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ATTORNEYS FOR BEARTOOTH ELECTIC COOPERATIVE, INC.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

In re SOUTHERN MONTANA ELECTRIC GENERATION AND TRANSMISSION COOPERATIVE, INC. Debtor.	))))))))	Case No. 11-62031-11 **NOTICE OF HEARING** **Date: September 24, 2013** **Time: 1:30 PM** **Location: Federal Courthouse** **2601 2nd Avenue North** **Billings, Montana**

OBJECTION OF BEARTOOTH ELECTRIC COOPERATIVE, INC. TO ENTRY OF AN ORDER APPROVING DISCLOSURE STATEMENT FOR TRUSTEE'S SECOND AMDENDED PLAN OF REORGANIZATION FOR SOUTHERN MONTANA ELECTRIC GENERATION AND TRANSMISSION COOPERATIVE, INC.

Beartooth Electric Cooperative, Inc. ("BEC"), as a creditor and member of Southern Montana Electric Generation and Transmission Cooperative, Inc., ("Debtor") and as a party in interest, by and through its counsel of record, hereby objects to entry of an order approving the Debtor's *Disclosure Statement for Trustee's Second Amended Plan of Reorganization for Southern Montana Electric Generation and Transmission Cooperative, Inc.* [docket 1018] (the "Disclosure Statement"). As discussed below, BEC objects to the Disclosure Statement because (i) the Disclosure Statement fails to provide adequate information as that term is defined in 11 U.S.C. § 1125(a)(1), and (ii) the *Trustee's Second Amended Plan of Reorganization for Southern*

Montana Electric Generation and Transmission Cooperative, Inc. [docket 1017] (the "Plan") that the Disclosure Statement describes is not capable of being confirmed.

In support of this Objection, BEC states as follows:

PERTINENT PROCEDURAL HISTORY

1. On September 12, 2013, the Trustee filed the Plan and Disclosure Statement.

2. The Court set a hearing to consider the adequacy of the Disclosure Statement, for September 24, 2013, at 1:30 PM, and has established September 18, 2013, as the deadline for filing objections to the Disclosure Statement.

3. The Trustee identifies BEC as an unsecured creditor under Class 6 and an interest holder under Classes 8 and 9.

BEC'S OBJECTIONS TO THE DISCLOSURE STATEMENT

4. Having reviewed the Disclosure Statement and the Second Amended Plan, BEC submits that the Court should not approve the Disclosure Statement because it does not contain adequate information as that term is defined in Section 1125(a)(1) of the Bankruptcy Code and because the Plan cannot be confirmed.

I. The Court Should Not Approve the Disclosure Statement Where It Fails to Provide Adequate Information under Section 1125 of the Bankruptcy Code.

5. The pertinent part of Section 1125 of the Bankruptcy Code states:

> An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written statement approved, after notice and a hearing, by the court as containing adequate information.[1]

6. Section 1125 further defines "adequate information" as:

[1] 11 U.S.C. § 1125(b).

> 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, 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 claims or interest 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 the creditors and other parties in interest, and the cost of providing additional information..[2]

7. Section 1125 further defines an "investor typical of holders of claims or interests of the relevant class" to mean an investor having (i) a claim or interest of the relevant class, (ii) a relationship with the debtor as the holder of the claim or interest of the relevant class generally have, and (iii) the ability to obtain information from sources other than the disclosure statement as the holder of the claim or interest of the relevant class.[3]

8. The standard for determining whether a plan proponent has provided the "adequate information" required under § 1125 is "whether hypothetical reasonable investors receive such information as will enable them to evaluate for themselves what impact the information might have on their claims and the outcome of the case, and to decide for themselves what course of action to take."[4] According to the legislative history to section 1125 of the Bankruptcy Code, "the disclosure statement was intended by Congress to be the primary source

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[2] 11 U.S.C. § 1125(a).

[3] *Id*.

[4] *In re Ferguson*, 474 B.R. 466, 471 (Bankr. D.S.C. 2012) (quoting *In re Applegate Prop., Ltd*., 133 B.R. 827, 831 (Bankr. W.D. Tex. 1991)); *see also Nelson v. Dalkon Shield Claimants Trust (In re A.H. Robins Co.)*, 216 B.R. 175, 180 (Bankr. E.D. Va. 1997) (adequate disclosure "is designed to provide information to creditors to permit them to determine whether to vote for or against the plan ... It plays a pivotal role in the give and take among creditors and between creditors and the debtor that leads to a confirmed negotiated plan of reorganization by requiring adequate disclosure to the parties so they can make their own decisions on the plan's acceptability"); *In re United States Brass Corp.*, 194 B.R. 420, 423 (Bankr. E.D. Tex.1996) ("The purpose of the disclosure statement is not to assure acceptance or rejection of a plan, but to provide enough information to interested persons so they may make an informed choice between two alternatives").

of information upon which creditors and shareholders would make an informed judgment about a plan of reorganization."[5] "[T]he importance of full disclosure and honest disclosure is critical and cannot be overstated."[6]

9. The determination of whether the disclosure statement contains adequate information is made on a case-by-case basis.[7] However, bankruptcy courts have identified a number factors "which may be mandatory, under the facts and circumstances of a particular case, to meet the statutory requirement of adequate information":

> '(1) the events which led to the filing of a bankruptcy petition; (2) a description of the available assets and their value; (3) the anticipated future of the company; (4) the source of information stated in the disclosure statement; (5) a disclaimer; (6) the present condition of the debtor while in Chapter 11; (7) the scheduled claims; (8) the estimated return to creditors under a Chapter 7 liquidation; (9) the accounting method utilized to produce financial information and the name of the accountants responsible for such information; (10) the future management of the debtor; (11) the Chapter 11 plan or a summary thereof; (12) the estimated administrative expenses, including attorneys' and accountants' fees; (13) the collectability of accounts receivable; (14) financial information, data, valuations or projections relevant to the creditors' decision to accept or reject the Chapter 11 plan; (15) information relevant to the risks posed to creditors under the plan; (16) the actual or projected realizable value from recovery of preferential or otherwise voidable transfers; (17) litigation likely to arise in a nonbankruptcy context; (18) tax attributes of the Debtor; and (19) the relationship of the debtor with affiliates.'[8]

Courts have recognized that even all of those factors are not always sufficient.[9] In every case, the disclosure statement must provide information "essential for a party weighing the creditability and merits of the plan," and "must contain factual support of the opinions contained

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[5] *In re Jeppson*, 66 B.R. 269, 291 (Bankr. D. Utah 1986). *See also In re Point Wylie Co*., 78 B.R. 453, 460 n. 6 (Bankr. D.S.C. 1987); *In re Galerie Des Monnaies of Geneva, Ltd*., 55 B.R. 253, 259 (Bankr. S.D.N.Y. 1985).

[6] *In re Radco Props., Inc*., 402 B.R. 666, 682 (Bankr. E.D. N.C. 2009).

[7] *In re Reilly*, 71 BR 132, 135 (Bankr. D. Mont. 1987)

[8] *Id.* at 134 (quoting *In re Metrocraft Pub. Service Inc*., 39 B.R. 567, 568 (Bankr. N.D. Ga. 1984)); *see also In re Scioto Valley Mortgage Co.*, 88 B.R. 168, 170-71 (Bankr. S.D. Ohio 1988)

[9] *Id. at* 134.

in the disclosure statement."[10] In this case, BEC asserts that the Disclosure Statement fails to provide meet the *Reilly* factors or otherwise provide adequate disclosure.

A. Factors that Led to the Filing of Bankruptcy.

10. At no point does the Trustee mention the discord and impasse that existed in the pre-petition Debtor's board of trustees, which, to a greater or lesser extent, continues. BEC has been outspoken in its desires to terminate its relationship with the Debtor and to cease being a business partner with the Debtor's members. BEC understands that all of the Debtor's current members have no desire to be members of the Debtor under the Plan.

B. Factual Support of Opinions Contained in the Disclosure Statement.

11. The Disclosure Statement includes the opinion that the Plan provides "reasonable rates to the Debtor's members for at least the next decade."[11] The Disclosure Statement does not provide any factual basis for the Trustee's opinion that the proposed rates are reasonable. What is the Trustee's comparison or baseline to determine reasonability, particularly given that market rates are at a historic low? Is the Trustee's comparison valid?

12. The Trustee also "believes that the Debtor's rates to its members under the Plan will be as low or lower than the rates that they would pay if they were to join another G & T cooperative."[12] The Trustee does not provide any facts to support this opinion. What are the rates of other distribution cooperatives and other G & T cooperatives, both in-state and out-of-state? How do the proposed rates under the Plan compare to the rates of public utilities?

13. Regarding the proposed rates, the Trustee further opines that the Debtor's members and "their members as the ultimate rate payers, are significantly benefited by the

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[10] *Id*. at 134-35 (quoting *In re Fierman*, 21 B.R. 314, 315 (Bankr. E.D. Pa. 1982).
[11] Disclosure Statement at "Summary of the Plan".
[12] *Id.* at § VII.A.4.

Trustee's Plan."[13] Again, the Trustee does not provide any relevant factual support of his opinion. Rather, in support of this allegation, he references a Financial Forecast prepared by Douglas Wilson & Co. P.C. in December 2009. However, the Trustee (i) fails to include a copy of the Financial Forecast with the Disclosure Statement; (ii) fails to discuss the facts and assumptions underpinning the Financial Forecast, including the source of the information, the economic environment in 2009, and the energy industry in 2009; (iii) fails to articulate how the Financial Forecast—particularly the rate forecast on which the Trustee relies—is relevant today[14]; and (iv) fails to identify and discus any limitations or faults of the Financial Forecast, including an relationship between the Debtor and Douglas Wilson & Co. P.C.

14. Next, one cornerstone of the Plan is the agreement under which Morgan Stanley Capital Group Inc. ("MSCGI") will provide power to the Debtor (the "MSCGI Agreement").[15] The Trustee assumes that the Debtor's members' demand for power will increase over the term of the MSCGI Agreement at a rate of 0.5% per year every year and that the MSCGI rate for power will increase annually by 2.0%.[16] These assumptions are lynchpins to the success of the Plan. The Trustee does not provide any factual basis for either of these vital assumptions, such as a load trend analysis containing at least five years of data for each of the Debtors' remaining members and a market analysis of long-term market rate projections.

C. Future Management of the Debtor.

15. As is discussed below in Section II of this Objection, the Trustee fails to disclose the management of the Debtor, including the name of the manager, the terms of his employment,

[13] *Id.* at § III.B.9.
[14] *Id*. at § III.C.
[15] *Id*. at §§ IV.R.2 and V.A (the MSCGI Agreement is one of the cornerstones to the Amended Plan.
[16] *Id*. at Exh. 2, Part 1, p. 1.

and the manager's qualifications. Moreover, the Trustee declares that he intends to amend the Debtor's Articles of Incorporation, Bylaws, and other governance documents (the "Corporate Governance Agreements").[17] The Corporate Governance Agreements set forth the rights and duties of members and trustees and provisions for regulating and managing the Debtor's affairs.[18] The Trustee omitted how he intends to alter the fundamental rights and duties of the members and how the Debtor's regulation and management will change.

D. Financial Information and Data Relevant to Decision to Accept or Reject the Plan.

16. The Trustee fails to provide the following financial information and data relevant to BEC's decision to accept or reject the Plan[19]: (i) financial statements (particularly a profit and loss statement and statement of cash flows) with the revenues and costs of YVEC and Great Falls/ECP stripped out; (ii) the effect of WAPA rates on the Plan rate; (iii) costs of transmission; and (iv) the manager, maintenance and management costs and fees, and interest rate of the "Credit Enhancement Fund" identified in Exhibit 2, Part 1 of the Disclosure Statement and who will receive the benefit of the interest thereon.

17. The Trustee entirely omitted any discussion as to why retaining the Highwood Generating Station ("HGS") is preferable to either surrendering HGS to the secured creditors or selling HGS. Typically, a business will determine whether to retain or dispose of an asset by calculating the value of retaining the asset over a relevant horizon and then comparing that value to the value derived from disposal and the opportunity costs. This almost always includes

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[17] *Id*. § V.C.4.

[18] Mont. Code Ann. § 35-18-203, -207.

[19] The Trustee has an obligation to "furnish such information concerning the estate and the estate's administration as is requested by a party in interest." 11 U.S.C. § 740(7). Section 1106(a)(1) of the Bankruptcy Code describes the duties of the Trustee and incorporates Section 704(7). *See In re Scott*, 172 F.3d 959, 967 (7th Cir. 1999).

financial analysis (e.g., net present value of cash flows, return on investment, etc.) The Trustee proposes that the Debtor retain HGS without disclosing any reasons and without any financial analysis of the benefit provided to the Debtor and its members.

18. The Trustee has also failed to disclose any non-financial problems associated with owning and operating HGS. BEC understands that HGS can only operate at a faction of its stated capacity and is not configured to provide peaking and firming power or to meet emergency demand. BEC further understands that, under current market conditions, the Debtor cannot economically dispatch HGS. Furthermore, the Trustee asserts that there are a number of Federal, state, and local environmental permits and requirements that are applicable and "have been addressed/or will be triggered by further operation of HGS"[20] but does not identify what those are, how they have been addressed, what is the projected cost of ongoing compliance, or what is the risk of regulatory non-compliance.

E. Information Relevant to Risks Posed under the Plan.

19. The Trustee's discussion of risks, contained entirely in Section VI, posed under the Plan is wholly inadequate. The Trustee fails to identify any substantive risks at all, leading to the erroneous conclusion that there are no risks. There are plenty of risks posed under the Plan. For example, what will happen if the Debtor's members' loads decrease in the fact of ever increasing rates? BEC understands that Fergus represents approximately fifty percent of the Debtor's current load and that sixty percent of Fergus's load is provided by three industrial users, including a coal mine that makes up forty percent of Fergus's load. If the coal mine fails to

[20] Disclosure Statement § II.B.6.

renew its contract or, in light of the coal regulatory environment[21], significantly curtails its operations or shuts down, then Southern will lose up to twenty-percent of its load. Other risks that the Trustee omitted include: (i) the historical enmity among the Debtor's members; (ii) the desire of at least BEC to terminate its membership in the Debtor; (iii) the potential Federal and state tax issues that may arise because of the membership of Great Falls/ECP;[22] and (iv) the environmental and financial risks with owning and operating HGS.

F. Terms of Settlement Agreement with the Noteholders.

20. The Trustee fails to disclose the terms of the settlement agreement between the Trustee and the Noteholders. Given that the proposed settlement agreement essentially is the Plan, the Trustee should disclose the settlement agreement in its entirety, not just a summary of the terms.[23] The undisclosed, critical information includes the following: the reasonableness of the proposed interest rates; the amount of and source of the set aside for working capital; identifying the claims to be assigned to the unsecured creditors and the expected value of those claims, and the amount of and source of the carve out for the unsecured creditors.

G. Guarantees of MSCGI Agreement by Members.

21. The Plan, particularly the cornerstone MSCGI Agreement, requires the members to guarantee payment and/or performance of the MSCGI Agreement. The Trustee has failed to disclose and discuss (i) the statutory impediments to provision of such guarantees (e.g., Montana

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[21] *See id.* at "Summary of Plan" ("the Debtor will be able to retain [HGS] in an environment in which coal-fired plants across the country are being shut down or scheduled to shut down due to environmental issues …")

[22] It is questionable whether Great Falls/ECP could be a member of Debtor. If it could not, then there may be a claim that the Debtor could not be a rural cooperative under Federal or state law and did not qualify as a not-for-profit. What are the potential tax implications, if any?

[23] *See In re Fullmer*, 62 CBC2d 1023, 2009 Bankr. LEXIS 2428 (Bankr. N.D. Tex. 2009) (holding that the importance of a settlement agreement to the case necessitates its comprehensive disclosure.)

law provides that cooperative members is not personally liable for the debts of the cooperative;[24]) the regulatory impediments to provision of such guarantees (e.g., approval of the guarantees may be subject to RUS approval and state regulatory approval) and the proposed terms of such guarantees.

H. Regulatory Approval of Rates and Rate Increases.

22. Under BEC's 2007 Wholesale Power Contract with the Debtor (the "WPC") the "RUS Administrator" must approve all rate increases before such rate increases become effective. The Plan requires rate increases each year as high as seven percent and averaging over two and one half percent during the term of the Plan. The Trustee has discussed neither whether the RUS must and will approve the proposed rate increases nor, if not approved, what is the effect on the Plan.

I. Plan Supplement.

23. The Trustee proposes that substantial critical information will be disclosed in a Plan Supplement to be filed at least five days before plan confirmation. The Plan Supplement will include at least the proposed amendments to the Corporate Governance Agreements, proposed revisions the Notes, Indenture, Collateral Agency Agreement, and any other documents evidencing the Debtor's obligations to the Noteholders and First Interstate Bank, and potential distributions. This information must be included in the Disclosure Statement.

J. Other Material Misrepresentations and Omissions.

24. Finally, the Disclosure Statement contains a number of misrepresentations and omissions, including: that the Debtor, through its members, serves 50,000 Montanans instead of saying it serves 11,364 members[25]; the rates charged by the Debtor as of January 1, 2009, and

[24] Mont. Code Ann. § 35-18-302.

[25] Disclosure Statement § III.B.1.b.

after each rate increase[26]; that the rates increased from January 2009 to June 2011 by 43.7% when they increased by over 53%[27]; that BEC's timely filed adversary proceeding disputes that the "Cash Collateral Order also served as a final determination as to the validity of the Noteholder's liens on substantially all of the Debtors assets…";[28] and the content of the Nancy Temple Report and Eide Bailly, LLP's forensic audit.[29]

II. The Court Should Not Approve the Disclosure Statement Where the Plan It Describes Is Not Confirmable.

25. It is well-settled that the Court should not approve a disclosure statement under Section 1125 of the Bankruptcy Code when the plan it describes is not capable of being confirmed.[30] For the reasons discussed below, BEC objects to approval of the Disclosure Statement because the Plan it describes is not capable of being confirmed. Accordingly, BEC submits that the Court not approve the Disclosure Statement to avoid the Trustee from expending valuable estate assets soliciting votes and seeking confirmation of the Plan.

26. The Court may confirm the Plan only if it satisfies all of the requirements set forth in Section 1129(a) of the Bankruptcy Code. Those requirements include the following:

> (5)(A) (i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, …
>
> (ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

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[26] *Id*. at § III.B.9.

[27] *Id*.

[28] *Id*. at § IV.K.

[29] *Id*. at § IV.U. Nancy Temple has had over eighteen months to complete her report. The information contained in the report—particularly what claims the Debtor may have and what potential claims third parties may have against the Debtor—are material to Plan confirmation.

[30] *See In re Tex. Extrusion Corp*., 844 F.2d 1142, 1157 (5th Cir. 1988), *cert. denied*, 488 U.S. 926 (1988).

(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided in the plan, or such rate change is expressly conditioned on such approval.[31]

BEC submits that the Plan fails to meet the requirements set forth in Section 1129(a)(5) and (6).

A. The Plan Fails To Make the Required Management Disclosures.

27. The Plan fails to disclose the identity and affiliations of proposed directors and officers and fails to discuss whether the appointment of such individuals is consistent with the interests of the Debtor's creditors and members and with public policy. With regard to management, the Plan simply states:

> **5.4 Management**. Upon the occurrence of the Effective Date, Reorganized Southern will be operated by substantially the same personnel that and [sic] operated the Debtor prior to the Confirmation Date, subject to such changes that may be made based upon and in accordance with the Corporate Governance Agreements after the Effective Date, and such individuals shall be identified at or before the Confirmation Hearing.
>
> **5.5 Board of Trustees**. On the Effective Date, the Board of Trustees of Reorganized Southern shall be comprised of the individuals who currently hold such positions on behalf of the Members, specifically, Arleen Boyd, David Dover, DeeDee Isaacs, and Jim DeCock, and such other and additional individuals as may be identified at or before the Confirmation Hearing, or as otherwise may be required by law.[32]

28. As noted in Section I.B. above, the Trustee omits entirely to disclose a manager, which he proposes to name at a later date. The Trustee has not disclosed the identity and affiliations of the "additional individuals" that may serve as trustees. In fact, in light of the fact that the Trustee has not disclosed his proposed amendments to the Corporate Governance Agreements, it is entirely uncertain what managers, officers, and trustees have to be identified.

[31] 11 U.S.C. § 1129(a).

[32] Plan §§ 5.4-5.5.

B. The Plan Fails To Discuss Regulatory Approval of any Rates.

29. The Plan fails to discuss regulatory approval of any rates proposed under the Plan. The Trustee proposes to assume the WPC. It is axiomatic that the Trustee must assume the WPC in its entirety.

30. Under the WPC, the RUS Administrator must approve all rate increases proposed by the Debtor. Any rate increase is ineffective until the RUS Administrator approves the rate increase.

31. The Trustee's failure to disclose either approval by the RUS administrator of the rate increases set forth in the Plan or that such rate increases are subject to RUS administrator approval is a fatal deficiency in the Plan. The Plan cannot be confirmed and, therefore, the Court should not approve the disclosure statement.

CONCLUSION

In light of the above, the Disclosure Statement does not provide adequate information; that is to say, it does not provide information essential for a hypothetical party in the members' class to weigh the creditability and merits of the Plan and to make an informed judgment how to act on the Plan. In fact, the Plan is facially deficient and cannot be confirmed. Therefore, Beartooth Electric Cooperative, Inc., respectfully requests that the Court deny approval of the Disclosure Statement.

Dated this 18th day of September 2013.

FELT, MARTIN, FRAZIER & WELDON, P.C.

/s/ Martin S. Smith

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CERTIFICATE OF SERVICE

The undersigned does certify under penalty of perjury that on September 18, 2013, a true copy of the foregoing document was served electronically by the Court's ECF notice to all parties requesting special notice or otherwise entitled to the same. The undersigned does further certify that service by mailing a true and correct copy, first class mail, postage prepaid, was made to the following parties: NONE.

FELT, MARTIN, FRAZIER & WELDON, P.C.

/s/ Martin S. Smith

By: Martin S. Smith

Attorneys for Beartooth Electric Cooperative, Inc.