The Debtors should be required to file the Plan Supplement no later than 20 days prior to the Voting Deadline.
- (ix) The Debtors must disclose why the fees and expenses of the Indenture Trustees for the Senior Notes, Subordinated Notes and PIK Notes are not being treated the same. Plan at 22-24.

III. Additional Plan Objections

31. In addition to those provisions that make the Plan patently unconfirmable, the Plan contains a number of other deficiencies and provisions that violate the Bankruptcy Code. The following changes to the Plan must be made prior to the commencement of solicitation to avoid the costs and expense of re-solicitation in the event such objections are sustained at the Confirmation Hearing:

- The Plan provides that the Litigation Trust Interests will not be transferable. Plan at 45. Holders of Litigation Trust Interests must be permitted to transfer such interests in order to maximize value distributed under the Plan.
- The Plan provides that TOUSA’s books and records shall be transferred to New TOUSA and shall be made available to the TOI Plan Administrator for inspection and copying. Plan at 30. The books and records must be made available to the Litigation Trustee, as well especially in light of the fact that New TOUSA will be controlled by the Second Lien Lenders.

- The Plan and the Disclosure Statement provide that that “any assets available for distribution to holders of allowed unsecured claims against TOUSA will first be paid to the TOI Plan Administrator in satisfaction of any expenses incurred pursuant to the Plan,” with any deficiencies to be paid by New TOUSA. Disclosure Statement at 90; Plan at 31. The Debtors do not provide any justification for the allocation of such amounts to unsecured creditors when the TOI Plan Administrator is responsible for liquidating assets in respect of both secured and unsecured claims. The inclusions of this provision evidences a lack of fundamental fairness to unsecured creditors and a further violation of Bankruptcy Code section 1129(a)(3).
- The Plan provides that the Litigation Trust Causes of Action include “all Causes of Action raised by or on behalf of any of the Debtors, including (i) the Fraudulent Transfer Action, (ii) the Preference Action and (iii) any claims or Causes of Action that the Committee or the Litigation Trustee are granted standing to pursue; *provided, however*, that the Litigation Trust Causes of Action shall not include the Excluded Claims.” Plan at 8. The Litigation Trust Causes of Action should include all causes of action arising under chapter 5 of the Bankruptcy Code and any claims against any person or entity arising from, or relating to, the Transeastern JV and the July Recapitalization.
- The Plan provides that “[t]he Litigation Trust and the Litigation Trustee shall be bound by the Plan and shall not challenge any provision of the Plan. Plan at 43. The Litigation Trustee must be permitted to (i) challenge any provision of the Plan inconsistent with the Litigation Trust Agreement and (ii) seek ruling regarding any ambiguous terms of the Plan.
- The Plan provides that the Prepetition Secured Lenders must disgorge all distributions or payments under the Plan made pursuant to the New Notes upon entry of a Final Order with respect to the Litigation Trust Causes of Action. Plan at 45-46. Final Order is defined as, among other things, an order of the Bankruptcy Court not subject to a pending appeal. Disgorgement should be required immediately upon entry of an order of the Bankruptcy Court, with procedures established to return any disgorged distributions upon reversal. Moreover, the Plan must explicitly provide that all payments made on account of the Prepetition Secured Lenders’ Claims, whether prepetition, postpetition or post-Effective Date must be subject to disgorgement. Additional provisions should be provided to specify to which entity (*i.e.*, the Litigation Trust, a Reorganized Debtor or New TOUSA), amounts shall be disgorged and the justification therefore. In addition, detailed procedures must be included in the Plan to ensure that the Prepetition Secured Lenders return amounts required to be disgorged to the proper parties.
- The Plan and Disclosure Statement provide for the dissolution of the Committee after the Effective Date except with respect to “(1) applications

filed pursuant to sections 330 and 331 of the Bankruptcy Code, (2) motions seeking the enforcement of the provisions of the Plan and the transactions contemplated hereunder or the Confirmation Order and (3) pending appeals and related proceedings.” Plan at 54. The Disclosure Statement provides that the Committee will file a notice of dissolution no later than the latest of (i) 30 days after the Effective Date; (ii) 30 days after any appeal of the Confirmation Order pending after the Effective Date terminates or is denied; and (iii) such other date as may be set by the Bankruptcy Court for cause. Disclosure Statement at 130. These provisions do not comport with, among other things, the provisions requiring the filing of final fee application 45 days after the Effective Date and objections 30 days thereafter, each of which the Committee must remain in existence to analyze and, if appropriate, pursue.

- The Plan defines the Senior Note Claims, Subordinated Note Claims and PIK Note claims to include “any claim derived from or based upon” such securities. Plan at 10, 12. This definition is overinclusive and would incorporate claims properly subordinated under Bankruptcy Code section 510(b). Accordingly, the Plan should provide for a class of subordinated claims (in addition to Intercompany Claims) that would include claims of directors and officers for indemnification and claims arising from the purchase or sale of securities.

SUPPLEMENT TO SOLICITATION MATERIALS

32. Pursuant to Bankruptcy Code section 1103(c)(3), the Committee may “advise those represented by [the Committee] of [the Committee’s] determinations as to any plan formulated.” 11 U.S.C. § 1103(c)(3); *see also Texas Extrusion Corp. v. Lockheed Corp. (In re Texas Extrusion Corp.)*, 844 F.2d 1142 (5th Cir. 1988) (member of committee is authorized by section 1103(c)(3) to encourage creditor to vote in favor of plan). Given the Committee’s concerns regarding the Plan and Disclosure Statement described above, the Committee requests that, in the event the Court approves the Disclosure Statement, the Debtors be required to include in the solicitation packages a letter from the Committee setting forth (i) the Committee’s position with respect to the Plan and (ii) a recommendation as to whether creditors should vote to accept or reject the Plan.

RESERVATION OF RIGHTS

33. The Committee continues to analyze the Plan. As such, this Objection is submitted without prejudice to, and with a full reservation of, the Committee’s rights to object to confirmation of the Plan on any basis or to supplement this Objection in the event the Debtors amend or otherwise modify the Disclosure Statement.

CONCLUSION

WHEREFORE, for all the foregoing reasons, the Committee respectfully requests that this Court (i) deny approval of the Disclosure Statement; and (ii) grant the Committee such other and further relief as this Court deems just, proper, and equitable.

Dated: November 8, 2008

Respectfully submitted,

I hereby certify that I am admitted to the Bar of the United States District Court for the Southern District of Florida and I am in compliance with the additional qualifications to practice in this court set forth in Local Rule 2090-1(A).

**STEARNS WEAVER MILLER WEISSLER
ALHADEFF & SITTERSON, P.A.**

By: /s/ Patricia A. Redmond
Patricia A. Redmond (Florida Bar No. 303739)
150 West Flagler Street
Miami, Florida 33130
Telephone: (305) 789-3553
Facsimile: (305) 789-3395

-and-

We hereby certify that the undersigned attorneys are appearing pro hac vice in this matter pursuant to Court orders dated February 27, 2008 and March 3, 2008.

AKIN GUMP STRAUSS HAUER & FELD LLP

Daniel H. Golden (New York Bar No. 1133859)
Philip C. Dublin (New York Bar No. 2959344)
One Bryant Park
New York, NY 10036
Telephone: (212) 872-1000
Facsimile: (212) 872-1002

*Co-Counsel to the Official Committee of Unsecured
Creditors of TOUSA, Inc., et al.*