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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

In re: **SOUTHERN MONTANA ELECTRIC GENERATION AND TRANSMISSION COOPERATIVE INC.** Debtor.	Case No. 11-62031

MOTION TO CONVERT TO CHAPTER 7 AND SUPPORTING MEMORANDUM

Fergus Electric Cooperative, Inc. and Beartooth Electric Cooperative, Inc. (the "Movants") move for an order converting this case to a case under Chapter 7 of the Bankruptcy Code pursuant to 11 U.S.C. § 1112(b).

Introduction

Southern filed a voluntary Chapter 11 case some 26 months ago. To date, no plan has been confirmed. While the Court "reluctantly"[1] approved the former Trustee's disclosure statement, that has become dated and Movants are informed that Southern – the heir apparent to the Trustee's plan and disclosure statement – intends to move to strike it and the Trustee's plan. Thus, there is effectively no approved disclosure statement.

While the Noteholders and Trustee did not diligently seek or obtain plan approval in the past 2 years, they and their professionals have billed the Estate for over $6 million[2] and the Noteholders have received tens of millions in adequate protection payments.[3] Meanwhile, Southern loses money. According to the operating reports, and excluding the non-recurring settlement payments from YVEC and Great Falls, in the period May through November of 2013, inclusive, Southern has experienced: Net Losses of $6.7 million; and Net Cash Flow of negative $9.8 million. *See* Exhibit 4 hereto. Moreover, during the same period, and even counting one of the $2.5 million settlement payments (the other is built into the starting cash balance on May 31), Southern's Cash Balance has decreased by over $5 million. *Id.*

It is bad enough that Montana families, businesses, and ranchers are footing the bill for all of this; it becomes intolerable when the entire effort (and expense) is for naught because no

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[1] *See* Memorandum of Decision, Doc. 1159, p. 12.

[2] Doc. 1159 at 16. That rate of expenditure seems unfathomable until one looks at a single example: the October 2013 Rule 2004 examination of Arlene Boyd. The Trustee allegedly sought that examination because of perceived violations of 11 U.S.C. § 1125(b) (solicitation of votes before disclosure statement approval) because Beartooth had communicated with its members. *See* Doc. 1003. Leave aside the hypocrisy in the fact that the Trustee, himself, had been extensively quoted in the newspaper on the merits of his plan. *See, e.g.*, Exhibit 1 hereto. The Trustee, his counsel, the Noteholders, and their financial advisors all attended. The latter three seek almost $60,000 for that effort, s*ee* Exhibit 2 hereto, not counting the Trustee's charges. Fergus wrote to the Trustee, imploring him not to continue to waste money. *See* Oct. 8, 2013 letter, Gardner to Parks (Exhibit 3, hereto). Parks reacted, not by acting frugally, but by charging the Estate to ponder whether Gardner's letter was a criminal act and plowing ahead with the examination. *See* Doc. 1154-3, p. 11 of 21 (first entry under 10/9/13 heading).

[3] Perhaps the Noteholders have not pushed this case because they know the wholesale power contracts are not assumable and the ongoing adequate protection payments are more than they will get once the issues are resolved.

plan of reorganization can be confirmed.

As the debtor in possession in a voluntary proceeding which has not been previously converted, Southern has an absolute right to convert. *See* § 1112(a); *see also* West, Bankruptcy Code, Rules and Forms, p. 284 ((2013 ed.) (Revision Notes and Legislative Reports: "Subsection (a) gives the debtor an absolute right to convert . . ."); 5 Collier on Bankruptcy, § 1112.03, pp. 1112–10 (15th ed.) (debtor has "an absolute right to convert" (citing H.R.Rep. No. 595, 95th Cong., 1st Sess. 405 (1977); S.Rep. No. 989, 95th Cong., 2d Sess. 117 (1978)); Norton Bankruptcy Law and Practice 3d, § 103:1 (speaking of the three preconditions of § 1112(a) which may prevent "automatic conversion" and referring to debtor's "absolute right to convert the case to chapter 7"); *Matter of Texas Extrusion Corp*., 844 F.2d 1142, 1161 (5th Cir. 1988) ("[a] debtor has the absolute right to convert his or her chapter 11 case to a chapter 7 case"); *In re Schuller*, 119 B.R. 191, 192 (Bankr. W.D.Mo. 1990) (refusing to address whether to convert for the benefit of the debtor or dismiss for the benefit of the creditor by "the simple expedient of following the law" in that § 1112 provides the debtor with "an absolute right to convert"); and *In re Dieckhause Stationers of King of Prussia, Inc*., 73 B.R. 969 (Bankr. E.D. Penn. 1987) (rejecting argument that court should deny conversion as not in best interests of creditors because § 1112(a) "by its terms, gives the debtor an absolute right to convert . . .").

But, Fergus and Beartooth are not Southern. Southern has its own board and its own counsel. One day, it may decide to exercise its absolute right. In the meantime, Fergus and Beartooth are "parties in interest" and bring this motion under § 1112(b) to advance their primary goal of dissolving Southern.

Like each and every member of Southern, Movants want Southern liquidated. While Movants have cooperated with the other Members in their preference for an orderly liquidation under Chapter 11, Movants have become increasingly less concerned with how liquidation is accomplished, whether by a Chapter 11 plan or conversion to Chapter 7.[4] They do not want the passage of time, the lack of a motion, or other events, to jeopardize liquidation.

Movants do not withdraw their joinder in the plan of liquidation, and intend to continue to cooperate with the other Members in amendment of the plan and related disclosure statement. Nonetheless, as to the Movants, that is the less preferred alternative. Fergus and Beartooth prefer that the Court grant this motion, and they remain joined in the liquidation plan only in the alternative. To be clear: Fergus and Beartooth[5] ask the Court to convert this case to one under Chapter 7, but if the Court denies this motion, they ask it to confirm the Members' plan of liquidation.

Argument

The issue is whether the contracts – both the wholesale power contracts and the membership contracts – can be assumed and assigned. If not, no plan of reorganization is remotely possible, and every passing day is just a waste of money squeezed from Montana ratepayers. While it may seem odd to address this dispositive issue prior to a plan confirmation hearing, it would be even stranger to continue to ignore the elephant in the room.

I. STANDARD FOR CONVERSION.

Unless it identifies unusual circumstances that establish that conversion or dismissal is not in the best interest of creditors and the estate, a court must convert a Chapter 11 case to a Chapter 7 case, or dismiss the case (whichever is in the best interests of creditors and the estate), if the movant establishes "cause." Section 1112(b)(4) contains a non-exclusive list of factors to

[4] Seems the Members cannot even reach consensus on how to go out of existence, which certainly bodes ill for a decade or more of forced continuation under a plan of reorganization.

[5] Tongue River and Mid-Yellowstone will have to speak for themselves – whether they join this motion, oppose it, or express no opinion.

consider in determining whether there is cause. Some factors pertinent to this motion include:

> (A) Substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation; . . . and
>
> (J) Failure to file a Disclosure Statement, or to file or confirm a Plan, within the time fixed by this title or by order of the court . . .

In addition, conversion is appropriate when there is no reasonable prospect for a reorganization of the debtor. *In re American Capital Equipment, LLC*, 688 F.3d 145, 161 (3rd Cir. 2012), explained that "Section 1112(b) provides a **nonexhaustive list** of grounds for finding 'cause' to convert or dismiss." (Emphasis added). "[A[court may also find cause where there is not 'a reasonable possibility of a successful reorganization within a reasonable period of time.'" *Id*. at 162 (quoting *In re: Brown*, 951 F.2d 564, 572 (3rd Cir. 1991)). In making this determination, the Court need not force the parties to incur the time and expense of a confirmation hearing if, for example, at the disclosure statement hearing, it is obvious that reorganization is impossible:

> [I]f it appears there is a defect that makes a plan inherently or patently unconfirmable, the Court may consider and resolve that issue at the disclosure stage before requiring the parties to proceed with solicitation of acceptances and rejections and a contested confirmation hearing.

Id. at 154 (quoting *In re Larsen,* No. 09-02630, 2011 WL 1671538, at *2 n. 7 (Bankr.D.Idaho, May 3, 2011).

> The rationale is that the court's equitable powers under 11 U.S.C. § 105 "surely enable it to control its own docket" and thus, a "[c]ourt [should] not proceed with the time-consuming and expensive proposition of hearings on a disclosure statement and plan when the plan may not be confirmable because it does not comply with [confirmation requirements]."

Id. (quoting *In re Kehn Ranch, Inc*., 41 B.R. 832, 832-33 (Bankr.S.D. 1984)).

American Capital Equipment affirmed a bankruptcy court which found the plan unconfirmable at the disclosure hearing stage and converted to Chapter 7.

> [W]here 'repeatedly unsuccessful attempts at confirmation are likely to generate enormous administrative costs, often without increasing the likelihood of success, § 1112(b) recognizes the court's ability to curtail the process through the ultimate conversion or dismissal of the case[,]' and to make sure the plan 'does not outlive the likelihood of its usefulness.'

Id. at 162 (quoting *In re Rand,* No. AZ-10-1160, No. 07-06801, 2010 WL 6259960, at *5 (9th Cir.BAP, Dec. 7, 2010).

Conversion is appropriate because Southern cannot be reorganized. There is no need to force the single mother in Lewistown and the retired grandmother in Red Lodge to pay another million dollars to get to the same place.

II. REORGANIZATION IS NOT POSSIBLE.

In a nutshell, any plan of reorganization, whether the Noteholders' (Doc. 1185) or the Trustee's (Doc. 1048), is doomed because:

- It necessarily depends upon assumption of two distinct but related non-assumable contracts: the Members' membership contracts and their wholesale power contracts ("WPCs")[6] with Southern (*see* Arg. IIA); **and**
- Even if assumable in the abstract, assumption here would impermissibly modify them (*see* Arg. IIB); **and**
- Any such plan can only lead to further reorganization or liquidation (*see* Arg. IIC).

Note the bolded "and." Each of these reasons, independently of the others, dooms any plan and requires conversion.

A. THE CONTRACTS ARE NOT ASSUMABLE.

The Trustee and, more recently, the Noteholders, have proposed plans which would repay the Noteholders by forcing Southern to remain in business over the wishes of its Members,

[6] *See* Noteholders' Disclosure Statement, Doc. 1191, p. 8 of 84 (the WPCs is a "key element" of their plan) and 64 of 84 (WPCs to be assumed).

charging rates determined, not by the Southern Board, but by someone else. Section 365 precludes this absent the Members' consent.

A trustee (or debtor in possession, here Southern, *see* § 1107) can assume an executory contract "except as provided in . . . subsection[] (c)". Section 365(a). Under subsection (c), the trustee can neither "assume" nor "assign"[7] over the Members' objections if "applicable law" excuses the Members from "accepting performance from or rendering performance to" someone other than Southern. *Id*. That is true even if the contract is silent on the issue. *Id*.

1. This is a "hypothetical" test.

It matters not that the Noteholders would reorganize Southern, so that, arguably, there has been no change.[8] In *Catapult*, Perlman licensed a patent to Catapult, which later filed for reorganization and sought to assume the Perlman license as part of a reorganization plan which had been approved by the requisite majorities of creditors and equity holders. *Id*. at 749. The bankruptcy court approved the assumption and the district court affirmed. *Id*. The Ninth Circuit reversed, rejecting the "actual" test in favor of the "hypothetical" test because it was "bound by the plain terms of the statute." *Id*. at 750. Thus, the "literal language of § 365(c)(1) establishes:

> a "hypothetical test": **a debtor in possession may not assume an executory contract** over the nondebtor's objection **if applicable law would bar assignment to a hypothetical third party, even where the debtor in possession has no intention of assigning the contract** in question to any such third party.

Id. at 750 (emphasis added).

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[7] These are "two conceptually distinct events." *Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)*, 165 F.3d 747, 752 (9th Cir. 1999). The statutory "or" between them is "disjunctive." *Id*. If the contracts cannot be assumed, there is no need to inquire whether they can be assigned. *Id*. at 749, n. 1; *see also* § 365(f)(2)(A) (trustee can assign a contract "only if" he has assumed it as allowed by § 365).

[8] Although that is a fiction. A "Southern" which lacks power to set rates via its Board, upon which the Members are each guaranteed a seat (M.C.A. § 35-18-311) and upon which no non-members – like the Noteholders – can sit (*id*.) is not the "Southern" with which the Members contracted.

2. "Section 365(f) does not alter this result.

Section 365(f)(1) allows assignment notwithstanding a law or contract provision which prohibits assignment. This subsection does not alter the analysis under (c)(1) for several reasons. First, it addresses only assignment, a "conceptually distinct" event from assumption. *Catapult*, at 752. Moreover, subsection (f)'s introduction – "[e]xcept as provided in subsections (b) and (c) of this section" – provides that, whatever (f)(1) means, it expressly yields to (c)(1). Finally, these two subsections deal with "'applicable law' of markedly different scope." *Id*. (citing *In re Magness*, 972 F.2d 689, 695 (6th Cir. 1992)). By (f)(1), the Code preempts state law or contract provisions which generally prohibit assignment. *Catapult*, at 752.

> Subsection (c)(1), however, states a carefully crafted exception to the broad rule—where applicable law does not merely recite a general ban on assignment, but instead more specifically "excuses a party ... from accepting performance from or rendering performance to an entity" different from the one with which the party originally contracted, the applicable law prevails over subsection (f)(1). In other words, in determining whether an "applicable law" stands or falls under § 365(f)(1), a court must ask *why* the "applicable law" prohibits assignment. Only if the law prohibits assignment on the rationale that the identity of the contracting party is material to the agreement will subsection (c)(1) rescue it.

Id. (internal citations omitted).

3. "Applicable law" excuses the Members from accepting performance from or rendering performance to anyone else, under either the WPCs or their membership contracts.

Catapult held the patent license was not assumable because the "applicable law," in that case federal common law,[9] includes a "principle against the assignability of nonexclusive patent licenses [which] is rooted in the personal nature of a nonexclusive license—the identity of a licensee may matter a great deal to a licensor." *Id*. at 752, n. 4 (citing *Everex*, 89 F.3d at 679). Thus, "straightforward application of § 365(c)(1) to the circumstances of this case precludes"

[9] "The statutes governing patents are basically silent on the issue of licenses." *Everex Systems, Inc. v. Cadtrak Corp. (In re: CFLC, Inc.)*, 89 F.3d 673, 677 (9th Cir. 1996).

assumption over Perlman's objection. *Catapult* at 755. *Everex* explained that to allow assignment of patent licenses would deprive the patent holder of "the very important ability to control the *identity* of the licensees" and might result in assignment to "a party whom the patent holder itself might be absolutely unwilling to license." *Id*. at 679 (emphasis in original).

Magness, which *Catapult* cited approvingly, involved country club golf memberships belonging to bankrupt debtors. Giving § 365(c) an "expansive reading," *id*. at 695, and "look[ing] at the rights and duties of the . . . other party to the contract," *id*. at 696, the court conducted a "careful examination of Ohio law" to determine whether it excused the club "from accepting as a full golfing member a person chosen by the trustee." *Id*. The contracts were not assignable without the club's consent because the contracts were personal arrangements among "individuals who play golf, who are waiting to play golf, who eat together, swim and play together." *Id*.

Likewise, the Members' membership in and WPC's with Southern are personal arrangements (albeit for a far weightier purpose – keeping the heat and lights on for rural Montanans) in which assumption and assignment would deprive the Members of "the very important ability to control the *identity* of the" other Members, the nature and composition of the cooperative of which they are members, and the party from whom they are obligated to purchase power. *See Everex*.

Both this Court and the Noteholders have recognized the unique interdependence of the WPCs which bind the Members together in the context of the cooperative structure of Southern.

> **A significant element of Southern Montana's cooperative structure is that the Members are self-regulating through their control of Southern Montana's Board** of Trustees. Southern Montana's bylaws constitute a contract between Southern Montana and each Member. Under the Montana Cooperative Act and Article III, § 1, of the Bylaws, the business and affairs of Southern Montana are managed by a Board of Trustees composed of one trustee representative chosen

> and elected by each Member. Article III, § 2 of the Bylaws requires that each trustee be a member of the Member he or she represents. The Members are empowered to remove Southern Montana's Board of Trustees.
>
> In April of 2007, each of the Members executed a virtually identical wholesale power contract with Southern Montana. One of the primary purposes of the wholesale power contracts was to secure for the Members a dependable source of power under their management and control. The wholesale power contracts were based on the **unique interrelationship and interdependence between Southern Montana and its Members, and is distinct from routine requirements contracts**.

Memorandum of Decision, Doc. 1159, pp. 3-4 (emphasis added).

Similarly, the Noteholders acknowledge Southerns' cooperative nature, by which it operates "pursuant to a set of Bylaws and Policies" and that each Member may designate its representative to the Southern Board. Noteholder's Disclosure Statement, Doc. 1191, p. 26 of 84. The WPC's[10] are the:

> structural keystone by which electric cooperative G & T systems . . . [*i.e.*, Southern] provide a stable, interdependent power supply network whereby the distribution cooperatives [*i.e.*, the Members] pool their resources and band together to obtain power at wholesale prices, build central electric generation facilities, obtain favorable loans, and attempt to provide reliable, affordable, and predictably priced electric service to the customers they serve. **The all requirements contract is a multi-party agreement creating an essential interlocking relationship among the Debtor and all of its member systems.**

Id. at 25 of 84 (emphasis added).

In *Magness*, the "arrangement between the members . . . and the Dayton Country Club [was] a complex one involving rights, privileges, and duties, all of which are bound up in what is loosely called the contract for 'full golf membership.'" *Id*., 972 F.2d at 692. It involved not just the executed portion (achievement of full membership status and payment of the associated fee)

[10] The Noteholders prefer the term "All-Requirements Contracts," s*ee generally*, Noteholders' Disclosure Statement, Doc. 1191, ignoring this Court's observation that the WPCs are "distinct from routine requirements contracts."

but also ongoing performance involving the "rules, procedures and practices of the club," the ongoing obligation to make further payments, and the club's obligation "to provide recreational facilities called for in its charter and bylaws." *Id*. It was not a "simple contract to buy and sell a product or service." *Id*.

Nor is the arrangement between the Members and Southern, with the interdependent and interlocking WPCs which bind them together a "simple contract to buy" electricity. The relationship is at least as "personal" as a golf membership, and the identity of the provider from whom the Members must purchase power, the other members, and who sets rates, is at least as important as who is teeing off in the foursome behind you at the country club. The "interlocking" arrangement involves Southern's nature as a cooperative, including the way it must operate under Montana law and the bylaws.

a. The bylaws and other aspects of the Members' membership in Southern are an executory contract which may not be assumed.

Memberships in Southern are "not transferable, except as provided in the bylaws." Section 35-18-301, MCA. Southern's Bylaws flatly prohibit transfer of memberships. *Id*., p. 5, Article I, Section 4 (Exhibit 5) ("Membership in the Cooperative shall not be transferable.").

This Court has already determined that: "Southern Montana's bylaws constitute a contract between Southern Montana and each Member." Memorandum of Decision, November 26, 2013, p. 3 (Doc. 1159). Thus, the question becomes whether the Bylaws are an executory contract. They are.

The Ninth Circuit has adopted the "Countryman Test" to determine if a contract is executory:

> [A] contract is executory if, when the bankruptcy petition is filed, the obligations of both parties are so unperformed that the failure of either party to complete

> performance would constitute a material breach and thus excuse the performance of the other.

In re Sjoquist, 484 B.R. 207, 213 (Bankr.C.D.Cal 2012) (quoting *Unsecured Creditors' Committee v. Southmark Corp. (In re Robert L. Helms Constr. Dev. Co.),* 139 F.3d 702, 705 (9th Cir. 1998)).

In considering whether the operating agreement of a limited liability company is an executory contract, one court explained:

> Although Santerra is a manager managed LLC, there are certain actions which require approval by 60%—a super majority—of the membership interest of Santerra. Three of these super majority provisions are not remote and are material: 1) sale of the Property; 2) refinancing of the Property; and 3) removal of the manager. It is clear from the pleadings and representations in Court that Santerra (and Mr. Lupypicw) are actively marketing the Property. Moreover, Santerra is facing a June 2013 refinancing deadline. The SAM Parties have also made a not so veiled reference to removing Mr. Lupypciw as manager. These issues require resolution through the Debtor's active participation. If the Debtor or Santerra's other members do not timely and in good faith make these decisions required by the Operating Agreement, there will be a breach of the Operating Agreement. For these reasons, the Court concludes the Operating Agreement is an executory contract.

In re Strata Title, LLC, 2013 WL 1773619, *2 (Bankr.D.Az. 2013). Another Court, noting that whether a contract is executory "hinges on the facts and circumstances of each individual case," found that an operating agreement was not executory "because, in reality, the Debtors have no real on-going obligations under the operating agreement." *In re Knowles*, 2013 WL 152434, *1 (Bankr.M.D.Fl. 2013).

In another exploration of whether an operating agreement is an executory contract, *In re Alameda Investments, LLC*, 2013 WL 3216129, *3 (Bankr.C.D.Cal. 2013) explained that the "issue of whether or not an operating agreement is an executory contract is determined on a case by case basis." In that case, it was not:

> The Operating Agreement is not an executory contract. Alameda had no

> outstanding performance due under the Operating Agreement on the date of bankruptcy. Alameda had no role in the management of West Lakesoide, and no obligation to provide any personal expertise or service to the company. Alameda had made all required capital contributions prior to the petition date. There is no evidence that Alameda had any continuing fiduciary obligation under the agreement.

Id. The Bankruptcy Court for the Western District of Washington recently considered the question and reached a different conclusion based on different facts. *In re McSwain*, 2011 WL 4706982 (Bankr.W.D.Wa. 2011). There, the Court noted that the "Operating Agreement contains multiple, mutual obligations between and among the parties that satisfy the Countryman definition of an executory contract." *Id*. at *6. As examples, the Court noted that "McSwain had ongoing management obligations" to the LLC, "was obligated to vote on Major Decisions, Initial Member Decisions and Disinterested Decisions," "was affirmatively restrained from engaging in unauthorized transfers of his membership interests" and "he was affirmatively restricted from voluntarily withdrawing as a member." *Id*. The Court concluded that "These provisions are hallmarks of executory contracts for LLC agreements." *Id*. (citing *Movitz v. Fiesta Investments, LLC (In re Ehmann)*, 319 B.R. 200, 205 (Bankr.D.Ariz. 2005) (citing obligations to contribute capital and continuing fiduciary obligations among members as obligations that would make an operating agreement executory)).

In this case, the Bylaws are the type of membership contract which is plainly executory. Most notably, the Bylaws require that Southern shall be managed by a Board of Trustees and that each Member have equal representation on the Board. Thus, the membership contract, including the bylaws and the cooperative nature of Southern, vest in the Members ongoing rights and duties, including direct and intimate involvement in its ongoing management.

The Ninth Circuit Bankruptcy Appellate Panel has explained that Sections 365(c)(1) and (e)(2)(A) "were designed 'to protect non-debtor third parties whose rights may be prejudiced by having a contract performed by an entity other than the one with which they originally contracted. . . .'" *In re First Protection, Inc*., 440 B.R. 821, 832 (9th Cir.BAP. 2010) (quoting *C.O.P Coal Dev. Co. v. C.W. Mining Co. (In re C.W. Mining Co.)*, 422 B.R. 746, 761 (10th Cir.BAP 2010)).

The Bylaws provide that "The business and affairs of the Cooperative shall be managed by a Board of not less than five (5) nor more than twelve (12) Trustees." *Id*., p. 8, Article III, Section 1a. Further, the "Trustees shall be chosen and elected from persons who are directors, trustee, or city managers of Class A Members of the Cooperative." *Id*., p. 8, Article III, Section 1b. Thus, the Members are responsible for the operation and management of Southern. Finally, the Bylaws require that the "Cooperative shall at all times be operated on a cooperative non-profit basis for the mutual benefit of its patrons." *Id*., p. 14, Article VII, Section 1.

Thus, the Members, through their Trustees on Southern's Board, manage Southern, including setting rates, for the benefit of themselves and, correspondingly, the Members' own customers. This clearly creates an interest in having Southern, not some other third party, perform pursuant to the Bylaws. Indeed, given the drafting of the Bylaws, it is impossible for a third party to perform Southern's duties under the Bylaws. As this Court noted the Members' right of "self-regulat[ion] as a "significant element of Southern Montana's cooperative structure." *See* Doc. 1159, pp. 3-4.

The membership contracts cannot be assumed under § 365(c)(1) if "applicable law" "prohibits assignment on the rationale that the identity of the contracting party is material to the agreement." *Catapult*, at 752. It cannot be seriously contended that, under the "unique interrelationship and interdependence between Southern Montana and its Members**,"** (Doc. 1159, pp. 3-4) it is immaterial: who the other Members are; who is the cooperative; who provides power; who sets rates; or who manages. "Applicable law" excuses Fergus and Beartooth from rendering performance of their membership contracts to or accepting performance of those membership contracts from anyone other than the cooperative they elected to join. The DIP, therefore, may not assume those membership contracts, and any plan is patently unconfirmable.

b. Likewise, the WPCs are executory contracts which may not be assumed.

This Court was absolutely correct in noting that the WPCs are "distinct from routine requirements contracts." The Members did not go out into the marketplace, and contract to buy power from just anyone. Instead, they left their prior G & T (Central Montana) to form a new cooperative (Southern) with carefully selected fellow Members. They contracted with Southern knowing, among other things that each Member would be represented on the Board, the Board would set rates and policies, and no one else would be on the Board or have authority to set rates or dictate policies, including from whom to purchase power. In a nutshell, "the identity of the contracting party is material to the agreement." *Catapult*, at 752.

Like Southern, Wabash Valley Power Ass'n, Inc. was a G & T cooperative comprised of member distribution cooperatives, which borrowed money to build a failed generation facility. In *Wabash Valley Power Ass'n, Inc. v. Rural Electrification Administration*, 903 F.3d 445 (7th Cir. 1990) ("*Wabash I*"), *Wabash Valley Power Ass'n, Inc. v. Rural Electrification Administration*, 988 F.2d 1480 (7th Cir. 1993) ("*Wabash II*"), and *In re Wabash Valley Power Ass'n, Inc.*, 72 F.3d 1305 (7th Cir. 1996) (cert. denied, 519 U.S. 965) ("*Wabash III*"), the Seventh Circuit repeatedly addressed many of the same issues confronting this Court.

Wabash I involved the creditor's (the Rural Electrification Administration, or "REA") attempt to force Wabash to raise rates sufficiently to pay the approximately $1 billion owed. In rejecting the REA's attempt to preempt state law by which a state agency controlled rates, the court noted that the REA could have "refuse[d] to approve a loan unless the customers (whose promises to buy power are the real security for the debt) guarantee the loan or authorize the REA to set rates." *Id*. at 453. Likewise, here, the Noteholders could have refused to lend unless the Members guaranteed the loan or agreed that the Noteholders could set the rates. The Noteholders sought neither concession, but seek to accomplish both objectives by their plan.[11]

Wabash II involved REA's second attempt to preempt state regulation of rates, so that it could force Wabash to set rates high enough to repay the debt. The court discussed extensively the wholesale power contracts upon which REA relied in lending funds and which are the "lynchpin" of the lending program. *Id*. at 1484. Once again, the court noted that REA could have refused the loan unless the member cooperatives "guarantee the loan or authorize the REA to oversee rates." *Id*. at 1491.

> Distilled to its essence, the REA would have Wabash Valley's subscribers absorb the losses stemming from Wabash Valley's default and the REA's mishandling of its security arrangement. While the monies disbursed through the REA are properly regarded as credit rather than grants, the tools in the REA's kit to ensure repayment are not without limits. As with any other lender, **the REA assumes the business risk of advancing money to a specific organization, the risk that the organization will not be able to repay**.

Id. (emphasis added).

Similarly, the Noteholders would have Southern's Members, and the members of those Members, absorb the loss from the Noteholders' mishandling of their security arrangement.[12]

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[11] *Wabash I* also noted that, the "[l]ack of guarantees from Wabash's customers," *i.e*., the member cooperatives, may have led to a higher interest rate because of the risk of default, and REA's attempt to essentially force a rate increase to cure the default while benefitting from the higher interest rate was a "[n]ice cushion, if you can get it." *Id*. at 455. Likewise, the Noteholders' presumably set their interest rate based on the risks involved without guarantees, but now want to essentially force each Member, and the rural Montanans who buy power from them, to become guarantors.

[12] Ironically, the Noteholders' plan would have the "intolerable result of subjecting" Southern's Members, and their members, "to unlimited liability." *See Nat'l Rural Utilities Finance Corp. v.*

The Noteholders, however, assumed the risk of lending to "a specific organization," Southern, without any guarantees from the Members. This Court cannot rescue the Noteholders without doing violence to (*i.e*., impermissibly modifying) the WPCs. More to the present point, the WPCs are not assumable.

Wabash III affirmed a district court opinion affirming the bankruptcy court's approval of Wabash's plan and rejecting the REA's plan which, like the Noteholders' plan, would have simply dictated rates at a level sufficient to repay the debt.

The bankruptcy court began by noting some "unique factors distinguishing this case" from other Chapter 11 cases, including Wabash's non-profit cooperative status and that the supply contracts "that hold Wabash and the Members together provide the Members with substantial rights and control over Wabash." *In re Wabash*, 1991 WL 11004220, *Findings & Conclusions on Confirmation of Debtor's Plan of Reorganization and Denying REA's Plan* (Bankr. S.D. Ind., Aug. 7, 1991), at *3. After finding that the supply contracts have "no independent liquidation value," *Id*. at *10, ¶ 40,[13] the court then held that their assumption by a reorganized Wabash would violate §365, rendering the REA's plan unconfirmable. *Id*. at *65-66.

Because the contracts are for goods (electricity),[14] the Uniform Commercial Code applies. The UCC definition of "agreement" means "the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course

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Indiana PSC, 552 N.E.2d 23 (Ind. 1990) (rejecting REA's attempt to force a rate increase before the Indiana Public Service Commission).

[13] The former Trustee, Mr. Freeman, was counsel for Wabash and prevailed on that argument in *Wabash*. He asserted the same argument here on behalf of Southern, before then settling with the Noteholders and proposing a plan to pay tens of millions of dollars via those supposedly-worthless contracts.

[14] This Court has already agreed. *See* Memorandum of Decision (Doc. 635), p. 7.

of dealing, or usage of trade . . . ." M.C.A. § 30-1-201(2)(c).[15] *Wabash*, 1991 WL 11004220, at *66, ¶ 71. The Members' exclusive right to control the cooperative was "implicit in both the language of" the contracts and "from 'other' circumstances." *Id.*, ¶¶ 71-72. In fact, it was "so fundamental that it was simply unnecessary to express it" in the contracts. *Id*. at ¶ 72. The "other circumstances" which made this member control a part of the bargain, including their establishment of Wabash as a non-profit cooperative and adoption of bylaws, established a "'course of dealing' which became an implicit part of the Supply Contracts." *Id*. at ¶ 73. Moreover, the "uniform practice" among G & T cooperatives of electing their own boards established a "'usage of trade' [which] also became an implicit part of the Supply Contracts." *Id*. at ¶ 73. *See generally* M.C.A. § 30-1-205 (course of performance, course of dealing, and usage of trade).

That analysis also applies directly to the § 365(c)(1) analysis. The bargain represented by the WPCs includes the Members' right to control Southern. Stated differently, the "identity of the contracting party is material to the agreement." *Catapult*, 165 F.3d at 752. It may not be assumed.

In fact, Montana's UCC provides:

> A party may perform the party's duty through a delegate . . . **unless the other party has a substantial interest in having the party's original promisor perform or control the acts required by the contract.**

M.C.A. § 30-2-210(1). This is "applicable law" under § 365(c)(1). Because the Members have a "substantial interest" in having Southern, and no one else, perform, "applicable law" excuses

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[15] *Wabash*, of course, cited to the Indiana UCC. In this discussion, however, Movants cite to and quote the Montana version, so that they will not have to repeat it all in a subsequent portion of the brief. The Indiana and Montana statutes are similar. It is, after all, a "Uniform" code, which is to be construed in a way to make "uniform the law among the various jurisdictions." M.C.A. § 30-1-102(1)(c).

them from accepting performance from or rendering performance to anyone else. The WPCs may not be assumed, and the Noteholders' plan is unconfirmable.

B. Even If The Contracts Were Assumable, Assumption Would Impermissibly Modify Them.

Ultimately, the bankruptcy court in Wabash concluded that:

> The REA Plan violates 11 U.S.C. § 365 by providing for the partial assumption of the Supply Contracts . . . without the implied provision requiring Member control of the Wabash Board. Under 11 U.S.C. § 365, the entire contract must be assumed, including any burdensome provisions.

Id., 1991 WL 11004220 at * 67, ¶ 74. Indeed, it would have been a breach for the contracts to be assumed. *Id*. at *35, ¶¶ 157-159; *see also* *37, ¶ 166.

In *In re Cajun Electric Power Cooperative, Inc*., 230 B.R. 693 (Bankr.M.D.La. 1999), the Court concluded that a forced reorganization plan impermissibly altered the supply contracts because, "[u]nder the Trustee's Plan, Reorganized Cajun will not function as a cooperative as was expected or intended by the Plaintiffs [the Members]." *Id*. at 712. The Court noted that the Trustee's own expert conceded:

> that it is neither normal nor customary for a G & T(a) to be bound to a supply contract that was negotiated without the members' participation or their evaluation of its economic options, or (b) to bind itself to a long-term contract that is not the most economic option available, or (c) to impose services on its members that members do not want; or (d) to enter into a 25–year contract that the members do not want. Nonetheless, all of these occurrences will transpire under the Trustee's Plan.

Id. The Court explained that there "is a fundamental economic difference between the Members' ability to control Cajun when they entered into the Supply Contracts and their ability after the bankruptcy" because all of the fundamental business decisions "will have been made by the Trustee." *Id*. The Court reiterated that "[d]emocratic control by the members is a fundamental principle of being an electric cooperative," and that "any cooperative exists solely to provide mutual benefits to its member-customers and is to be managed on that basis." *Id*. at 713. The Court concluded that "no rational economic justification exists to have a cooperative which is under the control of someone other than members; for a G & T to be bound to contract terms the members do not want; for a G & T to be a power supplier when the cooperative's members are not obtaining power on more favorable terms than they could otherwise; or to have a G & T that is not advancing the members' mutual economic interests." *Id*.

Due to the improper modification of the contracts under the Trustee's plan, the Court held:

> A direct result of the modification of the Supply Contracts resulting from confirmation of the Trustee's Plan would be the invalidation of the Supply Contracts based upon a failure of *cause* under Louisiana law.

Id. at 714. Likewise, Montana law requires "cause or consideration" as an essential element of a contract. M.C.A. § 28-2-102.

Prudential's Plan, like the plan in *Cajun*, forces Debtor and the Members into a long-term power supply contract with Morgan Stanley against their will. Although Southern's Board stays in place, all of the major business decisions for Southern's next decade-plus of operation are made by Prudential under the Plan. Thus, any claim that the Members will still have the benefit of their bargain, *i.e*. control of Southern, is purely a fiction. Assumption of the contracts would impermissibly modify them, destroying the "cause" for which the Members contracted. Just like in Cajun, there "is a fundamental economic difference between the Members' ability to control [Southern] when they entered into the Supply Contracts and their ability after the bankruptcy" because all of the fundamental business decisions "will have been made by [Prudential]." Section 365 precludes that result.

In fact, the "cause or consideration" likely has already been destroyed. The evidence will establish that small rural electric cooperatives join a larger cooperative not just for the economic benefits (power rates) but for intangible benefits like stability, predictability and the synergies of associating together so that the "whole is greater than the sum of the parts." Thus, small cooperatives can learn and benefit from associating with larger cooperatives, who have more resources and institutional knowledge. This "cause" has already been destroyed by the departure of YVEC, which was responsible for 50% of the combined electricity load. Independent of the economic impact, that has deprived the other Members of one key aspect of their bargain, impermissibly modifying their contract. See § 365(e)(2).

C. Plan Confirmation Will Inevitably Lead To Further Bankruptcy Proceedings.

Southern is dysfunctional. In fact, as the Court has repeatedly heard, the only thing upon which the Members can agree is that Southern must be liquidated. The Court has heard ample evidence of the dissension between the Members and the likelihood that reorganization will lead to the bankruptcy of one or more of the Members. Given this backdrop, it is not possible to find that Southern would be capable of carrying out a forced reorganization. Instead, it is inescapable that a forced reorganization will only lead to future litigation, Southern's re-entry into bankruptcy, additional bankruptcies, and liquidation.

There is no need to engage in this exercise in futility. *See* § 1129(a)(11). Conversion to Chapter 7 is required. There, Southern can be liquidated and the secured creditors, including the Noteholders, will obtain the benefit of their security, nothing more, nothing less.

III. Diminution Of The Estate.

Section 1112(b)(4)(A) directs the Court to consider "[s]ubstantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." The above discussion and Exhibit 4 establishes that Southern is hemorrhaging money. In *Loop Corp. v.*

U.S. Trustee, 379 F.3d 511 (8th Cir. 2004), the Court noted that it was conceded that the debtor "had a negative cash flow." *Id.* at 515. "Under the interpretation of § 1112(b)(1) consistently used in bankruptcy courts, this negative cash flow situation alone is sufficient to establish 'continuing loss to or diminution of the estate.'" *Id.* at 515-16 (citing *In re Schriock Constr., Inc.*, 167 B.R. 569, 575 (Bankr.D.N.D.1994) (continuing loss to or diminution of the estate can be established by showing that debtor incurred continuing losses or maintained negative cash flow after entry of the order for relief); *Matter of 3868-70 White Plains Road, Inc.,* 28 B.R. 515, 518 (Bankr.S.D.N.Y.1983) (continuing loss or diminution illustrated by debtor's continual negative cash flow); *see also* 7 *Collier on Bankruptcy* ¶ 1112.04[5][a][i] (Alan N. Resnick & Henry J. Sommer, eds. 15th ed. 2004) ("If the debtor is operating with a sustained negative cash flow after entry of the order for relief, this fact is sufficient to support a finding that the debtor is experiencing a 'continuing loss to ... the estate.' ")).

Since the departure of YVEC and the City of Great Falls, the Debtor is operating with a sustained negative cash flow. The Court should end the hemorrhaging and order liquidation under Chapter 7.

Conclusion

For the reasons discussed above, Movants respectfully submit that this matter should be converted to a proceeding under Chapter 7.

DATED this 27th day of December, 2013.

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NOTICE OF OPPORTUNITY TO RESPOND AND REQUEST A HEARING

If you object to the motion, you must file a written responsive pleading and request a hearing within fourteen (14) days of the date of the motion. The responding party shall schedule the hearing on the motion at least twenty-one 21 days after the date of the response and request for hearing and shall include in the caption of the responsive pleading in bold and conspicuous print the date, time and location of the hearing by inserting in the caption the following:

NOTICE OF HEARING
Date: ___________________
Time:___________________
Location:________________

If no objections are timely filed, the Court may grant the relief requested as a failure to respond by any entity shall be deemed an admission that the relief requested should be granted.

CERTIFICATE OF SERVICE

The undersigned hereby certifies under penalty of perjury that on Decmeber 27, 2013, a copy of the foregoing pleading was served (i) by electronic means pursuant to LBR 9013-1(c) on the parties noted in the Court's ECF transmission facilities and/or (ii) by mail on the following parties: None.

***/s/Trent M. Gardner*____________**
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