Selected Confirmation Issues in Small Business and Individual Debtor Cases

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TABLE OF CONTENTS

I. Introduction 1

II. Who May File a Plan 1

  A. Small Business Cases 1

  B. Individual Debtor Cases 4

III. Classification of Claims and Interests 5

  A. Overview 5

  B. To What Extent Can Substantially Similar Claims Be Classified Separately? 7

    1. Legitimate Business Reasons 11

    2. Nature of the Claim 15

IV. Impairment of Claims 20

  A. Overview 20

  B. What Is Artificial Impairment? 23

  C. Is Artificial Impairment Permitted Under the Bankruptcy Code? 23

    1. Cases Finding That Artificial Impairment Is Prohibited 24

    2. Cases Finding That Artificial Impairment Is Not Prohibited *Per Se* 27

V. Approval of Disclosure Statements 30

  A. Disclosure Statement Contents 30

  B. Objections to the Disclosure Statement 31

  C. Reservation of Future Avoidance and Other Litigation 32

VI. Selected Confirmation Issues 34

  A. Good Faith 34

  B. Best Interests 37

  C. Feasibility 37

  D. Projected Disposable Income Test for Individual Chapter 11 Debtors 41

  E. Cramdown 42

    1. Unfair Discrimination 43

    2. Fair and Equitable Treatment of Secured Claims 45

      a. Section 1129(b)(2)(A)(i) 45

      b. Section 1129(b)(2)(A)(ii) 49

      c. Section 1129(b)(2)(A)(iii) 52

    3. Fair and Equitable Treatment of Unsecured Claims 53

      a. The Absolute Priority Rule 53

        i. Lessons for Small Business Cases 56

        ii. Application in Individual Debtor Cases 58

VII. Conclusion 64

I. INTRODUCTION

This paper will present various issues related to Chapter 11 plans, including timing of filing, classification of claims, impairment of claims, and confirmation. While this is not an exhaustive discussion of all issues related to Chapter 11 plans, it focuses on the often litigated issues that can arise with Chapter 11 plans, with a special emphasis on these issues in small business and individual debtor Chapter 11 cases.

II. WHO MAY FILE A PLAN

A. Small Business Cases

The Bankruptcy Code (the "Code") defines a small business case as one filed under Chapter 11 where (i) the debtor is "engaged in commercial or business activities . . . [and] has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition . . . in an amount not more than $2,490,925 (excluding debts owed to 1 or more affiliates or insiders)," and (ii) the U.S. Trustee has not appointed a committee of unsecured creditors, or the bankruptcy court has determined that the committee of unsecured creditors "is not sufficiently active and representative to provide effective oversight of the debtor."[1]

The Code provides specific deadlines for Chapter 11 plans in small business cases. Courts have concluded that the purpose of these deadlines is to closely monitor small business cases.[2] These deadlines can be extended, but the Code requires that (i) the debtor "demonstrate[] by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time;" (ii) the court impose a new deadline when it grants the

[1] 11 U.S.C. §§ 101(51C)-(51D) (2012).

[2] *See, e.g.*, *In re* Castle Horizon Real Estate LLC, No. 09-05992, 2010 WL 3636160, at *1 (Bankr. E.D.N.C. Sept. 10, 2010) ("The timing requirements of § 1121(e) were imposed to closely supervise small business debtors and to manage these cases in an expedited manner."); *In re* Sanchez, 429 B.R. 393, 398 (Bankr. D.P.R. 2010) ("The expedited nature of the confirmation process pursuant to § 1129(e) is a clear example of Congress' attempt to keep small business cases on a short leash.").

extension; and (iii) the order granting the extension "is signed before the existing deadline has expired."[3]

The exclusivity period is the time during which only the debtor can propose and confirm a plan.[4] Unlike a typical Chapter 11 debtor who enjoys a 120-day exclusivity period in which to file its plan (subject to extension or reduction),[5] a small business debtor's exclusivity period is "180 days after the date of the order for relief" (subject to extension or reduction).[6]

The plan and disclosure statement (if any) must be filed within 300 days after the date of the order for relief.[7] A disclosure statement is not necessary in a small business case if the court determines that the plan provides adequate information.[8] However, if a disclosure statement is necessary, a court can conditionally approve it, subject to final approval after notice and hearing.[9] The debtor is able to solicit plan votes based on the conditionally approved disclosure statement, but it must mail the disclosure statement not later than 25 days before the plan confirmation hearing.[10] Once a plan is filed, it must be confirmed within 45 days, unless the court grants an extension in accordance with § 1121(e)(3).[11]

There have been some recent cases dealing with the deadlines that the Code imposes on small business cases. Courts have held that cause exits to dismiss or convert a small business case if the debtor does not strictly adhere to the deadlines in § 1121(e). In *In re Roots Rents,*

[3] 11 U.S.C. § 1121(e)(3)(A)-(C).
[4] Thurner Indus. v. Gunnison Energy Corp. (*In re* Riviera Drilling & Exploration Co.), 502 B.R. 863, 870 (10th Cir. BAP 2013).
[5] 11 U.S.C. § 1121(b).
[6] *Id.* § 1121(e)(1).
[7] *Id* .§ 1121(e)(2).
[8] *Id.* § 1125(f)(1).
[9] *Id.* § 1125(f)(3)(A).
[10] *Id.* § 1125(f)(3)(B).
[11] *Id.* § 1129(e).

Inc.,[12] the U.S. Trustee filed a motion to dismiss or convert the case after a small business debtor failed to obtain confirmation of its plan within 45 days of filing it.[13] The court granted the motion, finding that cause existed to dismiss the case because the debtor did not timely confirm its plan or timely seek an extension.[14]

Similarly, in *In re Save Our Springs (S.O.S.) Alliance, Inc.*,[15] a creditor moved to dismiss a debtor's case because, *inter alia*, the debtor did not meet the deadlines under § 1121(e).[16] The court granted the creditor's motion.[17] The *S.O.S.* court also discussed the debtor's attempt to amend its petition to no longer indicate that it was a small business debtor in an attempt to avoid dismissal.[18] The court held that the debtor was judicially estopped from amending its petition, particularly in light of the fact that the court approved the debtor's disclosure statement based on the fact that it was a small business debtor.[19] The court also held that the debtor was equitably estopped from amending its petition because the creditor moving for dismissal relied upon the debtor's representation that it was a small business debtor, and would be prejudiced if the debtor was able to amend its petition.[20]

As for the application of the deadlines in small business cases to plan proponents other than the debtor, courts have come to different conclusions. In *Thurner Industries, Inc. v. Gunnison Energy Corp.* (*In re Riviera Drilling & Exploration Co.*),[21] the issue before the Tenth Circuit Bankruptcy Appellate Panel was whether a creditor could file a plan after the 300-day

[12] 420 B.R. 28 (Bankr. D. Idaho 2009).
[13] *Id.* at 33.
[14] *Id.* at 41.
[15] 393 B.R. 452 (Bankr. W.D. Tex. 2008).
[16] *Id.* at 456.
[17] *Id.* at 463-64.
[18] *Id.* at 456.
[19] *Id.* at 458-59.
[20] *Id.* at 463.
[21] 502 B.R. 863 (10th Cir. BAP 2013).

deadline for confirming a plan in a small business case had passed.[22] The court concluded that the 300-day deadline only applied to plans filed by a debtor because "applying the 300-day deadline to defeat a result that is otherwise beneficial to the creditors and the estate makes little sense."[23] However, the bankruptcy court in *In re Randi's, Inc.*[24] reached an opposite result, holding that "cause exists to dismiss or convert [a] case for the failure of any party to file a plan within the 300-day period or to timely obtain an extension."[25]

B. Individual Debtor Cases

Unlike small business debtors, individual debtors who file for Chapter 11 follow the same timetable for plan confirmation as any other Chapter 11 debtor. An individual Chapter 11 debtor has a 120-day exclusivity period in which to file a plan.[26] If the debtor files a plan during the exclusivity period, she has an additional 60 days within which to exclusively solicit acceptances of her plan.[27] A court may, for cause, shorten or enlarge the debtor's exclusivity periods.[28] Not just the debtor, but any party in interest, can move to shorten or enlarge the exclusivity periods for cause.[29] The exclusivity period to file a plan cannot be extended beyond 18 months after the date of the order for relief,[30] while the exclusivity period to solicit acceptances cannot be extended beyond 20 months after the date of the order for relief.[31]

[22] *Id.* at 866.
[23] *Id.* at 873.
[24] 474 B.R. 783 (Bankr. S.D. Ga. 2012).
[25] *Id.* at 786.
[26] 11 U.S.C § 1121(b) (2012).
[27] *See id.* § 1121(c)(3).
[28] *Id.* § 1121(d)(1).
[29] *Id.*
[30] *Id.* § 1121(d)(2)(A).
[31] *Id.* § 1121(d)(2)(B).

Once the exclusivity period to file a plan runs without the debtor filing a plan, any party in interest can file a plan.[32] Even if the debtor files a plan during the exclusivity period, any party in interest can file a plan if the debtor cannot get her plan accepted within the additional 60-day solicitation exclusivity period.[33] If a Chapter 11 trustee is appointed, any party in interest can file a plan, regardless of whether the exclusivity periods have run.[34]

Unlike a small business debtor, an individual debtor must always file a disclosure statement. The Federal Rules of Bankruptcy Procedure (the "Rules") require that a plan proponent file a disclosure statement with the plan, or within a time set by the court.[35] No acceptances or rejections of the plan can be solicited until the disclosure statement is approved by the court.[36]

III. CLASSIFICATION OF CLAIMS AND INTERESTS

A. Overview

Section 1123(a) of the Code generally requires that a Chapter 11 plan designate classes of claims and interests and specify the treatment of those claims and interests.[37] Because a plan cannot be confirmed under § 1129(a)(1) unless it complies with all of the provisions of Chapter 11 of the Code, classifying claims and interests is necessary for a confirmable plan. Section 1122(a) of the Code provides that "a plan may place a claim or an interest in a particular class only if such claim or interest is *substantially* similar to the other claims or interests of such class."[38] An exception to this general rule is found in § 1122(b), which provides that a plan may

[32] *Id.* § 1121(c)(2).
[33] *Id.* § 1121(c)(3).
[34] *Id.* § 1121(c)(1).
[35] FED. R. BANKR. P. 3016(b).
[36] 11 U.S.C. § 1125(b).
[37] *Id.* § 1123(a)(1), (3).
[38] *Id.* § 1122(a) (emphasis added).

place unsecured claims under a certain amount (or those reduced to that amount) in their own class "for administrative convenience."[39]

In *John Hancock Mutual Life Insurance Co. v. Route 37 Business Park Associates (In re Route 37 Business Park Associates)*,[40] the Third Circuit described the two purposes of classifying claims: the treatment of claims and voting to confirm a plan.[41] As for treatment of claims, how claims are classified will affect the distribution received by claimants. Under § 1123(a)(4) of the Code, each claim or interest within a class must be treated the same unless the holder of a particular claim or interest agrees to its less favorable treatment.[42] As for voting, proper classification ensures that in balloting on a plan, junior claim holders do not deny senior holders their senior rights under the absolute priority rule. If dissimilar claims are permitted to be singularly classified, a majority of claim holders might vote to deprive the minority of their rights in accordance with the absolute priority rule.

Under § 1129(a)(8), for a plan to be confirmed, each impaired class must vote to accept the plan.[43] A class of claims accepts a plan if at least two-thirds in dollar amount and more than one-half of the number of claims voting in the class vote to accept the plan.[44] A class of interests accepts a plan if at least two-thirds in amount of allowed interests voting in the class vote to accept the plan.[45]

[39] *Id.* § 1122(b).
[40] 987 F.2d 154 (3d Cir. 1993).
[41] *Id.* at 159.
[42] 11 U.S.C. § 1123(a)(4).
[43] *Id.* § 1129(a)(8). However, a plan can still be confirmed even if § 1129(a)(8) is not satisfied if (i) it meets all the other requirements in § 1129 for confirmation; (ii) it is "fair and equitable;" and (iii) it does not unfairly discriminate against the dissenting class. *Id.* § 1129(b)(1); *see also* pp. 42-55, *infra*.
[44] 11 U.S.C. § 1126(c).
[45] *Id.* § 1126(d).

B. To What Extent Can Substantially Similar Claims Be Classified Separately?

Section 1122(a) of the Code does not provide that all substantially similar claims or interests must be placed in the same class. Rather, it only states that claims or interests within a class must be "substantially similar" to other claims or interests within that class. The legislative history is notably silent on the issue of whether a plan can separately classify similar claims or interests. As such, courts, academics, and commentators have come to different conclusions on the issue.

Most courts have held that the Code imposes some limits on a plan proponent's ability to separately classify similar claims. They require that proposed classifications be reasonable, and comport with a basic sense of fairness. Therefore, many courts will deny confirmation of a plan that separately classifies similar claims solely to create an impaired accepting class.[46] For example, in the often cited case of *Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)*,[47] the Fifth Circuit found that the debtor "impermissibly classified like creditors in different ways and manipulated classifications to obtain a favorable vote."[48] In *Greystone*, the debtor, who owned an office building in Austin, Texas, owed more than $9 million to its secured creditor.[49] Because the secured creditor's collateral was worth less than its secured claim, the secured creditor had a significant deficiency claim.[50] The debtor's plan attempted to separately classify the secured creditor's unsecured deficiency claim from the unsecured claims of the debtor's trade creditors.[51] The debtor did this

[46] *See, e.g.*, *In re Holywell Corp.*, 913 F.3d 873, 880 (11th Cir. 1990) ("If the plan unfairly creates too many or too few classes, if the classifications are designed to manipulate class voting, or if the classification scheme violates basic priority rights, the plan cannot be confirmed.").
[47] 995 F.3d 1274 (5th Cir. 1991).
[48] *Id.* at 1276.
[49] *Id.*
[50] *Id.* at 1276-77.
[51] *Id.*

so there would be an impaired accepting class—the trade creditors—in an attempt to cramdown the plan.[52]

In a more recent Fifth Circuit case, *In re Save Our Springs (S.O.S.) Alliance, Inc.*,[53] the panel reiterated the rule from *Greystone*: a debtor cannot place claims into separate classes solely to manipulate voting.[54] In that case, the debtor—who filed as a small business debtor—was a nonprofit that filed lawsuits against developers in an attempt to protect the Edwards Aquifer in the Texas Hill Country.[55] Two developer-defendants obtained sizeable attorney's fees awards against the debtor, and when the debtor could not pay the awards, the debtor filed for Chapter 11.[56] The debtor's plan proposed three classes of unsecured creditors: one class for each of the developer-defendants' claims for attorney's fees and a third class for the remaining unsecured creditors.[57] The Fifth Circuit affirmed the bankruptcy court's denial of confirmation because it found that the debtor separately classified its unsecured creditors in an attempt to create an impaired accepting class.[58] The Fifth Circuit found this because the debtor's plan proposed identical treatment for each of the three classes of unsecured creditors, and there was no credible evidence as to why all unsecured creditors could not be placed in the same class.[59]

Another frequently cited case about the classification of claims is *In re Route 37 Business Park Associates*.[60] In that case, a debtor attempted to separately classify an unsecured deficiency claim from other unsecured claims. The debtor did this because it sought confirmation through cramdown, and could only cramdown the plan if its secured creditor's unsecured deficiency

[52] *Id.* at 1278.
[53] 632 F.3d 168 (5th Cir. 2011).
[54] *Id.* at 174.
[55] *Id.* at 171.
[56] *Id.*
[57] *Id.*
[58] *Id.* at 174.
[59] *Id.* at 174-75.
[60] John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs. (*In re* Route 37 Bus. Park Assocs.), 987 F.2d 154 (3d Cir. 1993).

claim was separately classified.[61] The Third Circuit, in an opinion written by then Circuit Judge Samuel Alito, reasoned that even though the Code does not provide an answer to whether a debtor can separately classify similar claims, "it seems clear that the Code was not meant to allow a debtor complete freedom to place substantially similar claims in separate classes."[62] The court further reasoned that such manipulation "would lead to abuse of creditors and would foster reorganizations that do not serve any broader public interest."[63] Accordingly, the court held that the debtor did not have a confirmable plan.[64]

In *In re Torgro Atlantic City, LLC*,[65] a limousine company filed for Chapter 11 as a small business debtor.[66] Its plan sought to classify its unsecured creditors into four classes.[67] The bankruptcy court did not confirm the plan because, *inter alia*, the debtor did not provide sufficient evidence as to why unsecured creditors were placed in separate classes.[68] The court began its analysis with a discussion of *Greystone* and *Route 37* and their holdings that a plan cannot separately classify claims for the purpose of vote manipulation.[69] Relying on those holdings, and in light of what the court found to be unpersuasive justifications for separately classifying like claims, the court held that it could not confirm a plan that separately classified creditors "solely to allow the Debtor the chance to reorganize."[70]

The majority of courts presume that the purpose of separate classification of claims of equal rank is to manipulate voting and therefore scrutinize the alleged justification for separate

[61] *Id.* at 157.
[62] *Id.* at 158.
[63] *Id.*
[64] *Id.* at 162.
[65] No. 08-13458, 2009 WL 1288367 (Bankr. D.N.J. May 7, 2009).
[66] *Id.* at *2.
[67] *Id.* at *3.
[68] *Id.* at *11.
[69] *Id.*
[70] *Id.* at *13.

classification.[71] For example, in *In re Roswell-Hanover Joint Venture*,[72] the court scrutinized a debtor's separate classification of like claims and found that because none of the debtor's reasons for separate treatment were legitimate, "the separate classification [was] an attempt to manipulate the vote to assure one impaired class."[73] Similarly, in *In re Porcelli*,[74] the court denied confirmation of an individual debtor's Chapter 11 plan that separately classified a judgment creditor from other unsecured creditors.[75] Despite the debtor's argument that he was not attempting to manipulate voting and that he separately classified the judgment creditor because an appeal was pending in the case from which the creditor obtained a judgment, the court concluded that the separate classification was done to manipulate the outcome of voting.[76]

Although there seems to be a case for all seasons, courts have generally adopted one of two theoretically different approaches to determine whether it is reasonable to separately classify similar claims: (i) based upon "legitimate business reasons;" and (ii) based upon the "nature" of the claim—*i.e.*, legal distinctions that justify separate classification. There are also a few courts that follow a third theory: the plain meaning approach.[77]

[71] *See, e.g.*, One Times Square Assocs. Ltd. P'ship v. Banque Nationale de Paris (*In re* One Times Square Assocs. Ltd. P'ship), 165 B.R. 773, 778 (S.D.N.Y. 1996) ("[A] debtor's motives must be scrutinized to prevent the possibility of vote manipulation."); *In re* Heritage Org., 375 B.R. 230, 298 (Bankr. N.D. Tex. 2007) (quoting *One Time Square Assocs.*, 165 B.R. at 778).

[72] 149 B.R. 1014 (Bankr. N.D. Ga. 1992).

[73] *Id.* at 1021.

[74] 319 B.R. 8 (Bankr. M.D. Fla. 2004).

[75] *Id.* at 10.

[76] *Id.* at 11.

[77] Under the plain meaning approach, "a court's only task should be to ascertain whether the claims within that class are substantially similar in character to each other." *In re* Dow Corning Corp., 244 B.R. 634, 651 (Bankr. E.D. Mich. 1999). In *Dow Corning*, the bankruptcy court, although bound to follow the legitimate business reason theory, encouraged the Sixth Circuit to reconsider that standard and instead follow a plain meaning approach to § 1122(a). *Id.* However, the plain meaning approach is not widely followed and the Sixth Circuit still follows the legitimate business reason theory. *See, e.g.*, Zantek GBV Fund IV v. Vesper, 19 Fed. App'x 238, 249 (6th Cir. 2001).

1. Legitimate Business Reasons

In courts that adopt the legitimate business reasons approach, the question becomes, would the debtor's business be adversely affected if it were precluded from treating the two groups of creditors differently? The answer to that question lies in a factual determination of whether a separate class of claimants is essential to the debtor's future business success.

In *In re Chateaugay Corp.*,[78] one of the issues before the Second Circuit was whether the plan filed in the bankruptcy proceeding arising out of the LTV Corporation's ("LTV") bankruptcy permissibly classified certain claims.[79] Prepetition, Aetna Casualty and Surety Company ("Aetna") issued surety bonds on behalf of LTV to secure payment of workers' compensation claims in states where LTV was self-insured for workers' compensation.[80] Aetna asserted subrogation claims against LTV.[81] Pursuant to the plan, LTV segregated unpaid workers' compensation claims and proposed to pay them in full, while Aetna—whose claims were derivative of workers' compensation claims—was to receive common stock for its surety-reimbursement and receive only a portion of its original claim.[82] Aetna objected to the plan, arguing that the "separate classification of its claims and the claims of the unpaid workers was improper."[83]

The Second Circuit stated that "to warrant the separate classification of similar claims, the debtor must advance a legitimate reason supported by credible proof."[84] LTV presented evidence that its employees perceived workers' compensation benefits to be state-law entitlements, and those benefits might be the only wage replacement that the employees would

[78] 89 F.3d 942 (2d Cir. 1996).
[79] *Id.* at 945.
[80] *Id.*at 946.
[81] *Id.*
[82] *Id.*
[83] *Id.*
[84] *Id.* at 949.

receive.[85] This led to the court's finding that in the absence of the treatment proposed, "LTV's employees would react so negatively as to jeopardize peaceful labor relations and thereby cast into doubt LTV's ability to secure sales contracts from customers."[86] Because treatment of Aetna's claim would not have the same impact on LTV's reorganization, the Second Circuit found that the bankruptcy court's determination that LTV had a valid business reason for providing superior treatment to its unpaid workers was not clearly erroneous.[87]

In *In re Snyders Drug Stores, Inc.*,[88] the debtor proposed to separately classify its unsecured trade creditors from its landlords' claims for lease rejection damages.[89] Objecting creditors argued that both classes were unsecured claims, so they should be classified together.[90] However, the debtor argued that it sought to continue to do business with its trade creditors, so the trade creditors were necessary for its reorganization; whereas, the landlords were not necessary for its reorganization.[91] The bankruptcy court agreed with the debtor, and found that it was permissible for the debtor to separately classify its trade creditors from its landlords based on its intention to do business in the future with one class, but not the other.[92]

In *In re Premiere Network Services, Inc.*,[93] one of the issues before the court was whether a debtor could separately classify the claim of its competitor.[94] In that case, the debtor was a local telephone company.[95] One of its competitors filed an unsecured proof of claim.[96] The debtor's plan classified the competitor's claim separately from the debtor's general unsecured

[85] *Id.*
[86] *Id.*
[87] *Id.* at 950.
[88] 307 B.R. 889 (Bankr. N.D. Ohio 2004).
[89] *Id.* at 892.
[90] *Id.* at 892-93.
[91] *Id.* at 893.
[92] *Id.* at 898-94.
[93] 333 B.R. 130 (Bankr. N.D. Tex. 2005).
[94] *Id.* at 133.
[95] *Id.* at 131.
[96] *Id.* at 132.

creditors.[97] The court found that such separate treatment was permissible because, *inter alia*, the debtor had a legitimate business reason for doing so.[98] The court found this because the competitor would benefit if the plan was rejected.[99] Further, the court found that there was no evidence that the debtor attempted to separately classify its competitor so as to manipulate voting.[100]

Plan proponents have also failed in their efforts to argue that a legitimate business reason exists to separately classify similar claims. For example, in *Greystone*, which was previously discussed, the debtor argued that it separately classified its mortgagee's deficiency claim for a business reason that related to its need to maintain good will among its trade creditors who otherwise would stop engaging in business with the debtor.[101] However, the debtor proposed identical treatment of the two classes, which caused the Fifth Circuit to reject the debtor's "realities of business" argument.[102] Similarly, in *In re CRB Partners, LLC*,[103] a recent case relying on *Greystone*, the court rejected the debtor's argument that it could separately classify one unsecured creditor from the general class of unsecured creditors based on the debtor and the separately classified creditor's contentious past.[104] The court noted that if anything, the contentious past between the debtor and the separately classified creditor supported the creditor's theory that the debtor separately classified it in order to manipulate voting.[105]

[97] *Id.*
[98] *Id.* at 133.
[99] *Id.*
[100] *Id.*
[101] Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (*In re* Greystone III Joint Venture*)*, 995 F.2d 1274, 1280 (5th Cir. 1991).
[102] *Id.* (internal quotation marks omitted).
[103] No. 11-11924, 2013 WL 796566 (Bankr. W.D. Tex. Mar. 4, 2013).
[104] *Id.* at *11.
[105] *Id.*

In *Lumber Exchange Building Ltd. Partnership v. Mutual Life Insurance Co. of New York (In re Lumber Exchange Building Ltd. Partnership)*,[106] the debtor argued for separate classification of an undersecured creditor's deficiency claim because "secured creditors look to different assets for repayment than do unsecured creditors and because the maintenance of good business relationships is important to a debtor's ongoing business."[107] The Eighth Circuit stated that there is some authority for the proposition that a debtor can separately classify trade creditors and treat them more favorably.[108] However, the debtor's argument was not persuasive because the plan treated trade creditors less favorably.[109] This caused the court to conclude that the debtor had an illegitimate motive in separately classifying the relevant creditors.[110] The Bankruptcy Court for the Western District of Missouri relied on the *Lumber Exchange* decision in *In re Hillside Apartments, L.P.*[111] In *Hillside*, the court concluded that the debtor cannot simply propose to treat trade creditors more generously as justification for separate classification.[112] Instead, the debtor had to show that the more generous treatment was necessary for the debtor's ongoing business.[113] The court noted that the debtor "presented no evidence of a limited market in Kansas City for trade goods and services and presented no evidence that it would be unable to obtain any of the trade services if the trade creditors did not receive preferential treatment under the plan."[114]

[106] 968 F.2d 647 (8th Cir. 1992).
[107] *Id.* at 649.
[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] 205 B.R. 177 (Bankr. W.D. Mo. 1997).
[112] *Id.* at 189.
[113] *Id.*
[114] *Id.*

2. Nature of the Claim

Courts that adopt the nature of claim theory focus on the nature of the claim or interest instead of on the intent of the plan proponent. This view is premised, in part, on a belief "that each class must represent a voting interest that is sufficiently distinct and weighty to merit a separate voice."[115] For example, in the *Route 37* case, which was previously discussed above, the secured creditor moved for relief from the automatic stay under § 362(d)(2), arguing that the property for which it sought stay relief was not necessary for an effective reorganization.[116] In support of its motion for relief from stay, the secured creditor argued that the plan improperly placed its unsecured deficiency claim in a separate class, so the plan could not be confirmed.[117] The Third Circuit found that the debtor's plan contained an impermissible classification scheme for unsecured claims because all unsecured claims, even though they were in separate classes, were receiving the same treatment.[118]

In *In re W.R. Grace & Co.*,[119] the District Court for the District of Delaware, applied the nature of the claim theory in deciding an appeal of, *inter alia*, confirmation of a debtor's Chapter 11 plan.[120] In that case, the debtor's plan "classifie[d] all personal injury claims resulting from exposure to Grace Asbestos in Class 6."[121] Two creditors with claims for indemnity and contribution argued that they should not be classified with the personal injury claimants.[122] However, the court rejected their argument, finding that their claims for indemnity and

[115] John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs. *(In re* Route 37 Bus. Park Assocs.*)*, 987 F.2d 154, 159 (3d Cir. 1993).
[116] *Id.* at 155-56.
[117] *Id.* at 156.
[118] *Id.* at 159.
[119] 475 B.R. 34 (D. Del. 2012).
[120] *Id.* at 109.
[121] *Id.*
[122] *Id.*

contribution sought to recover for the debtor's asbestos liability.[123] Therefore, the court upheld the classification because both direct and indirect claims for asbestos liability would have the same effect on the debtor's bankruptcy estate.[124]

Other courts that follow the nature of the claim theory look to the explanation offered in *In re Los Angles Land and Investments, Ltd.*[125] and analyze the nature or legal character of claims as they relate to the debtor's assets.[126] For example, in *Teamsters National Freight Industry Negotiating Committee v. U.S. Truck Co. (In re U.S. Truck Co.)*,[127] the debtor was a trucking company that shipped parts for the automotive industry.[128] The Teamsters National Freight Industry Negotiating Committee (the "Teamsters Committee") asserted a claim based on the debtor's rejection of a collective bargaining agreement.[129] The Teamsters Committee objected to the debtor's plan alleging, *inter alia*, that the debtor manipulated "the classes in order to neutralize the Teamsters Committee's dissenting vote."[130] The issue before the court, then, was whether it was permissible under the Code for the debtor to separately classify the Teamsters Committee's claim from other claims of a similar nature to the Teamsters Committee's claim.[131] The court found that the debtor could separately classify the Teamsters Committee's claim because "the Teamsters Committee had a different stake in the future viability of the reorganized company and ha[d] alternative means at its disposal for protecting its

[123] *Id.* at 110.

[124] *Id.* ("It makes no difference whether this recovery is sought directly by an individual plaintiff or indirectly through indemnity and/or contribution, or what the applicable legal theory is that underlies the claim, because, after all is said and done, all these claims 'relate to the assets of the debtor' in substantially the same way.").

[125] 282 F. Supp. 448, 453–54 (D. Haw. 1968), *aff'd*, 447 F.2d 1366, 1367 (9th Cir. 1971).

[126] *See, e.g.*, Wells Fargo Bank, N.A. v. Loop 76 LLC (*In re* Loop 76), 465 B.R. 525, 536 (9th Cir. 2012) ("The Ninth Circuit has determined that the bankruptcy judge must evaluate the nature of each claim, *i.e.*, the kind, species, or character of each category of claims." (internal quotation marks omitted)).

[127] 800 F.2d 581 (6th Cir. 1986).

[128] *Id.* at 583.

[129] *Id.* at 582-83.

[130] *Id.* at 584.

[131] *Id.*

claim."[132] Because of the Teamsters Committee's "virtually unique interest," the court held that the debtor could separately classify its claim.[133]

In *Steelcase, Inc. v. Johnston (In re Johnston)*,[134] another court to follow the nature of the claim theory, a creditor objected to an individual debtor's separate classification of its claim.[135] The claim arose from a counterclaim filed against the debtor by the creditor, and the debtor proposed to pay the claim in full, within 120 days, contingent upon the creditor's success in the underlying litigation.[136] The creditor argued that the debtor's proposed classification was impermissible under the Code because the creditor's claim was substantially similar to claims of other creditors.[137] However, the court rejected the creditor's argument and found that the creditor was "situated differently from other unsecured creditors."[138] The court based this conclusion on the fact that the creditor's claim was disputed, was the subject of litigation, and would be paid in full before any other unsecured creditors would be paid in full.[139] The court also noted that the creditor was differently situated because its claim against the debtor arose from an unsecured personal guarantee, and it also had a partially secured claim in the primary obligor's bankruptcy case.[140]

In *Wells Fargo Bank, N.A. v. Loop 76, LLC (In re Loop 76, LLC)*,[141] a recent decision from the Bankruptcy Appellate Panel for the Ninth Circuit, the court applied *In re Johnston*.[142] In the case, a secured creditor argued that its deficiency claim should not have been separately

[132] *Id.* at 587.
[133] *Id.*
[134] 21 F.3d 323 (9th Cir. 1994).
[135] *Id.* at 325-26.
[136] *Id.* at 325.
[137] *Id.* at 326.
[138] *Id.* at 328.
[139] *Id.*
[140] *Id.*
[141] 465 B.R. 525 (9th Cir. BAP 2012).
[142] *Id.* at 540-541.

classified from other unsecured claims.[143] However, the panel, based on its interpretation of *Johnston*, rejected the secured creditor's argument.[144] The panel found that the rule from *Johnston* was that there is no narrow definition of the nature of the claim, and the court can therefore consider factors beyond how the claims related to a debtor's assets.[145] So, in that case, the court found that the undersecured creditor could be separately classified because it had a third-party guarantor against whom it could seek payment for the deficiency. The court referred to the third-party guarantor as a "'special circumstance' that did not apply to any other unsecured claimants and accords [the undersecured creditor] a different status."[146]

In *Heartland Federal Savings & Loan Ass'n v. Briscoe Enterprises, Ltd., II (In re Briscoe Enterprises Ltd, II)*,[147] a decision issued shortly after *Greystone*, the issue before the court was whether a debtor could separately classify two deficiency claims.[148] The debtor owned a low-to-moderate-income apartment complex in Fort Worth, Texas.[149] Two lenders financed the complex, one of which was the city of Fort Worth, who held a junior lien.[150] Because the apartment complex was worth significantly less than the liens asserted against it, the senior lender was partially unsecured and the city of Fort Worth was wholly unsecured.[151] The debtor's plan proposed to treat both deficiency claims separately, and the senior secured lender objected.[152] However, the court, in what it referred to as a narrow holding,[153] permitted the separate classification because "[t]he city of Fort Worth is distinct from other creditors including

[143] *Id.* at 538.
[144] *Id.* at 540.
[145] *Id.*
[146] *Id.* at 541.
[147] 994 F.2d 1160 (5th Cir. 1993).
[148] *Id.* at 1162, 1167.
[149] *Id.* at 1162.
[150] *Id.*
[151] *Id.*
[152] *Id.* at 1163.
[153] The court stated that "[i]n many bankruptcies, the proffered reasons as in *Greystone* will be insufficient to warrant separate classification." *Id.* at 1167.

[the senior lender.]."[154] The city of Fort Worth was different because "it ha[d] non-creditor interests relating to its urban housing program" and "it contributed $20,000 a month in rental assistance."[155]

In *In re Woodbrook Associates*,[156] the debtor owned an apartment complex and filed for bankruptcy after the complex was posted for foreclosure.[157] The debtor proposed a Chapter 11 plan with eight classes.[158] However, prior to confirmation, the debtor's secured creditor moved to dismiss the case on the grounds that it would not support a plan that did not pay it in full.[159] The bankruptcy court dismissed the debtor's case, finding that the debtor's plan could not be confirmed.[160] One of the issues before the Seventh Circuit on appeal from the dismissal of the debtor's case was whether the debtor could confirm a plan by separately classifying its secured creditor's unsecured deficiency claim from other unsecured creditors.[161] The secured creditor argued that separate classification was improper and done for purposes of vote manipulation.[162] However, the Seventh Circuit held that "the legal rights of a § 1111(b) claimant are substantially different from those of a general unsecured claimant," "at least where the debtor is a partnership comprised of a fully encumbered single asset."[163] As a result of the "[s]ignificant disparities . . . between the legal rights of the holder of a § 1111(b) claim and the holder of a general unsecured claim," the circuit concluded that the secured creditor's unsecured deficiency claim was "not substantially similar" to the general unsecured claims, which "preclude[d] the

[154] *Id.*
[155] *Id.*
[156] 19 F.3d 312 (7th Cir. 1994).
[157] *Id.* at 315.
[158] *Id.*
[159] *Id.* at 316.
[160] *Id.*
[161] *Id.* at 317.
[162] *Id.*
[163] *Id.* at 319.

two from being classified together under § 1122(a).”[164] Other courts have not followed the decision in *Woodbrook*, and have instead found that general unsecured claims and deficiency claims should not be separately classified.[165]

Given the dispute in the case law over these classification issues, plan proponents should be aware of Rule 3013, which permits the court to determine classes of creditors and equity security holders under § 1122 by motion after hearing on notice “as the court may direct.”[166] Such a determination in advance of, or contemporaneously with, approval of a disclose statement may be helpful.

IV. Impairment of Claims

A. Overview

To obtain confirmation of a plan by cramdown, a plan must (i) be “fair and equitable;” (ii) not discriminate unfairly against the dissenting class; and (iii) satisfy all of the other § 1129(a) requirements, including acceptance of the plan by at least one impaired, non-insider class.[167] Section 1124 governs the impairment of claims. It provides that a class is impaired unless the class’s treatment pursuant to the plan:

> (1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or
>
> (2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—
>
>> (A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365 (b)(2) of this title or of a kind that section 365 (b)(2) expressly does not require to be cured;

[164] *Id.* at 318.

[165] *See, e.g.*, *In re* JRV Indus., Inc., 342 B.R. 635, 638 (Bankr. M.D. Fla. 2006) (“The Court agrees with the Second, Third, Fourth, Fifth, Eighth and Ninth Circuits and holds that a non-recourse deficiency claim is not sufficiently dissimilar from other unsecured claims to mandate separate classification.”).

[166] Fed. R. Bankr. P. 3013.

[167] 11 U.S.C. § 1129(b)(1) (2012).

> (B) reinstates the maturity of such claim or interest as such maturity existed before such default;
>
> (C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;
>
> (D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365 (b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and
>
> (E) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.[168]

Impairment is defined in the broadest possible terms: any alteration of a claimant's legal rights constitutes impairment.[169] If a class is impaired, it is entitled to vote on the plan of reorganization.[170]

However, courts have found that not all alterations of a creditor's legal rights constitute impairment for purposes of § 1124. In *Solow v. PPI Enterprises (U.S.), Inc. (In re PPI Enterprises (U.S.), Inc.*,[171] the issue before the Third Circuit was whether a creditor—the debtor's landlord—was impaired and therefore had voting rights on the debtor's plan.[172] The debtor's plan limited the landlord's claim for lease termination damages to the statutory cap under § 502(b)(6) of the Code.[173] The debtor argued that its landlord was not impaired by this treatment, and the bankruptcy court confirmed the plan, finding that the landlord was deemed to have accepted the plan.[174] The circuit court agreed with the bankruptcy court, and concluded that even if a creditor's rights are impaired under nonbankruptcy law, the relevant analysis is

[168] *Id.* § 1124(a).

[169] Barakat v. The Life Ins. Co. of Va. (*In re* Barakat), 99 F.3d 1520, 1527 (9th Cir. 1996); *see also In re* Greenwood Point, LP, 445 B.R. 885, 906 (Bankr. S.D. Ind. 2011) (describing how § 1124 "broadly defines impairment" (internal quotation marks omitted)).

[170] *See In re Barakat*, 99 F.3d at 1528.

[171] 324 F.3d 197 (3d Cir. 2003).

[172] *Id.* at 202.

[173] *Id.*

[174] *Id.*

"whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights."[175] Because the landlord's rights were limited by the Code, and the plan provided for all that the landlord was entitled to receive under the Code, the landlord's claim was not impaired and therefore not eligible to vote.[176]

Even where treatment under a plan improves a creditor's position, courts have found the claim to be impaired. In *L & J Anaheim Associates v. Kawasaki Leasing International, Inc.*,[177] the debtor owned a hotel.[178] After the debtor failed to confirm a plan during the exclusivity period, the debtor's secured lender filed a plan, and the plan provided that the hotel would be auctioned and the proceeds would be used to pay creditors with liens on the hotel.[179] The debtor objected to cramdown of the plan, arguing that the impaired accepting class—the secured creditor—was not really impaired because the plan improved the secured creditor's legal rights.[180] While the court acknowledged that "[a]t first blush the idea that an improvement in one's position as a creditor might constitute 'impairment' seems nonsensical," it focused on the plain language of § 1124 and found that *any* alteration of rights constitutes impairment.[181] Therefore, it was irrelevant whether the secured creditor's rights were "enhanced or diminished under the Plan; [the] inquiry end[ed] with the conclusion that those rights were changed."[182] In *In re Reuter*,[183] a more recent case from the Bankruptcy Court for the Western District of

[175] *Id.* at 204.
[176] *Id.* at 205.
[177] 995 F.2d 940 (9th Cir. 1993).
[178] *Id.* at 941.
[179] *Id.*
[180] *Id.* at 942.
[181] *Id.* at 943.
[182] *Id.*
[183] 427 B.R. 727 (Bankr. W.D. Mo. 2010).

Missouri, the court relied on the definition of impairment from *L & J Anaheim* in its analysis of whether a creditor's rights were impaired under a plan.[184]

B. What Is Artificial Impairment?

Artificial impairment is the alteration of a claimant's rights under a plan based solely on the debtor's exercise of discretion, absent sufficient economic justification for the alteration. Put another way, it is any alteration of a creditor's rights for the sole purpose of effecting compliance with the requirements of § 1129(a)(10). Courts that prohibit artificial impairment "have denied confirmation where the plan's proponents have 'artificially impaired' a class in order to take advantage of the cramdown provisions of § 1129(a)(10)."[185] However, as discussed below, other courts permit artificial impairment.

C. Is Artificial Impairment Permitted Under the Bankruptcy Code?

The practice of artificial impairment is not expressly addressed in the Code. As a result, there is a split among courts as to whether the practice is permitted. Courts that prohibit artificial impairment do so because if the practice were permitted, it would render § 1129(a)(10) superfluous and leave dissenting creditors vulnerable to the gamesmanship of the plan proponent. Courts that permit artificial impairment argue that the unambiguous language of the Code must be read literally, and that purely tactical attempts to impair a class of claims may be addressed through other provisions of the Code, such as the good faith requirements in § 1129(a)(3).

[184] *Id.* at 773 ("Impairment is a term of art, extending beyond a worsening of a creditor's position to include virtually any alteration of the rights of interested parties beyond those specifically designated in § 1124 as not affecting impairment.").

[185] *In re Swartville, LLC*, No. 11-08676, 2012 WL 3564171 (Bankr. E.D.N.C. 2012).

1. Cases Finding That Artificial Impairment Is Prohibited

The Eighth Circuit explored the issue of artificial impairment in *Windsor on the River Associates, Ltd. v. Balcor Real Estate Finance, Inc. (In re Windsor on the River Associates, Ltd.)*.[186] The debtor in *In re Windsor* was a limited partnership whose only asset was an apartment complex in Iowa.[187] The debtor's largest creditor, Balcor Real Estate Finance ("Balcor") was a secured lender who held a mortgage on the apartment complex.[188] The debtor's plan proposed to pay Balcor a fixed amount at confirmation and then enter into a new loan agreement that extended the maturity date of the original loan by 10 years.[189] The debtor would make monthly payments amortized over 30 years and then would make a final balloon payment.[190] The plan proposed to pay the other two classes of claims 60 days after the plan's effective date.[191] Balcor appealed confirmation of the debtor's plan.[192] The issue before the Eighth Circuit was "whether a debtor's voluntary Chapter 11 reorganization plan can be confirmed over the objection of a secured creditor . . . when no other creditors are materially affected by the plan.[193]

The court analyzed the treatment of the two classes of claims that would be paid 60 days after the effective date to determine whether they were really impaired.[194] At the outset, the court noted that a delay in payment could be impairment.[195] However, "[i]f [that] impairment has been manufactured, then the plan must be regarded as having circumvented the [Code]."[196]

[186] 7 F.3d 127 (8th Cir. 1993).
[187] *Id.* at 129.
[188] *Id.*
[189] *Id.* at 129-130.
[190] *Id.* at 130.
[191] *Id.* at 129.
[192] *Id.*
[193] *Id.*
[194] *Id.* at 132.
[195] *Id.*
[196] *Id.*

The court treated the issue of whether a debtor artificially impaired a class so as to secure confirmation as a question of fact.[197] Based on the plan, the court found that the other two classes of claims were "arbitrarily and artificially impaired" because the debtor could have structured its plan to pay the other two classes of claims in full upon the effective date.[198] As a result of artificial impairment, Balcor was the only impaired creditor and therefore, its acceptance was necessary for confirmation.[199] Because the debtor could not propose a confirmable plan, the Court ordered that the debtor's case be dismissed.[200]

Other courts have found similarly to the Eighth Circuit in *Windsor*, including a recent case from a bankruptcy court in the Tenth Circuit. In *In re Deming Hospitality, LLC*,[201] a 2013 decision from the Bankruptcy Court for the District of New Mexico, the court addressed objections to a disclosure statement filed by various creditors.[202] The creditors argued that approval of the disclosure statement should be denied because the plan was unconfirmable.[203] The court, stating that it had the "discretion to deny approval of a disclosure statement if the accompanying plan is unconfirmable on its face," examined the alleged defects raised by the creditors.[204] One of those alleged defects was that the plan artificially impaired general unsecured creditors.[205] While not ultimately finding that the general unsecured creditors were artificially impaired, the court noted that the debtor would have to provide evidence of a legitimate business reason to impair the general unsecured creditors by not paying them in full, when a proposed equity infusion under the plan would provide enough funds to pay the general

[197] *Id.*
[198] *Id.* at 133.
[199] *Id.*
[200] *Id.*
[201] No. 11-13377, 2013 WL 1397458 (Bankr. D.N.M. Apr. 5, 2013).
[202] *Id.* at *1.
[203] *Id.*
[204] *Id.*
[205] *Id.* at *6.

unsecured creditors in full.[206] The court, though, ultimately did not approve the disclosure statement because the plan violated the absolute priority rule.[207]

In another recent case, *In re RYYZ, Inc.*,[208] a creditor moved for relief from the automatic stay in a single asset real estate case, alleging, *inter alia*, that the debtor's plan did not have a reasonable likelihood of being confirmed.[209] Therefore, the court analyzed the debtor's plan to see if it could be confirmed, and one of the issues before the court was whether the debtor artificially impaired a class of claims in the hopes of obtaining cramdown.[210] In particular, the court analyzed the treatment of the allegedly impaired tenant class, which consisted of claims for security deposits.[211] The court found that the debtors did not articulate a business reason for their proposed impairment of the tenant class.[212] Moreover, the court found that the debtor had the ability to treat the tenant class as unimpaired based on a capital contribution from the debtor's principals.[213] Therefore, the court found that it would not be able to confirm a plan based on the tenant class's vote because that class was artificially impaired.[214] As such, the court lifted the stay.[215]

In *In re All Land Investments, LLC*,[216] one of the issues before the court was whether there was an impaired accepting class so that the plan could be confirmed under § 1129(a)(10).[217] The court found that the debtor's proposed treatment of two classes of claims that accepted the plan amounted to artificial impairment because the debtor failed to provide a business reason as

[206] *Id.* at *7.
[207] *Id.* at *9.
[208] 490 B.R. 29 (Bankr. E.D.N.Y. 2013).
[209] *Id.* at 35.
[210] *Id.* at 43.
[211] *Id.*
[212] *Id.*
[213] *Id.*
[214] *Id.*
[215] *Id.* at 46.
[216] 468 B.R. 676 (Bankr. D. Del. 2012).
[217] *Id.* at 689.

to why it needed to impair those classes.[218] As such, the court disqualified those classes' votes in determining whether an impaired class had accepted the plan. The court noted that "the circumstances indicate that [the classes] are impaired solely to obtain the requisite vote to permit confirmation by cramdown."[219]

Similarly, in *In re Dean*,[220] a court denied confirmation because, *inter alia*, the plan artificially impaired unsecured creditors.[221] The debtor proposed to pay its unsecured creditors in full, but 60 days after the effective date.[222] The debtor did not present a sufficient reason to the court as to why it needed to delay the payment.[223] Instead, the court found the impairment to be engineered, and would not confirm a plan where the debtor "improperly impaired a class for the purpose of trying to literally satisfy the cram down requirements."[224] And, while not finding that the debtor artificially impaired a class, the court in *In re Club Associates*,[225] noted that "[a]n alteration which is clearly intended only to create an impaired class to vote in favor of a plan so that a debtor can effectuate a cramdown . . . [is] not allowed."[226]

2. Cases Finding That Artificial Impairment Is Not Prohibited *Per Se*

In a recent Fifth Circuit case, *Western Real Estate Equities, L.L.C. v. Village at Camp Bowie I, L.P.*, *(In re Village at Camp Bowie I, L.P.)*,[227] the court expressly rejected *In re Windsor*.[228] In *Camp Bowie*, the debtor owned a parcel of real estate.[229] On the eve of

[218] *Id.* at 691-92.
[219] *Id.*
[220] 166 B.R. 949 (Bankr. D.N.M. 1994).
[221] *Id.* at 954.
[222] *Id.*
[223] *Id.*
[224] *Id.*
[225] 107 B.R. 385 (Bankr. N.D. Ga. 1989).
[226] *Id.* at 401.
[227] 710 F.3d 239 (5th Cir. 2013).
[228] *Id.* at 245.
[229] *Id.* at 242.

foreclosure, the debtor filed for Chapter 11.[230] The debtor proposed a plan with two impaired classes: (i) its secured creditor who held a mortgage on its real estate; and (ii) its unsecured trade creditors.[231] The mortgagee was fully secured.[232] The debtor owed over $32,000,000 to its secured lender, but only owed about $60,000 to its unsecured trade creditors.[233] The debtor proposed to give its secured creditor a new note, and to pay its unsecured trade creditors "in full within three months from the effective date, [but] without interest."[234] The trade creditors accepted the plan, but the secured creditor voted against the plan.[235] The secured creditor then objected to confirmation, arguing that the debtor artificially impaired the trade creditors.[236] Despite the secured creditor's argument, the bankruptcy court confirmed the plan.[237]

On appeal, the secured creditor argued that a plan proponent cannot artificially impair a class so as to create an impaired accepting class.[238] The Fifth Circuit rejected the *Windsor* court's analysis, concluding that the Code does not provide support for the Eighth Circuit's "motive inquiry."[239] Because the secured creditor's only argument on appeal was that the debtor artificially impaired the unsecured trade creditors, the court affirmed the lower court's finding that the debtor proposed a confirmable plan.[240] However, the Fifth Circuit did note that when a court conducts a good faith analysis of a plan, "[a]n inference of bad faith might be stronger where a debtor created an impaired accepting class out of whole cloth by incurring a debt with a

[230] *Id.*
[231] *Id.* at 243.
[232] *Id.* at 242.
[233] *Id.*
[234] *Id.* at 243.
[235] *Id.*
[236] *Id.*
[237] *Id.*
[238] *Id.* at 244.
[239] *Id.* at 245.
[240] *Id.* at 248.

related party, particularly if there is evidence that the lending transaction is a sham."[241] The Fifth Circuit's conclusion in *Camp Bowie* is similar to an earlier decision from the Bankruptcy Court for the Western District of Texas, *In re Landing Associates, Ltd.*,[242] where the court concluded that "[t]he proper analysis of so-called 'artificial impairment' is to be conducted under the rubric of the plan's *bona fides* under section 1129(a)(3)."[243]

The *Camp Bowie* court adopted the reasoning of the Ninth Circuit in *In re L & J Anaheim Associates*.[244] In *L & J Anaheim*, the Ninth Circuit stated that "[t]here is no suggestion [in § 1124] that only alterations of a particular kind or degree can constitute impairment."[245] A decision by the Ninth Circuit Bankruptcy Appellate Panel, *Connecticut General Life Insurance Co. v. Hotel Associates of Tucson (In re Hotel Associates of Tucson)*,[246] also relied on *L & J Anaheim*, and rejected a creditor's argument that a plan artificially impaired a class of unsecured creditors.[247] In that case the court concluded that "a plan proponent's motivations will not be questioned in determining whether a class is impaired under Section 1129(a)(1), but will be examined in deciding whether a plan was proposed in bad faith."[248]

Another recent case also relied on *L & J Anaheim* to reject the concept of artificial impairment. In *In re Bataa/Kierland LLC*,[249] a case from the Bankruptcy Court of the District of Arizona, a creditor argued that the debtor artificially impaired a class so that the debtor could

[241] *Id.*

[242] 157 B.R. 791(Bankr. W.D. Tex. 1993).

[243] *Id.* at 822. Section 1129(a)(3) of the Code provides that one of the requirements for confirmation of a plan is that "[t]he plan has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3) (2012).

[244] *Camp Bowie*, 710 F.3d at 245.

[245] L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc., 995 F.2d 940, 943 (9th Cir. 1993).

[246] 165 B.R. 470 (9th Cir. BAP 1994).

[247] *Id.*at 474.

[248] *Id.* at 475.

[249] 476 B.R. 558 (Bankr. D. Ariz. 2012).

obtain confirmation by cramdown.[250] The creditor alleged that the class consisting of a certain secured claim was artificially impaired because the debtor had the ability to pay that claim in full.[251] However, the court rejected that argument.[252] It found that that "[i]f a claim is properly classified and the plan modifies the creditor's state law rights, there is no reason to inquire into the motive for that claim's treatment under the plan."[253] Therefore, because the secured creditor's claim was properly classified and impaired—regardless of the debtor's motives—it qualified as an impaired accepting class for purposes of § 1129(a)(10).[254]

V. APPROVAL OF DISCLOSURE STATEMENTS

A. Disclosure Statement Contents

Section 1125 requires that, other than in a small business case under § 1125(f), a written disclosure statement must be approved by the court, after notice and a hearing, and sent to holders of claims and interests along with a copy of the plan of reorganization and/or a summary of the plan.[255] A disclosure statement must contain "adequate information," which the Code defines as:

> [I]nformation of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan and in determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information . . . .[256]

[250] *Id.* at 563.
[251] *Id.* at 561.
[252] *Id.* at 563.
[253] *Id.* at 564 (footnote omitted).
[254] *Id.*
[255] 11 U.S.C. 1125(b) (2012).
[256] *Id.* § 1125(a)(1).

Generally, courts consider 19 factors in evaluating the adequacy of a disclosure statement. The most commonly cited version of the factors appears in *In re Metrocraft Publishing Services, Inc.*[257] Those factors are:

> (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 collectibility 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.[258]

B. Objections to the Disclosure Statement

Both creditors and debtors should be practical when dealing with objections to a disclosure statement. An objecting creditor should always consider whether what it is asking to be included is likely to be significant to other creditors and/or interest holders. Similarly, the debtor should try to resolve disclosure statement issues in advance of the hearing if possible. Adding additional relevant information to a disclosure statement should be an easy fix.

Raising confirmation objections in connection with the disclosure statement hearing is not likely to succeed in short-circuiting the plan solicitation/confirmation process, unless the plan is fatally flawed—*i.e.*, the plan cannot be confirmed as a matter of law. While it may make sense to educate the judge about a serious confirmation issue at the disclosure statement hearing, many judges will have already identified the potential problems.

[257] 39 B.R. 567 (Bankr. N.D. Ga. 1984).

[258] *Id.* at 568.

C. Reservation of Future Avoidance and Other Litigation

Section 1123 of the Code governs the contents of a Chapter 11 plan. Sections 1123(b)(3)(A) and (B) set forth the pertinent subjects that a plan may provide for, including "the settlement or adjustment of any claim or interest belonging to the debtor or to the estate" or "the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest." The Code provides that the Trustee may "avoid" preferences,[259] fraudulent transfers,[260] and certain setoffs.[261] This is the statutory authority under which a debtor-in-possession may pursue avoidance actions on behalf of its estate. Whether the reorganized debtor (or its successor or representative) may actually pursue these types of claims or other claims post-confirmation is a function of whether the intent to pursue the claims has been adequately disclosed in the plan and disclosure statement.

Cases law is divided on how specific a plan proponent must be to retain the right to pursue these claims post-confirmation in accordance with § 1123(b)(3)(B). In *Harstad v. First American Bank*,[262] the Eighth Circuit concluded that two individual debtors lacked standing to pursue preference actions that they filed post-confirmation because their plan did not have a provision stating that they would retain those causes of actions.[263] The debtors' disclosure statement provided that "Debtors and the Committee of Unsecured Creditors have not yet completed the analysis of pre-petition preferential transfers subject to avoidance under 11 U.S.C. § 547. Debtors do not know at the present time whether or not there are any avoidable preferential transfers."[264] The debtors made two arguments as to why their causes of action were

[259] 11 U.S.C. § 547(b).

[260] *Id.* §§ 544, 548.

[261] *Id.* § 553.

[262] 39 F.3d 898 (8th Cir. 1994).

[263] *Id.* at 902.

[264] *Id.* at 901.

preserved, both of which were rejected. First, that their plan provided that the bankruptcy court would have post-confirmation jurisdiction over causes of action between the debtors and other parties.[265] However, the Eighth Circuit held that "if [the debtors] wished to retain the power to enforce [a preference action], it would have been a simple matter to do so with straightforward language."[266] The debtors also argued that under § 1141(b)[267] they retained their causes of action.[268] However, the circuit court concluded that the specific language of § 1123(b)(3) "preempts the general provision of § 1141."[269] Other courts, including the Fifth Circuit and the Bankruptcy Court for the district of Colorado have followed the *Harstad* court's strict approach to the retention of causes of action and require a plan to specifically state that a reorganized debtor will retain them for post-confirmation prosecution.[270]

[265] *Id.*

[266] *Id.*

[267] Section 1141(b) provides that "the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1141(b).

[268] *Harstad*, 39 F.3d at 902.

[269] *Id.*

[270] *See, e.g.*, Compton v. Anderson (*In re* MPF Holdings US LLC), 701 F.3d 449, 455, 457 (5th Cir. 2012) (finding that reservation language that identified each defendant by name and stated the basis of recovery from those defendants was "sufficiently specific and unequivocal," even though the Fifth Circuit does not require that a plan name each defendant individually); Spicer v. Laguna Madre Oil & Gas II (*In re* Tx. Wyo. Drilling, Inc.), 647 F.3d 547, 552 (5th Cir. 2011) (holding that a plan and disclosure statement reserved the right to pursue avoidance actions where the debtor identified the prospective defendants as "[v]arious pre-petition shareholders of the Debtor" (alteration in original) (internal quotation marks omitted)); Nat'l Benevolent Ass'n of the Christian Church (Disciples of Christ) v. Weil, Gotshal & Manges, LLP (*In re* Nat'l Benevolent Ass'n of the Christian Church (Disciples of Christ)), 333 Fed. App'x 822, 827 (5th Cir. 2009) (per curiam) ("[T]he dispositive question is whether the plan specifically and unequivocally reserved the pre-petition malpractice claims."); Dynasty Oil and Gas, LLC v. Citizens Bank (*In re* United Operating, LLC), 540 F.3d 351, 355 (5th Cir. 2008) ("For a debtor to preserve a claim, the plan must expressly retain the right to pursue such actions. The reservation must be specific and unequivocal." (citations omitted) (internal quotation marks omitted)); Mercury Cos. Inc. v. Comerica Bank, No. 13-01921, 2014 WL 561993, at *4-5 (D. Colo. Feb. 12, 2014) (finding that a debtor failed to retain state law claims, even though the plan included that the reorganized debtor could prosecute any cause of action); Blue Water Endeavors, LLC v. AC & Sons, Inc. (*In re* Blue Water Endeavors, LLC) No. 08–10466, 2011 WL 52525, *6 (Bankr. E.D. Tex. Jan. 6, 2011) (finding the phrase "[l]awsuits or other claims against third parties" insufficient to retain common law claims); *In re* W. Integrated Networks, LLC, 329 B.R. 334, 339 (Bankr. D. Colo. 2005) ("Because the reservation of rights under which [the liquidation trustee] seeks to bring his §§ 542(a) and 544 claims is based on . . . vague, 'blanket' language . . . , this Court found [that the liquidation trustee] did not possess standing to pursue such claims, because the Confirmed Plan failed clearly to reserve rights to such actions.").

However, other courts take a more lenient approach. For example, in *Cooper v. Tech Data Corp. (In re Bridgeport Holdings, Inc.*),[271] the bankruptcy court for the District of Delaware found that a general retention provision that was clear and unambiguous was sufficient to retain causes of actions.[272] Similarly, in *Alary Corp. v. Sims (In re Associated Vintage Corp.)*,[273] the Bankruptcy Appellate Panel for the Ninth Circuit found that it was "impractical and unnecessary to expect that a disclosure statement and plan must list each and every possible defendant and each and every possible theory."[274] The Seventh Circuit also found that general language was sufficient to preserve a claim.[275]

Given the dispute in the case law, however, a plan proponent should be cautious, and be as specific as possible with language intending to preserve causes of action.

VI. SELECTED CONFIRMATION ISSUES

A. Good Faith

For a plan of reorganization to be confirmed, the plan must be proposed in good faith. The debtor, or other plan proponent, bears the burden of proof on this issue by a preponderance of the evidence.[276] In accordance with Rule 3020(b)(2), unless there is an objection to

[271] 326 B.R. 312 (Bankr. D. Del. 2005).
[272] *Id.* at 327.
[273] 283 B.R. 549 (9th Cir. BAP 2002).
[274] *Id.* at 564.
[275] P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (*In re* P.A. Bergner & Co.), 140 F.3d 1111, 1117 (7th Cir. 1998); *see also In re* Kmart Corp., 310 B.R. 107 (Bankr. N.D. Ill. 2004) (finding that a broad, but clear, retention provision was sufficient to retain certain causes of actions).
[276] Fin. Sec. Assurance Inc. v. T-H New Orleans Ltd. P'ship (*In re* T-H New Orleans Ltd. P'ship), 116 F.3d 790, 802 (5th Cir. 1997) ("The standard of proof required by the debtor to prove a Chapter 11 plan was proposed in good faith is by a preponderance of the evidence."); *In re* Nevel Props. Corp., No. 09-00415, 2012 WL 528179, at *5 (Bankr. N.D. Iowa Feb. 17, 2012) ("The proponent of the plan bears the burden of proof with respect to each element of § 1129(a) under a preponderance of the evidence standard. Section 1129(a) specifically requires that a plan be proposed in good faith." (citations omitted) (internal quotation marks omitted)); *In re* Global Water Techs., 311 B.R. 896, 902 (Bankr. D. Colo. 2004) (citing to *In re T-H New Orleans Ltd. P'ship* for the proposition that the debtor bears the burden of proof that a plan was proposed in good faith by a preponderance of the evidence).

confirmation of a plan on good faith grounds, a bankruptcy court may make a finding of good faith without receiving any evidence.[277]

"Good faith" is not defined in the Code. Although different courts have formulated the "good faith" requirement in different ways, they have generally concluded that for the purpose of § 1129, good faith requires that the court find "a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Code."[278]

There is a split among courts about whether prepetition conduct is relevant to a finding of good faith. One line of cases holds that it is not.[279] According to the courts that hold such conduct is not relevant, their analysis is limited to the totality of the circumstances related to the negotiation, preparation, and proposal of the plan itself. However, the other line of cases holds

[277] FED. R. BANKR. P. 3020(b)(2).

[278] McCormick v. Banc One Leasing Corp. (*In re* McCormick), 49 F.3d 1524, 1526 (11th Cir. 1995) (per curiam); *see, e.g.,* Fireman's Fund Ins. Co. v. Plant Insulation Co. (*In re* Plant Insulation Co.), 544 Fed. App'x 669, 671 (9th Cir. 2013) ("A plan is proposed in good faith as long as it 'satisfies the purposes of the bankruptcy code.' And the review focuses on the 'totality of the circumstances.' (citation omitted) (quoting *In re* Gen. Teamsters, Warehousemen, and Helpers Union, Local 890, 265 F.3d 869, 877 (9th Cir. 2001)); Search Market Direct, Inc. v. Jubber (*In re* Paige), 685 F.3d 1160, 1179 (10th Cir. 2012) ("We reaffirm today that the test of good faith under § 1129(a)(3) focuses on whether a plan is likely to achieve its goals and whether those goals are consistent with the Code's purposes."); *In re T-H New Orleans Ltd. P'ship*, 116 F.3d at 802 ("The requirement of good faith must be viewed in light of the totality of the circumstances surrounding establishment of a Chapter 11 plan, keeping in mind the purpose of the Bankruptcy Code is to give debtors a reasonable opportunity to make a fresh start."); Hanson v. First Bank of S.D., N.A., 828 F.2d 1310, 1315 (8th Cir. 1987) ("In the context of a chapter 11 reorganization . . . a plan is considered proposed in good faith if there is a reasonable likelihood that the plan will achieve a result consistent with the standards prescribed under the Code." (internal quotation marks omitted)); *In re* Geijsel, 480 B.R. 238, 255 (Bankr. N.D. Tex. 2012) ("A plan proposed in good faith must have reorganization as its honest and legitimate purpose."); *In re* Riverbend Leasing LLC, 458 B.R. 520, 529 (Bankr. S.D. Iowa 2011) ("In [the Eighth] Circuit, a chapter 11 [p]lan is considered proposed in good faith if there is a reasonable likelihood that the plan will achieve a result consistent with the standards prescribed under the Code." (internal quotation marks omitted)).

[279] *See, e.g.*, Burns v. MacGibbon (*In re* MacGibbon), No. 05-15099, 2006 WL 6810935, at *8 (9th Cir. BAP Aug. 14, 2006) ("Regarding prepetition conduct issues, such as [the debtor's] multiple bankruptcy filings, failure to include creditors in the initial schedules, payments to children and family members, allegedly excessive expenditures and the like, while these topics are fair game in analyzing [the debtor's] good faith in *filing* for chapter 11 relief, they do not assist in determining whether her plan is proposed in good faith, the focus of § 1129(a)(3). The good faith standards required to file a petition are different from those for proposing the plan." (emphasis in original)); *In re Geijsel*, 480 B.R. at 255 ("Courts do not consider pre-petition actions when assessing the good faith of a proposed plan."); *In re* Machne Menachem, Inc., 371 B.R. 63, 69 (Bankr. M.D. Pa. 2006) ("Although this Court is well aware of the scathing opinion by Judge Glasser concerning . . . pre-petition corporate law violations, that conduct may not be a factor in determining whether this plan is proposed in good faith. Again, the good faith requirement of a § 1129(a)(3) inquiry pivots on the plan itself." (footnote omitted)); *In re* Valley View Shopping Ctr., L.P., 266 B.R. 10, 29 (Bankr. D. Kan. 2001) ("[I]n determining whether the Plan was proposed in good faith, the proper focus . . . is on the Debtor's postpetition conduct and on the plan itself, not on prepetition conduct.").

that prepetition conduct is relevant.[280] Those cases argue that the good faith requirement in § 1129(a)(3) focuses on plan development, and courts must analyze the totality of the circumstances, including pre-petition conduct.

Moreover, to be confirmed, the plan cannot be proposed "by any means forbidden by law."[281] This provision has been interpreted to mean that the plan proponent need not establish that the contents of the plan comply with all non-bankruptcy law, but rather that the proposal of the plan complies with law. For example, in *In re Frascella Enterprises*,[282] a creditor objected to a debtor's plan, arguing that the debtor's continued business was illegal.[283] However, the court declined to decide whether the business was illegal.[284] Instead, it found that for purposes of § 1123(a)(3), the relevant inquiry is not about the contents of the plan, but whether the proposal of the plan complied with non-bankruptcy law.[285] Similarly, in *In re 20 Bayard Views, LLC*,[286] the court found that § 1123 "does not require the bankruptcy judge to determine whether the ends

[280] Natural Land Corp. v. Baker Farms, Inc. (*In re* Natural Land Corp.), 825 F.2d 296, 298 (11th Cir. 1987) ("It seems unquestionable to us that the taint of a petition filed in bad faith must naturally extend to any subsequent reorganization proposal; thus, any proposal submitted by a debtor who filed its petition in bad faith would fail to meet § 1129's good faith requirement."); Univ. Creek Plaza, Ltd. v. N.Y. Life Ins. Co. *(In re* Univ. Creek Plaza, Ltd.), 176 B.R. 1011, 1020 (S.D. Fla. 1995) ("[T]he Court correctly held that the [debtor's] plan could not meet the good faith requirement set forth in 11 U.S.C. § 1129(a)(3) since it was determined that [the debtor's] petition was filed in bad faith."); *In re* Quigley Co., 437 B.R. 102, 125 (Bankr. S.D.N.Y. 2010) ("Section 1129(a)(3) speaks more to the process of plan development than to the content of the plan. It must be viewed in light of the totality of the circumstances surrounding the establishment of a chapter 11 plan, including the debtor's pre-filing conduct." (citations omitted) (internal quotation marks omitted)); *In re* Leslie Fay Cos., Inc., 207 B.R. 764, 781 (Bankr. S.D.N.Y. 1997) ("The requirement of good faith must be viewed in light of the totality of the circumstances surrounding the establishment of a chapter 11 plan, which may include considering the debtor's pre-filing conduct." (citations omitted) (internal quotation marks omitted)); *In re* SM 104, Ltd., 160 B.R. 202, 244 (Bankr. S.D. Fla. 1993) ("The court may consider prepetition conduct of the debtor only if that conduct is relevant to show a desire on the part of the debtor to use bankruptcy procedures to avoid paying a debt rather than for rehabilitation." (internal quotation marks omitted)).

[281] 11 U.S.C. § 1129(a)(3) (2012).

[282] 360 B.R. 435 (Bankr. E.D. Pa. 2007).

[283] *Id.* at 444.

[284] *Id.* at 445.

[285] *Id.*

[286] 445 B.R. 83 (Bankr. E.D.N.Y. 2011).

achieved in the plan contravene non-bankruptcy law."[287] Other court have also held that § 1123(a)(3) focuses on the proposal of the plan, and not the implementation of the plan.[288]

B. Best Interests

Section 1129(a)(7) generally requires that:

> (7) With respect to each impaired class of claims or interests—
>
> (A) each holder of a claim or interest of such class—
>
> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date . . . .[289]

What this means is that the plan proponent must be prepared to prove at the confirmation hearing that each non-accepting creditor or interest holder within an impaired class of claims or interests will receive at least as much under the plan as it would receive in a Chapter 7 liquidation.[290]

C. Feasibility

Section 1129(a)(11) requires a court to prevent confirmation of "visionary schemes" which promise creditors more under a proposed plan than the debtor can possibly attain after confirmation.[291] A court's examination of feasibility must be based on objective facts.[292] The

[287] *Id.* at 96.

[288] *See, e.g.*, Irving Tanning Co. v. Me. Superintendent of Ins. (*In re* Irving Tanning Co.), 496 B.R. 644, 660 (1st Cir. BAP 2013) ("Section 1129(a)(3) focuses not on the terms of the plan and its means of implementation but on the manner in which the plan has been *proposed*." (emphasis in original) (internal quotation marks omitted)).

[289] 11 U.S.C. § 1129(a)(7) (2012).

[290] *In re* Affiliated Foods, Inc., 249 B.R. 770, 787 (Bankr. W.D. Mo. 2000) ("The plan proponent bears the burden of proof to establish by a preponderance of the evidence that its plan meets the best interests test.").

[291] Travelers Ins. Co. v. Pikes Peak Water Co. (*In re* Pikes Peak Water Co.), 779 F.2d 1456, 1460 (10th Cir. 1985) ("The purpose of section 1129(a)(11) is to prevent confirmation of visionary schemes which promise creditors and equity security holders more under a proposed plan than the debtor can possibly attain after confirmation." (internal quotation marks omitted)); Bowman v. Bond (*In re* Bowman), 253 B.R. 233, 238-39 (8th Cir. BAP 2000) ("According to the Eighth Circuit, the feasibility test contemplates the probability of actual performance of provisions of the plan. . . . [S]incerity, honesty, and willingness are not sufficient to make the plan feasible, and neither are visionary promises." (internal quotation marks omitted)); *In re* Padda Hotels, 2014 WL 505118, at *4 (Bankr. D.N.M. Feb. 7, 2014) (citing *In re Pikes Peak*); *In re* Las Vegas Monorail Co., 462 B.R. 795, 801 (Bankr. D. Nev. 2011) ("The purpose of section 1129(a)(11) is to prevent confirmation of visionary schemes which promise creditors and equity security holders more under a proposed plan than the debtor can possibly attain after

court must look at the probability of actual performance of the proposed plan. "Sincerity, honesty and willingness are not sufficient to make the plan feasible, and neither are visionary promises."[293] Courts view the word "feasible" within its ordinary meaning—*i.e.*, that something is capable of being done or carried out.[294] It does not connote absolute assurance of success but, only reasonable assurance of success. Even the Supreme Court has spoken on likelihood of success of reorganization in *United Savings Ass'n v. Timbers of Inwood Forest Associates, Ltd.*,[295] stating that "there must be a reasonable possibility of a successful reorganization within a reasonable time."[296]

While § 1129(a)(11) recognizes the possibility of liquidating plans, the appropriate application of the feasibility requirement in the context of a liquidating plan is an open question. One line of cases takes a narrow approach and interprets the plain language of § 1129(a)(11) to

confirmation."); *In re* Trans Max Techs., Inc., 349 B.R. 80, 95 (Bankr. D. Nev. 2006) ("The obligation to scrutinize reorganizing debtors and not to release them until they are shown to be a viable business is echoed in the Ninth Circuit's exhortation that a court should prevent confirmation of visionary schemes . . . ." (internal quotation marks omitted)).

[292] F.H. Partners, L.P. v. Inv. Co. of the Sw. (*In re* Inv. Co. of the Sw.), 341 B.R. 298, 311 (10th Cir. BAP 2006); *In re* K & K Holdings, LLC, No. 12-23916, 2014 WL 585953, at *19 (Bankr. N.D. Ill. Feb. 13, 2014); *In re* Young Broad., 430 B.R. 99, 129 (Bankr. S.D.N.Y. 2010); *In re* Clark, 288 B.R. 237, 248 (Bankr. D. Kans. 2003).

[293] Clarkson v. Cooke Sales & Serv. Co. (*In re* Clarkson), 767 F.2d 417, 420 (8th Cir. 1985).

[294] *See, e.g.,* Kane v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 843 F.2d 636, 649 (2d Cir. 1988) ("Success need not be guaranteed"); Acequia v. Clinton (*In* Acequia), 787 F.2d 1352, 1364 (9th Cir. 1986) ("[W]e find that the Plan satisfies the 'feasibility' requirement of 11 U.S.C. § 1129(a)(11). The Debtor presented ample evidence to demonstrate that the Plan has a reasonable probability of success."); Prudential Ins. Co. v. Monnier (*In re* Monnier Bros.), 755 F.2d 1336, 1341 (8th Cir. 1985) ("Success need not be guaranteed."); *In re* Baker, No. 02-018, 2003 WL 90453, at *5 (10th Cir. BAP 2003) ("Debtors need not have convinced the bankruptcy court that they could guarantee success. Rather, they need only convince the court that their plan has a reasonable assurance of success."); *In re* Manchester Oaks Homeowners Ass'n, No. 11-10179, 2014 WL 961167, at *7 (Bankr. E.D. Va. Mar. 12, 2014) ("The feasibility standard is whether the plan offers a reasonable assurance of success; success need not be guaranteed." (internal quotation marks omitted)); *In re* 710 Long Ridge Road Operating Co., II, No. 13-13653, 2014 WL 886433, at *18 (Bankr. D.N.J. Mar. 5, 2014) ("Although the standards for determining feasibility are not rigorous, the court is obligated to independently evaluate the plan and determine whether it offers a reasonable probability of success"); *In re* Friendship Dairies, No. 12-20405, 2014 WL 29081, at *9 (Bankr. N.D. Tex. Jan. 3, 2014) ("The Court's overarching goal in assessing a plan's feasibility is to determine whether the debtor has shown, by a preponderance of the evidence, the existence of a reasonable possibility that a successful rehabilitation . . . can be accomplished within a reasonable period of time." (internal quotation marks omitted)); *In re* Bryan, 439 B.R. 724, 739 n.15 (Bankr. E.D. Ark. 2010) (citing to *Johns Manville*).

[295] 484 U.S. 365 (1988).

[296] *Id.* at 376 (internal quotation marks omitted).

say that feasibility need not be established when liquidation is proposed in the plan.[297] Or, stated another way, courts find that § 1129(a)(11) is satisfied where such liquidation is proposed in the plan itself. Other courts take a broader approach and apply the feasibility test to plans of liquidation, focusing their analysis on whether the liquidation itself, as proposed in the plan, is feasible.[298]

When challenging feasibility, factors to consider include: the debtor's prior performance,[299] the adequacy of the capital structure and availability of credit under the plan,[300] the earning power of the debtor's business,[301] economic conditions in which the debtor's

[297] *See, e.g.*, *In re* Cellular Info. Sys., Inc., 171 B.R. 926, 945 (Bankr. S.D.N.Y. 1994); *In re* 47th and Belleview Partners, 95 B.R. 117, 120 (Bankr W.D. Mo. 1988).

[298] *See, e.g.*, *In* re Am. Capital Equip, LLC, 688 F.3d 145, 156 (3d Cir. 2012); *In re* Holmes, 301 B.R. 911, 914 (Bankr. M.D. Ga. 2003).

[299] *See, e.g.*, Fin. Sec. Assurance Inc. v. T-H New Orleans Ltd. P'ship (*In re* T-H New Orleans Ltd. P'ship), 116 F.3d 790, 801-02 (5th Cir. 1997) (finding that a plan was feasible based in part on the debtor's past performance); Gros v. Walton (*In re* Gros), No. 12-61905, 2013 WL 3927826, *3 (S.D. Fla. July 29, 2013) (listing past performance as a criterion for judging a plan's feasibility); *In re* Settlers' Housing Svcs., Inc., 505 B.R. 483, 490 (Bankr. N.D. Ill. 2014) ("In assessing feasibility, a bankruptcy judge must make an informed judgment which embraces all facts relevant to future earning capacity . . . including . . . the past earning record."); *In re* Waterford Hotel, Inc., 497 B.R. 255, 263 (Bankr. E.D. Mich. 2013) (noting that a debtor's past financial performance is a factor used to determine feasibility); *In re* JRV Indus., Inc., 344 B.R. 679, 683-84 (Bankr. M.D. Fla. 2006) (finding a plan to not be feasible based on the debtor's past performance).

[300] *See, e.g.*, *In re* WR Grace & Co., 729 F.3d 332, 348-49 (3d Cir. 2013) (upholding a bankruptcy court's confirmation of a plan where the evidence, including the debtor's capital structure, "established a reasonable likelihood of the Plan's success"); *In re* 710 Long Ridge Road Operating Co., II No. 13-13653, 2014 WL 886433, at *19 (Bankr. D.N.J. Mar. 5, 2014) (stating that courts should consider the adequacy of a debtor's capital structure when analyzing feasibility); *In re* Young Broad., Inc., 430 B.R. 99, 130 (Bankr. S.D.N.Y. 2010) (considering expert testimony on the debtor's capital structure in its analysis of whether a plan was feasible); *In re* Chadda, No. 07-12665, 2007 WL 3407375, *4-5 (Bankr. E.D. Pa Nov. 9, 2007) (finding that a plan was not feasible where plan funding was dependent upon refinancing and the debtor produced no evidence of a loan commitment); *In re* Repurchase Corp., 332 B.R. 336, 343 (Bankr. N.D. Ill. 2005) (finding that a plan was not feasible where evidence about the debtor's ability to obtain post-confirmation funding was not corroborated or credible); *In re* Global Ocean Carriers Ltd., 251 B.R. 31, 46 (Bankr. D. Del. 2000) (finding a plan feasible where the post-petition lender issued a commitment letter, even though documentation was not finalized); *In re* Georgetown Ltd. P'ship, 209 B.R. 763, 770 (Bankr. M.D. Ga. 1997) (stating that a court should consider the adequacy of the debtor's capital structure when determining if a plan is feasible); *In re* Westpark Vill. Apartments of Douglas Cnty., Ltd., 133 B.R. 894, 897-98 (Bankr. S.D. Ohio 1991) (finding that commitments by the debtor's limited partners were sufficient to establish feasibility of a plan); *In re* Apex Oil Co., 118 B.R. 683, 708 (Bankr. E.D. Mo. 1990) (finding a plan feasible that provided, *inter alia*, that proposed financing would take place 10 days after confirmation); *In* re 222 Liberty Assocs., 108 B.R. 971, 986-87 (Bankr. E.D. Pa. 1990) (finding a plan feasible where a bank provided a commitment letter).

[301] Pan Am Corp. v. Delta Air Lines, Inc., 175 B.R 438, 508 (S.D.N.Y. 1994) ("To establish feasibility, the debtor must present proof through reasonable projections that there will be sufficient cash flow to fund the plan and maintain operations according to the plan. Such projections cannot be speculative, conjectural or unrealistic." (internal quotation marks omitted); *In re* Klondike Ranch Ltd. P'ship, No. 12-20013, 2013 WL 6045739, at *3

business operates,[302] the ability of management and probability of continuance of the same management,[303] and other factors, including the length of payout,[304] whether the plan proposes a fundamental change in the debtor's business operations,[305] whether the debtor is postponing the inevitable with negative amortization[306] and balloon payments,[307] and whether the plan is

(Bankr. D. Wyo. Nov. 14, 2013) (finding that a plan was not feasible because the debtor was not operating at a profit); *In re* Five Rivers Petroleum, LLC, No. 11-25202, 2013 WL 656026, at *4-5 (Bankr. W.D. Pa. Feb. 22, 2013) (finding a small business plan not feasible where the debtor did not have enough income to meet its expenses); *In re* SM 104 Ltd., 160 B.R. 202, 234 (Bankr. S.D. Fla. 1993) ("Section 1129(a)(11) requires the plan proponent to show concrete evidence of a sufficient cash flow to fund and maintain both its operations and obligations under the plan."); *In re* Nelson*,* 84 B.R. 90, 93 (Bankr. W.D. Tex. 1988) ("The concept of feasibility does not require a guarantee that there will be a return to all unsecured creditors. Rather, it requires that there be sufficient money to fund the Plan.").

[302] *In re* DBSD N. Am., Inc., 634 F.3d 79, 137 (2d Cir. 2011) (finding a plan feasible, where, among other factors, debtor demonstrated that the general creditor markets at the time of confirmation had improved from their low a year before, as that fact increased the likelihood that the debtor would be able to repay its creditors); *In re* GAC Storage Lansing, LLC, 485 B.R. 174, 188 (Bankr. N.D. Ill. 2013) (finding that a plan was not feasible where "[t]he Debtor's projections simply do not line up with economic reality."); *In re* Jennifer Convertibles, Inc., 447 B.R. 713, 725 (Bankr. S.D.N.Y. 2011) (finding a plan feasible in light of expert testimony about market and economic conditions).

[303] *In re* Seasons Partners, LLC, 439 B.R. 505, 515 (Bankr. D. Ariz. 2010) (finding a plan feasible because there was credible evidence that the reorganized debtor would be adequately managed); *In re* Apex Oil, 118 B.R. at 708 (observing that in judging feasibility, courts often consider the experience and ability of management); *In re* C & P Gray Farms, Inc., 70 B.R. 704, 706-07 (Bankr. W.D. Mo. 1987) (finding a plan feasible where, *inter alia*, that individuals who performed actual farming for debtor corporation were "good farmers"); *cf.* Quality Inns Int'l, Inc. v. L.B.H. Assoc. Ltd. P'ship, No. 89-2443, 1990 WL 116761, at *3 (4th Cir. 1990) ("When a principal of the debtor is to continue managing the debtor after confirmation, evidence of the principal's past performance is relevant to the confirmation decision.").

[304] *See, e.g.*, *In re In re* Mallard Pond, Ltd., 217 B.R. 782, 786 (Bankr. M.D. Tenn. 1997) ("[T]he longer the proposed plan, the more difficult it is for the debtor to prove feasibility."); *In re* Overland Park Merch. Mart P'ship, 167 B.R. 647, 660 (Bankr. D. Kan. 1997) (permitting a plan to include a 25-year payout because it was still within market limits of similar loans).

[305] *See, e.g.*, Cantu v. Romero Gonzalez & Benavides L.L.P. (*In re* Cantu), 398 Fed. App'x 76, 78 (5th Cir. 2010) (finding that a debtor's proof of feasibility was insufficient when he intended to change the nature of his law practice); Wiersma v. Bank of the W. (*In re* Wiersma), 227 Fed. App'x 603, 606 (9th Cir. 2007) (upholding a decision that found a plan not feasible where the debtor's business operations were substantially changing).

[306] *See, e.g.*, *In re* K & K Holdings, LLC, No. 12-23916, 2014 WL 585953, *18 (Bankr. N.D. Ill. Feb. 13, 2014) ("Negative amortization plans are not barred per se. But they are viewed with suspicion." (internal quotation marks omitted)); *In re* Good, 413 B.R. 552, 561 (Bankr. E.D. Tex. 2009) (finding a plan feasible, even though it provided for negative amortization); *In re* Mount Carbon Metro. Dist., 242 B.R. 18, 25 (Bankr. D. Colo. 1999) ("Plan terms which provide for negative amortization . . . may make the showing of feasibility difficult."); *In re* M & S Assocs., Ltd., 138 B.R. 845, 851 (Bankr. W.D. Tex. 1992) ("A reorganization plan which provides for negative amortization is not *per se* inequitable and a bar to confirmation, but may be highly suspect.").

[307] *See, e.g.*, F.H. Partners, L.P. v. Inv. Co. of the Sw. (*In re* Inv. Co. of the Sw.), 341 B.R. 298, 311 (10th Cir. BAP 2006) ("While courts often do not require projections for the same period over which a long-term plan spans, a debtor must still sustain its burden to somehow prove that it will be able to perform all obligations it is assuming under the plan. This is especially true when significant balloon payments are required in years not covered by the projections." (footnotes omitted)); SPCP Grp., LLC v. Cypress Creek Assisted Living Residence, Inc., 434 B.R. 650, 657 (M.D. Fla. 2010) (finding that the bankruptcy court did not err in finding a plan feasible that provided for a balloon payment because "the evidence presented was not too speculative regarding the Debtors' ability to make the

dependent upon the future sale of real property.[308] A court does not have to consider all of these factors.[309] It can consider only the factors it finds relevant, or may consider factors beyond this non-exclusive list.

D. Projected Disposable Income Test for Individual Chapter 11 Debtors

Section 1129(a)(15) provides that:

> (15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan—
>
> > (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
> >
> > (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.[310]

An unsecured creditor does not trigger § 1129(a)(15) by voting against the plan. Rather, the unsecured creditor must file a written objection to confirmation.

In *In re Washington*,[311] the issue before the court was whether it could confirm a Chapter 11 plan that did not comply with § 1129(a)(15).[312] The court concluded that § 1129(a)(15) only applies if an unsecured creditor objects to confirmation of a plan.[313] Simply voting against the plain is insufficient to trigger § 1129(a)(15) because a vote rejecting the plan is not tantamount to

balloon payment"); *In re* Am. Trailer & Storage, Inc., 419 B.R. 412, 431 (Bankr. W.D. Mo. 2009) (finding a plan feasible even though it provided for a balloon payment because there was sufficient evidence to support the debtor's ability to refinance the balloon payment).

[308] *See, e.g.*, *In re* Renegade Holdings, Inc., No. 09-50140, 2013 WL 2353940, at *13 (Bankr. M.D.N.C. May 29, 2013) (finding that a plan dependent upon the future sale of equity was "shrouded by uncertainty" and therefore not feasible); *In re* South Canaan Cellular Inv., 427 B.R. 44, 63 (Bankr. E.D. Pa. 2010) ("[A] party proposing a chapter 11 plan that calls for the sale of an asset typically will need to present some evidence of a bona fide offer or competent marketing effort to establish feasibility."); *In re* Smitty Inv. Grp., LLC, NO. 07-00020, 2008 WL 2095523, *11 (D. Idaho May 16, 2008) (finding that a plan which fully hinged on a dramatically improving real estate market was not feasible, and rejecting expert testimony as to future changes in the real estate market under *Duabert*).

[309] *In re* Save Our Springs (S.O.S.) Alliance, Inc., 632 F.3d 168, 173 (5th Cir. 2011).

[310] 11 U.S.C. § 1129(a)(15) (2012).

[311] No. 09-30103, 2010 WL 1417708 (Bankr. N.D. Tex. 2010).

[312] *Id.*

[313] *Id.* at *2.

an objection to the plan.[314] The court noted that even though the debtors were not paying unsecured creditors their entire disposable income, that "result is permitted by the Bankruptcy Code."[315]

Similarly, in *In re Shat*,[316] the court concluded that "a plan proponent need only satisfy the disposable income test of Section 1129(a)(15) if the holder of an allowed unsecured claim *objects* to the confirmation of the plan. . . . [S]imply cast[ing] a ballot rejecting the Plan . . . is insufficient to invoke Section 1129(a)(15)."[317] The Bankruptcy Appellate Panel of Ninth Circuit in *Friedman v. P+P, LLC (In re Friedman*),[318] also concluded that § 1129(a)(15) is not triggered simply by voting against the plan, but instead is only triggered if an unsecured creditor objects to confirmation.[319] It came to this conclusion because the purpose of § 1129(a)(15) was to "create symmetry between chapter 11 and 13 for individual debtors" and in a Chapter 13 case, creditors do not vote for a plan, but instead object to the confirmation of a plan.[320]

E. Cramdown

For the court to confirm a plan, the plan must satisfy each of the requirements in § 1129(a).[321] However, § 1129(b) provides an exception if the plan meets all of the requirements of § 1129(a) except (a)(8).[322] Section 1129(a)(8) requires that all impaired classes have accepted the plan.[323] Under § 1129(b), the plan can still be confirmed even if all impaired classes have not voted to accept the plan "if the plan does not discriminate unfairly, and is fair and equitable, with

[314] *Id.* at *2.
[315] *Id.* at *3.
[316] 424 B.R. 854 (Bankr. D. Nev. 2010).
[317] *Id.* at 857 n.4 (emphasis in original).
[318] 466 B.R. 471 (9th Cir. BAP 2012).
[319] *Id.* at 484.
[320] *Id.*
[321] 11 U.S.C. § 1129(a) (2012).
[322] *Id.* § 1129(b)(1).
[323] *Id.* § 1129(a)(8).

respect to each class of claims or interests that is impaired under, and has not accepted, the plan."[324]

1. Unfair Discrimination

While some disparate treatment of similar claims in separate classes is permitted, the disparate treatment cannot constitute "unfair discrimination." In other words, a plan proponent may discriminate, just not unfairly.[325] In *In re American Trailer & Storage, Inc.*,[326] a secured creditor objected to the debtor's plan, alleging that the plan unfairly discriminated between it and other secured creditors.[327] Pursuant to the debtor's plan, the objecting secured creditor would not be paid its contract rate of interest or retain certain covenants in its loan documents.[328] However, the other secured creditors would be paid their contract rate of interest.[329] The court applied a four part test to determine whether the disparate treatment was unfair discrimination: "(1) a reasonable basis for the discrimination exists; (2) the debtor cannot consummate its plan without discrimination; (3) the discrimination is proposed in good faith; and (4) the degree of discrimination is directly proportional to its rationale."[330] Applying that test, the court found that

[324] *Id.* § 1129(b)(1).

[325] *See, e.g.*, Ala. Dep't of Eco. & Cmty. Affairs v. Ball Healthcare—Dall., LLC (*In re* Lett), 632 F.3d 1216, 1220 (11th Cir. 2011) ("By providing a rigid set of obligations for the court in approving a plan in cram down, Chapter 11 serves to prevent both a debtor from unfairly discriminating against a specific creditor or group of creditors, as well as obstinate creditors from holding up the approval of an otherwise sound plan of reorganization."); *In re* Tribune Co., 464 B.R. 126, 199 (Bankr. D. Del. 2011) ("Minor or immaterial differences in plan treatment do not rise to the level of *unfair* discrimination." (emphasis in original)); *In re* Unbreakable Nation Co., 437 B.R. 189, 202 (Bankr. E.D. Pa. 2010) (finding that a plan did not discriminate unfairly because there was a rational basis to treat certain claims differently."); *In re* TCI 2 Holdings, LLC, 428 B.R. 117, 157 (Bankr. D.N.J. 2010) ("Generally, a plan will not be found to have unfairly discriminated if: (a) the discrimination is supported by a reasonable basis, (b) the discrimination is necessary for reorganization, (c) the discrimination is proposed in good faith, and (d) the degree of discrimination is directly related to the basis or rationale for the discrimination." (internal quotation marks omitted)); *In re* Dow Corning Corp., 244 B.R. 705, 710 (Bankr. E.D. Mich. 1999) ("Section 1129(b)(1) prohibits discrimination against a non-accepting class only when that discrimination is 'unfair.'"); *In re* Stratford Assocs. Ltd. P'ship, 145 B.R. 689, 700-01 (Bankr. D. Kan. 1992) ("While the Plan discriminates, to violate § 1129(b)(1), the discrimination must be *unfair*." (emphasis in original)).

[326] 419 B.R. 412 (Bankr. W.D. Mo. 2009).

[327] *Id.* at 442.

[328] *Id.* at 443.

[329] *Id.*

[330] *Id.*

the proposed discrimination was not unfair. It noted that "due to the minimal impact that the Debtor's other loans have on its reorganization, there was little, if any, incentive to spend resources litigating interest rates or inclusion of various loan covenants."[331] The court also noted that if the debtor had to treat all of its secured creditors under the plan the same way, the debtor would not have been able to reorganize.[332]

Plan proponents should be mindful of their burden if a creditor challenges the plan as unfairly discriminating between classes. In *In re Deming Hospitality, LLC*,[333] one of the issues before the court was whether a plan unfairly discriminated between a secured lender's unsecured deficiency claim and general unsecured creditors, where the unsecured deficiency would receive a 1.67% dividend and the general unsecured creditors would receive a 75% dividend.[334] The creditor with the unsecured deficiency claim argued that it was unfair discrimination, and therefore the court should not approve the debtor's disclosure statement because the underlying plan was facially unconfirmable.[335] Noting that "[t]here was no controlling Tenth Circuit authority on what 'discriminate unfairly' means," the court found that the plan was not facially unconfirmable, but the debtor would bear the burden of justifying the "grossly disproportionate" treatment, especially if a plan could be confirmed that did not result in such disparate treatment of the claims.[336] Ultimately, though, a plan was not confirmed in the case and the debtor consented to dismissal.[337]

[331] *Id.* at 444.
[332] *Id.*
[333] No. 12-13377, 2013 WL 1297458 (Bankr. D.N.M. Apr. 5, 2013).
[334] *Id.* at *4-5.
[335] *Id.* at *1, *4.
[336] *Id.* at *6.
[337] Order Dismissing Bankruptcy Case, *In re* Deming Hospitality, LLC, No. 12-13377 (July 9, 2013 D.N.M.), ECF No. 137.

2. Fair and Equitable Treatment of Secured Claims

The plan must be fair and equitable with respect to each dissenting class of claims or interests. Section 1129(b)(2)(A) provides three express alternatives in order that a plan may be fair and equitable with respect to a class of secured claims: (i) that the claimant retain its lien and receive deferred cash payments totaling its allowed claim;[338] (ii) that the claimant's collateral be sold with liens attaching to the proceeds of the sale;[339] or (iii) that the claimant receive the indubitable equivalent of its secured claim.[340]

a. Section 1129(b)(2)(A)(i)

There are certain problems associated with § 1129(b)(2)(A)(i). The present value analysis associated with the deferred cash payment requirement is controversial. This present value requirement, which compensates the secured creditor for the delay in receiving payment in respect of its allowed secured claim, includes, by definition, an interest component. There was much controversy in the case law regarding how to determine an appropriate interest rate for the purpose of this present value analysis. Some courts used the prepetition contract rate,[341] while other courts used a "market" rate analysis.[342] Still other courts used a so-called "forced loan

[338] 11 U.S.C. § 1129(b)(2)(A)(i) (2012).

[339] *Id.* § 1129(b)(2)(A)(ii).

[340] *Id.* § 1129(b)(2)(A)(iii).

[341] *See, e.g.*, Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211, 213, (5th Cir. 1997), *overruled by* Drive Fin. Servs, L.P. v. Jordan, 521 F.3d 343 (5th Cir. 2008) ("[O]ften the contract rate will be the appropriate rate" (internal quotation marks omitted)); Fin. Sec. Assurance Inc. v. T-H New Orleans Ltd. P'ship (*In re* T-H New Orleans Ltd. P'ship), 116 F.3d 790, 801 (5th Cir. 1997) (finding that the contract rate was the appropriate rate of interest); Heartland Fed. Sav. & Loan Assoc. v. Briscoe Enters., Ltd. II (*In re* Briscoe Enters., Ltd., II), 994 F.2d 1160, 1169 (5th Cir. 1993) ("Often the contract rate will be an appropriate rate . . . ").

[342] *See, e.g.*, Gen. Motors Acceptance Corp. v. Valenti (*In re* Valenti), 105 F.3d 55, 64 (2d Cir. 1997), *abrogated on other grounds by* Assocs. Comm. Corp. v. Rash, 520 U.S. 953 (1997) (holding that the market rate "should be fixed at the rate on a United States Treasury instrument with a maturity equivalent to the repayment schedule under the debtor's reorganization plan" plus "a premium to reflect the risk to the creditor in receiving deferred payments under the reorganization plan"); *see also* Key Bank Nat'l Assn. v. Milham (*In re* Milham), 141 F.3d 420, 425 (applying the holding from *In re Valenti*).

rate."[343] While the Supreme Court's decision in *Till v. SCS Credit Corp.*[344] provided some guidance to the lower courts on how a market rate of interest is to be determined, there is still significant uncertainty about the application of *Till* in the Chapter 11 context.

In *Till*, the issue before the Court was what was the appropriate method for calculating the cramdown rate of interest for a secured creditor in a Chapter 13 case.[345] The debtors proposed a plan where they would pay their secured creditor interest at a rate of 9.5%, which they calculated to be the national prime rate plus additional interest "to account for the risk of nonpayment posed by borrowers in their financial position."[346] The secured creditor objected, and argued that the interest rate should be the rate it would obtain if it used the proceeds from the foreclosed collateral to reinvest in loans of identical risk and duration.[347] The Court ultimately adopted the debtor's approach—which the Court referred to as the "formula approach."[348] In its analysis the Court noted that "[t]he Bankruptcy Code provides little guidance as to which of the rates of interest advocated by the four opinions in this case—the formula rate, the coerced loan rate, the presumptive contract rate, or the cost of funds rate—Congress had in mind when it adopted the cramdown provision."[349] The Court adopted the formula approach because it is "a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly

[343] *See, e.g.*, Koopmans v. Farm Credit Servs. of Mid-Am., ACA, 102 F.3d 874, 875 (7th Cir. 1996) ("[W]e now hold that the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk.").

[344] 541 U.S. 465 (2004).

[345] *Id.* at 468. The Code mandates one of three treatments for a secured creditor under a Chapter 13 plan:

> (1) by obtaining the creditor's acceptance of the plan; (2) by surrendering the property securing the claim; or (3) by providing the creditor both a lien securing the claim and a promise of future property distributions (such as deferred cash payments) whose total value, as of the effective date of the plan, . . . is not less than the allowed amount of such claim.

Id. at 468 (alteration in original) (footnote omitted) (internal quotation marks omitted).

[346] *Id.* at 471.

[347] *Id.*

[348] *Id.* at 478-79.

[349] *Id.* at 473.

additional evidentiary proceedings."[350] Further, the formula approach puts the burden on creditors, and the Court noted that creditors "likely . . . have readier access to information."[351] In footnote 14, the Court stated, as dicta, that "when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce."[352]

After *Till*, both the Fifth and Sixth Circuits discussed the impact of that decision on Chapter 11 cases, as *Till* was a plurality decision and was decided in the context of a Chapter 13 case. In *Wells Fargo National Ass'n. v. Texas Grand Prairie Hotel Realty, L.L.C. (In re Texas Grand Prairie Hotel Realty, L.L.C.)*,[353] the Fifth Circuit noted how courts have used the formula approach in Chapter 11 "because they were *persuaded* by the plurality's reasoning, not because they considered *Till* binding."[354] The court went on to hold that there is no specific method for determining the cramdown rate of interest in Chapter 11.[355] Similarly, in *Bank of Montreal v. Official Committee of Unsecured Creditors (In re American HomePatient, Inc.)*,[356] the Sixth Circuit declined to adopt *Till* as binding in Chapter 11 cases.[357] In that case, the bankruptcy court held that the appropriate cramdown rate of interest for the secured lenders was 6.785%.[358] The district court affirmed, also finding that 6.785% was the appropriate rate of interest.[359] On appeal to the Sixth Circuit, the lenders argued that the bankruptcy court erred in calculating the interest rate because the court relied on the coerced loan theory.[360] Specifically, the lenders argued that in light of the Supreme Court's decision in *Till*, applying the coerced loan theory is

[350] *Id.* at 479.
[351] *Id.*
[352] *Id.* at 476 n.14.
[353] 710 F.3d 324 (5th Cir. 2013).
[354] *Id.* at 331 (emphasis in original).
[355] *Id.*
[356] 420 F.3d 559 (6th Cir. 2005).
[357] *Id.* at 568.
[358] *Id.* at 561.
[359] *Id.* at 562.
[360] *Id.* at 565.

inappropriate.[361] However, the Sixth Circuit rejected the lenders' argument, and "decline[d] to blindly follow *Till*'s endorsement of the formula approach for Chapter 13 cases in the Chapter 11 context."[362] Instead, it looked to footnote 14 in the *Till* decision, and concluded that the market rate should be used in Chapter 11 cases where there is such a market.[363] However, the court noted that when there is no market, courts should use the formula approach.[364] Because the court found that 6.785% was the appropriate market rate, it upheld the bankruptcy court's decision.[365]

In *In re American Trailer and Storage*, the Bankruptcy Court for the Western District of Missouri applied the formula approach, noting that one of its reasons for doing so was the "uncontradicted evidence of a lack of an efficient market."[366] In that case, the debtor's plan provided that its secured lender would receive 5% interest, or a rate to be determined by the court. The secured creditor argued that 5% interest was inadequate.[367] The issue before the court, then, was how to calculate the cramdown rate of interest.[368] The court adopted a "nuanced version of *Till*," and first considered whether there was an efficient market.[369] Based on the evidence before it, the court found that there was no efficient market.[370] Because of this, the court adopted the formula approach, and found that 5.5% was an appropriate rate of interest.[371] The court also noted that applying the formula approach in this case was consistent with Eighth Circuit precedent because the circuit had used the formula approach in the past.[372]

[361] *Id.* at 566.
[362] *Id.* at 568.
[363] *Id.*
[364] *Id.*
[365] *Id.* at 569.
[366] *In re* Am. Trailer & Storage, Inc., 419 B.R. 412, 438 (Bankr. W.D. Mo. 2009).
[367] *Id.* at 433.
[368] *Id.* at 434.
[369] *Id.* at 438.
[370] *Id.*
[371] *Id.* at 438, 440.
[372] *Id.* at 436, 438.

b. Section 1129(b)(2)(A)(ii)

There are also problems associated with § 1129(b)(2)(A)(ii). A plan that denies a secured creditor the right to credit bid[373] at any sale of property that is subject to its lien will not satisfy § 1129(b)(2)(A)(ii).[374] The Supreme Court recently addressed this issue in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*.[375] Before this issue was before the Supreme Court, however, lower courts, including the Third and Fifth Circuits, had addressed a secured creditor's right to credit bid in the context of a plan sale.

In *In re Philadelphia Newspaper, LLC*,[376] the issue before the court was whether a plan that proposed a sale of assets free and clear of secured creditors' liens could be crammed down where the secured creditors did not have the right to credit bid.[377] In that case, the debtor proposed a plan where it would sell substantially all of its assets.[378] The secured creditors were to receive the proceeds of the sale.[379] The first bid procedures for the sale were not approved by the bankruptcy court because they did not give the secured creditors the right to credit bid. The bankruptcy court then approved amended bid procedures that allowed the secured creditors to

[373] Section 363(k) of the Code provides:

> At a sale . . . [of property of the estate outside of the ordinary course of business] that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. § 363(k) (2012).

[374] *See, e.g.*, *In re* Monarch Beach Venture, Ltd., 166 B.R. 428 (C.D. Cal. 1993) ("[T]he right to credit bid may not be taken from the creditor. Since [the creditor] was not given the right to credit bid, the Debtor's plan cannot qualify as 'fair and equitable . . . . '"); H & M Parmely Farms v. Farmers Home Admin., 127 B.R. 644, 648 (D.S.D. 1990) ("[B]efore a plan which provides for a prospective sale of property can be confirmed under § 1129(b)(2)(A)(ii), it must comply with § 363(k)." (footnote omitted)); *In re* WE Co., No. BK06-80006, 2007 WL 4893471, at *6 (Bankr. D. Neb. Dec. 19, 2007) ("Section 1129(b)(2)(A)(ii) of the Bankruptcy Code requires that a cramdown proposing to sell collateral after confirmation must be subject to § 363(k) of the Bankruptcy Code. That section grants a secured creditor the right to credit bid.").

[375] 132 S. Ct. 2065 (2012).

[376] 599 F.3d 298 (3d Cir. 2010).

[377] *Id.* at 301.

[378] *Id.*

[379] *Id.* at 302.

credit bid. However, on appeal, the district court held that the secured creditors had "no legal entitlement . . . to credit bid."[380] The circuit court agreed with the district court, and concluded that § 1129(b)(2)(A) provides three alternatives for fair and equitable treatment, and even if a plan proposes a sale without giving secured creditors the right to credit bid, the plan can still be confirmed as long as the creditors receive the indubitable equivalent of their claim.[381]

The *Philadelphia Newspapers* decision was not unanimous; Judge Thomas Ambro dissented. In his dissent, Judge Ambro argued that § 1129(b)(2)(A)(ii) is the only way for a debtor to cramdown a plan that proposes a sale of collateral free and clear.[382] Judge Ambro found that § 1129(b)(2)(A)(ii) was ambiguous because it was susceptible to two reasonable interpretations: (i) that § 1129(b)(2)(A) contains three alternatives for plan confirmation, or (ii) that § 1129(b)(2)(A) contains three "distinct routes that apply specific requirements depending on how a plan proposes to treat the claims of secured creditors.[383] So, Judge Ambro then applied various canons of statutory construction to determine which reading was more plausible.[384] First, he applied the canon that specific provisions control over general provisions and concluded that § 1129(b)(2)(A)(ii) is a specific provision.[385] Next, he applied the anti-superfluousness canon and concluded that § 1129(b)(2)(A)(ii) would be a nullity if a plan that proposes a sale free and clear could be confirmed under § 1129(b)(2)(A)(iii).[386] Judge Ambro also looked to other sections of the Code, which provide secured creditors with protection from undervalued collateral, and the legislative history to support his conclusion that "[i]n enacting the Code to provide enhanced protections to secured creditors, Congress only contemplated sales through the

[380] *Id.*
[381] *Id.* at 318.
[382] *Id.* at 319 (Ambro, J., dissenting).
[383] *Id.* at 323-25.
[384] *Id.* at 327.
[385] *Id.* at 328-29.
[386] *Id.* at 330.

'self-explanatory' procedures of clause (ii), not clause (iii), as the latter was intended for situations of abandonment or substitute collateral."[387]

In *In re Pacific Lumber Co.*,[388] noteholders challenged confirmation of a debtor's Chapter 11 plan.[389] The noteholders argued that the plan was not fair and equitable because the plan sold their collateral without giving them the opportunity to credit bid.[390] Specifically, the noteholders argued that because the plan contemplated a sale, § 1129(b)(2)(A)(ii) "should prevail under the canon of statutory construction that the more specific provision controls over the general indubitable equivalent alternative" in § 1129(b)(2)(A)(iii).[391] However, the court rejected that argument, and concluded that § 1129(b)(2)(A) provides three alternatives, and the debtor's plan could be confirmed as long as the noteholders received the indubitable equivalent of their claims.[392] Because the plan would pay the noteholders the allowed amount of their secured claim, the court found that the noteholders were receiving the indubitable equivalent of their claims, and thus, the plan was fair and equitable.[393]

The issue before the Supreme Court in *RadLAX* was whether a plan could be confirmed that "provide[d] for the sale of collateral free and clear of the creditor's lien, but did not permit the creditor to 'credit bid' at the sale."[394] The debtors argued that even though their plan did not satisfy the second of the three ways for a plan to be fair and equitable because it denied the secured creditor the right to credit bid, the plan could still be confirmed as fair and equitable under § 1129(b)(2)(A)(iii) since the creditor would get the indubitable equivalent of its claim.[395]

[387] *Id.* at 334-36.
[388] 584 F.3d 229 (5th Cir. 2009).
[389] *Id.* at 236.
[390] *Id.* at 239.
[391] *Id.* at 246.
[392] *Id.*
[393] *Id.* at 249.
[394] RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065, 2069 (2010).
[395] *Id.* at 2070.

Like Judge Ambro in *Philadelphia Newspapers*, the Court began its analysis with the canon of construction that specific provisions govern general provisions.[396] Applying that canon, the Court concluded that § 1129(b)(2)(A)(ii) is a specific provision for plans that propose to sell property, and subsumes the general "indubitable equivalent" provision in § 1129(b)(2)(A)(iii).[397] Therefore, if a plan proposes a sale, it must allow the secured creditor to credit bid in order to be confirmed under § 1129(b).[398]

c. Section 1129(b)(2)(A)(iii)

Issues arise in connection with § 1129(b)(2)(A)(iii) as well. That section provides that a secured creditor must receive the indubitable equivalent of its secured claim in order for a plan to be confirmed over its objection. If a plan proposes to substitute collateral, a creditor receives the indubitable equivalent only if the substituted collateral is of the same value and same degree of risk.[399] The Bankruptcy Court for the District of Kansas dealt with § 1129(b)(2)(A)(iii) in *In re Rim Development, LLC*.[400] In that case, the court found that a plan that rearranged creditors' lien priorities by proposing to sell collateral, but distribute proceeds "in a manner inconsistent with the priorities of their liens," did not provide secured creditors with the indubitable equivalent.[401] Relying on case law from the Tenth Circuit Bankruptcy Appellate Panel, the *Rim Development* court found that the indubitable equivalent standard is that "there is no reasonable doubt that [the lender] will receive the full value of what it bargained for when it made its contracts with [the]

[396] *Id.* at 2071.
[397] *Id.* at 2071-72.
[398] *Id.* at 2073.
[399] F.H. Partners, L.P. v. Inv. Co. of the Sw. (*In re* Inv. Co. of the Sw.), 341 B.R. 298, 319 (10th Cir. BAP 2006).
[400] 448 B.R. 280 (Bankr. D. Kan. 2010).
[401] *Id.* at 291.

Debtor."[402] Applying that standard, the court found that the lenders did not bargain for rearranged lien priorities, and therefore the debtor's plan was "patently unconfirmable."[403]

3. Fair and Equitable Treatment of Unsecured Claims

The plan must also provide fair and equitable treatment to each class of rejecting unsecured claims. Section 1129(b)(2)(B) provides two express alternatives in order that a plan may be found to be fair and equitable with respect to a class of unsecured claims: (i) that each creditor receive or retain property of a value equal to the allowed amount of its claim; or (ii) that any junior creditor or interest holder not receive or retain any property on account of its claim or interest.

Section 1129(b)(2)(B)(i) requires that the court determine the present value of the deferred consideration being distributed under the plan. As with secured claims, controversy surrounds the appropriate interest, or discount, rate to be used to determine present value. The second alternative raises even greater issues, however, to which we now turn.

a. The Absolute Priority Rule

Section 1129(b)(2)(B)(ii), known as the absolute priority rule, provides that if a class of unsecured claims is not paid in full as provided in § 1129(b)(2)(B)(i) and votes against the plan, no class junior to the dissenting class of unsecured claims may receive or retain any property on account of such junior claim or interest.[404] Thus, the absolute priority rule prohibits equity holders—or any junior class of claims—from receiving "any property" from the reorganized debtor "on account of such junior claim or interest" unless the senior creditors vote to accept the plan as a class or the senior creditors receive full satisfaction of their allowed claims.[405] The

[402] *Id.* (quoting *In re Inv. Co. of the Sw.*, 341 B.R. at 319) (alteration in original) (internal quotation marks omitted).
[403] *Id.*
[404] 11 U.S.C. § 1129(b)(2)(B)(ii) (2012).
[405] *Id.* § 1129(b)(2)(B)(ii).

ownership interest of an insolvent entity with no going concern value is considered "property" within the meaning of the absolute priority rule.[406] Accordingly, even though an enterprise is insolvent and the ownership interest arguably has no "value," under the absolute priority rule the ownership interest cannot be retained by the old equity holders over the objection of an impaired rejecting class of unsecured claims.

The new value exception to the absolute priority rule as articulated in *Case v. Los Angeles Lumber Products Co.*[407] likely survived the adoption of the Code in 1978. Although not expressly stated by the Supreme Court in *Bank of America National Trust and Saving Ass'n v. 203 North LaSalle Street Partnership*[408] the Court's (i) rejection of the government's argument that old equity holders should be categorically barred from utilizing new value plans; (ii) recognition that permitting old holders to utilize new value plans is consistent with the underlying policies of reorganization; and (iii) conclusion that pre-Code precedent and the legislative history of § 1129 do nothing to disparage the continued viability of the new value exception, constitutes the strongest endorsement of the new value exception since *Los Angles Lumber*. Although the Court declined to expressly rule on the subject, the majority opinion clearly went out of its way to issue dictum in support of the continued vitality of the new value exception.

According to the *LaSalle* Court, the fundamental requirement that must be satisfied to confirm a new value plan is that it must be shown that old equity holders did not acquire new equity "at a price that failed to provide the greatest possible addition to the bankruptcy estate" as

[406] *See, e.g.*, Nw. Bank Worthington v. Ahlers, 485 U.S. 197, 208 (1988); Unruh v. Rushfield State Bank, 987 F.2d 1506, 1508-09 (10th Cir. 1993).

[407] 308 U.S. 106, 121-22 (1939) ("In view of these considerations we believe that to accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.").

[408] 526 U.S. 434 (1999).

a result of their prior position as equity holders and that old equity holders' prior position did not in any way permit them to obtain "an ownership interest for less than someone else would have paid."[409] Time and again, the Court emphasized that the old equity holders must pay "full value" and "top dollar" and that they not be permitted to obtain an equity interest at a "bargain."[410] In a footnote, the Court observed that "[e]ven when old equity would pay its top dollar and that figure was as high as anyone else would pay, the price might still be too low unless the old equity holders paid more than anyone else would pay."[411]

The means of satisfying the foregoing requirement is to subject the equity holder's bid or new value plan to "competition" and "market valuation."[412] The Court expressed its disfavor of judicial valuations "untested by competitive choice," and indicated that such valuation should not be used "in administering subsection (b)(2)(B)(ii) when some form of market valuation may be available to test the adequacy of an old equity holder's proposed contribution."[413] The Court repeatedly recommended the use of competing bids or competing plans, and consistently proposed these two alternative market mechanisms by using the disjunctive connector "or." In the final articulation of its holding, the Court reserved deciding the question of "[w]hether a market test would require an opportunity to offer competing plans or would be satisfied by a right to bid for the same interest sought by old equity," and simply held that new value plans which provide old equity holders with "exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of § 1129(b)(2)(B)(ii)."[414]

[409] *Id.* at 436.
[410] *Id.* at 456-57.
[411] *Id.* at 453 n.26.
[412] *Id.* at 458.
[413] *Id.*
[414] *Id.* at 458.

And, significantly, the other *Los Angeles Lumber* requirements[415] must still be satisfied. The *LaSalle* Court noted that equity holders' "full value" contribution must still "be in cash or realizable monies worth" as required by *Los Angeles Lumber*, and suggested that equity holders might "need to show that no one else would pay as much" to satisfy the "necessity" requirement.[416] Immediately following these remarks, the Court cautioned that "our holding here does not suggest an exhaustive list of the requirements of a proposed new value plan."[417]

Since the Court's decision in *LaSalle*, parties and lower courts appear to have been reluctant to explore its ramifications—particularly its "market test"—requirement in reported decisions.[418]

i. Lessons for Small Business Cases

There are lessons to be learned from *LaSalle* for small businesses. If a debtor cannot pay unsecured creditors in full, the debtor should try to get them to vote in favor of the plan because the absolute priority rule will not apply if the unsecured class does not have to be crammed down under § 1129(b)(2)(B)(ii). If an unsecured class votes to reject the plan and old equity holders want to own the reorganized debtor, the prepetition shares or interests must be cancelled under the plan and new shares or interests must be issued following the effective date of the plan. To satisfy the new value exception to the absolute priority rule, the equity interests to be issued

[415] The additional factors that are required to prove the new value exception are that the offered value be (i) new; (ii) substantial; (iii) money or money's worth; (iv) necessary for a successful reorganization; and (v) reasonably equivalent to the value or interest received. *See, e.g.*, *In re* RYYZ, LLC, 490 B.R. 29, 44 (Bankr. E.D.N.Y. 2013) (quoting BT/SAP Pool C Assoc. v. Coltex Loop Cent. Three Partners, 203 B.R. 527, 534, *aff'd* 138 F.3d 39 (2d Cir. 1998)).

[416] *Id.* at 453 & n.26.

[417] *Id.* at 453.

[418] Paul B. Lewis, 203 N. LaSalle *Five Years Later: Answers to the Open Questions*, 38 J. MARSHALL L. REV. 61, 83 (2004) ("Five years after the ruling in *203 N. LaSalle*, as a general matter, lower courts have been reluctant to provide much guidance in terms of exploring the ramifications of *203 N. LaSalle*. Not only does there appear to be a shortage of cases which involve fact-specific determinations, but courts also appear reluctant to take the reasoning behind *203 N. LaSalle* and expand it to its logical limits.").

under the plan must be subject to a "market test" and the former interest holders must pay "full value" for them in order for the plan to be confirmed under § 1129(b)(2)(B)(ii).

But, with this said, there are still open issues in the wake of *LaSalle* in order to satisfy the new value exception to the absolute priority rule. For example, how does a small business debtor satisfy the market test? Is termination of exclusivity a sufficient market test to satisfy the new value exception?[419] What about auctioning the equity in the reorganized debtor with the old equity holders making the opening bid? Courts have confirmed plans that auctioned the equity interests in the reorganized debtor at confirmation. However, the disclosure statement and plan must describe the auction of the equity interests, the bid requirements and increments, and state what old equity's opening bid is for the equity interests in the reorganized debtor. But, questions still remain, such as to whom notice must be given of the auction besides the debtor's creditors, if anyone. In other words, is giving notice only to the debtor's creditors enough of a market test?

There are also issues surrounding the "substantial" requirement. For example, against what does a court compare old equity's proposed contribution to determine if it is substantial? In other words, how substantial a contribution does old equity have to make in order to satisfy the new value exception? Some courts compare the contribution to the value of the enterprise, others compare it to the amount of unsecured debt, while still others compare it to the net available cash in the debtor. At least one court has stated that whether a contribution is substantial will "depend on the circumstances of the individual case."[420] Another court used "special factors" to determine whether a contribution is substantial in the context of a small closely-held entity: (i) whether the proposed payment represents the partner's best efforts; and

[419] *See In re* Castleton Plaza, LP, 707 F.3d 821, 824 (7th Cir. 2013) (nothing that there is disagreement among courts over whether competition is necessary when a plan gives an insider the opportunity to purchase equity for new value, and finding that competitive bidding is necessary for new equity, regardless of who proposed the plan).
[420] *In re* Snyder, 967 F.2d 1126, 1132 (7th Cir. 1992).

(ii) the amount of the contribution compared to the projected return to creditors.[421] While a leading bankruptcy treatise notes that the substantial requirement is of "dubious heritage" and "unnecessary" in light of the "necessary" requirement, it observes that courts often look at whether the payment is substantial "based upon the ratio of the amount of the proposed contribution to the amount of claims affected by the plan."[422]

Courts have come to different conclusions as to what is required to satisfy the necessary requirement. Some courts follow a more restrictive or, according to a leading treatise, a "narrow" view that the funds must be necessary to the continued operations of the debtor.[423] Under this view, that the contribution may be used to pay claims, including administrative claims like attorneys' fees is not enough.[424] Other courts have applied a more open view and have found that if the contribution is necessary to pay, for example, administrative claims of the debtor's professionals, it is necessary to the debtor's successful reorganization because the debtor must pay those claims in cash, in full, under the Code in order to obtain confirmation of a plan and achieve its reorganization.[425]

ii. Application in Individual Debtor Cases

As discussed above, § 1129(b)(2)(B)(ii) now provides that to be fair and equitable, a plan must either pay unsecured creditors in full or provide that:

> [T]he holder of any claim or interest that is junior to the [unsecured creditors] will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under § 1115*, subject to the requirements of subsection (a)(14) . . . .[426]

[421] *In re* Wynnefield Manor Assocs., L.P., 163 B.R. 53, 56-57 (Bankr. E.D. Pa. 1993).
[422] 7 COLLIER ON BANKRUPTCY ¶1129.03[4][c][iv][D] (Alan N. Resnick & Henry J. Sommer eds. 16th ed.).
[423] *Id.* at ¶1129.03[4][c][iv][C].
[424] *See, e.g.*, Oxford Life Ins. Co. v. Tucson Self-Storage, Inc. (*In re* Tucson Self-Storage, Inc.), 166 B.R. 892, 899 (9th Cir. BAP 1994); *In re* Mangia Pizza Invs., LP, 480 B.R. 669, 699 (Bankr. W.D. Tex. 2012).
[425] *See, e.g.*, *In re* Red Mountain Mach. Co., 448 B.R. 1, 16 (Bankr. D. Ariz. 2011).
[426] 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added). Subsection (a)(14) requires that in order for a debtor to confirm a plan, she must have paid all of her domestic support obligations that first become payable post-petition *Id.* § 1129(a)(14).

While a complete discussion of the use of Chapter 11 by individuals is beyond the scope of this paper, it must be noted that there is a split in the case law with respect to whether the absolute priority rule survives in an individual debtor case. Or, stated another way, courts disagree over what the italicized language above means.

One line of authority holds that the absolute priority rule has been abrogated for individuals. For example, in *In re Shat*, the court concluded that the absolute priority rule does not apply to individuals because of the language of § 1129(b)(2)(B)(ii).[427] As for the statutory language, the court looked to § 1115, concluding that the language of that section includes as property of the estate all property under § 541 *and* earnings from the debtor's services during the pendency of the case.[428] Therefore, § 1129(b)(2)(B)(ii) "extends to *all* property of the estate, including such things as prepetition ownership interests in nonexempt property."[429] The court also noted that this result is supported by changes to individual Chapter 11 cases to have them more closely resemble Chapter 13 cases.[430]

The Bankruptcy Appellate Panel for the Ninth Circuit in *Friedman v. P+P, LLC (In re Friedman)* also concluded that the absolute priority rule does not apply to individual debtors, and came to this conclusion based on the plain meaning of § 1129(b)(2)(B)(ii) and § 1115.[431] Similarly, in *In re O'Neal*,[432] the court concluded that § 1115 includes all property in § 541, and earnings from post-petition personal services.[433] Therefore, it concluded that the absolute priority rule did not apply to individual debtors.[434]

[427] *In re* Shat, 424 B.R. 854, 865 (Bankr. D. Nev. 2010).
[428] *Id*. at 863 (emphasis in original).
[429] *Id*. at 865 (emphasis in original).
[430] *Id*.
[431] Friedman v. P+P, LLC (*In* re Friedman), 466 B.R. 471, 482 (9th Cir. BAP 2012).
[432] 490 B.R. 837 (Bankr. W.D. Ark. 2013).
[433]*Id*. at 851.
[434] *Id*.

The opposing line of authority holds that the absolute priority rule survives in individual Chapter 11 cases, making Chapter 11 a difficult alternative for individuals. The Fifth Circuit in *In re Lively*,[435] observed that a broad interpretation of § 1129(b)(2)(B)(ii) and § 1115 abrogates the absolute priority rule.[436] In coming to its conclusion that a narrower view of the statutory language was appropriate, the Fifth Circuit first noted that it was inclined to agree with the bankruptcy court below that § 1129(b)(2)(B)(ii) was not ambiguous, but even if the statute was ambiguous, canons of statutory construction dictated that the absolute priority rule still applied to individuals.[437] The court relied on the canon of construction that implied repeals of a statute are disfavored, and concluded that "Congress was well aware of the [absolute priority] rule and, in the absence of a clearer directive, modified § 1129(b)(2)(B)(ii) in order to refine it, not reverse it, for individual debtors."[438]

The Fourth and Tenth Circuits have also held that the absolute priority rule still applies to individual Chapter 11 debtors. In *In re Stephens*,[439] the Tenth Circuit held that that the absolute priority still applies, relying, like the Fifth Circuit, on the presumption that Congress did not intend to impliedly repeal the absolute priority rule.[440] Similarly, the Fourth Circuit in *In re Maharaj*,[441] concluded that the absolute priority applies because had Congress intended to abrogate the absolute priority rule, "it could have done so in a far less convoluted manner."[442] However, unlike the Fifth Circuit, both the Fourth and Tenth Circuits found § 1129(b)(2)(B)(ii) to be ambiguous.[443]

[435] 717 F.3d 406 (5th Cir. 2013).
[436] *Id.* at 410.
[437] *Id.* at 409.
[438] *Id.*
[439] 704 F.3d 1279 (10th Cir. 2013).
[440] *Id.* at 1286.
[441] 681 F.3d 558 (4th Cir. 2012).
[442] *Id.* at 571.
[443] *Stephens*, 704 F.3d at 1285; *Maharaj*, 681 F.3d at 568.

Assuming that the absolute priority rule survived, one last question remains – does the retention of exempt property by the debtor violate the absolute priority rule if the unsecured class votes to reject the plan? As was the case with whether the absolute priority rule survived in individual Chapter 11 cases, this issue has also caused a conflict among the courts to consider it. In *In re Egan*,[444] the debtors had claimed exemptions for the property they proposed to retain under their plan. No objections were timely filed to the claimed exemptions. The unsecured class voted to reject the plan. In confirming the plan, the court observed: "if debtors intend to retain only exempt property, then they are merely retaining that which is their absolute right to retain in any event, and they are not, properly speaking, receiving or retaining 'any interest that is junior to the interests' of any class of creditors, 11 U.S.C. § 1129(b)(2)(B)(ii), including the class of unsecured creditors."[445] A similar conclusion was reached in *In re Shin*,[446] where the court observed that "to apply the absolute priority rule to an individual debtor's wholly exempt property stands the absolute priority rule on its head – affording to unsecured creditors an artificial 'priority' in exempt property that unsecured creditors simply do not otherwise possess.[447]

The court in *In re Grosman*[448] reached a contrary result. There, the debtor's plan proposed limited payments to the unsecured creditors and sought to exempt (and retain) the exempted assets. The bankruptcy court denied confirmation (through denial of approval of the disclosure statement on feasibility grounds), finding that "[t]here can be no question that the Debtor in this case is a 'holder of an interest that is junior' to the claims of unsecured creditors

[444] 142 B.R. 730 (Bankr. E.D. Pa. 1992).
[445] *Id*. at 733.
[446] 306 B.R. 397 (Bankr. D.C. 2004).
[447] *Id*. at 404 n.17.
[448] 282 B.R. 45 (Bankr. S.D. Fla. 2002).

… because] Debtor owns an interest in the Exempt Property."[449] The court also ruled that the § 1129(b)(2)(B)(ii) reference to including "any property" prevents a debtor from retaining exempt or non-exempt property without paying the value of all such property to creditors.

When applying the new value exception to the absolute priority rule in individual debtor cases, the question becomes: if a class of unsecured creditors votes against the plan, can an individual Chapter 11 debtor retain property if he provides new value? The Bankruptcy Court for the Western District of North Carolina recently addressed this issue in *In re Eagan*.[450] In that case, the court found that the new value exception does apply to individual debtors.[451] Pursuant to the debtor's plan, his family members were to provide a cash contribution.[452] The court found that this was sufficient new value because the contribution was substantial, and was reasonably equivalent to the assets that the debtor retained under the plan.[453] Specifically, the court noted that the distributions under the plan, including the $200,000 contribution from the debtor's family members, exceeded the value of the estate's assets by at least $137,000.[454]

Similarly, in *In re Tucker*,[455] the Bankruptcy Court for the District of Oregon concluded that because the absolute priority rule applies in individual Chapter 11 cases, the new value exception also applies.[456] In that case, the debtors proposed to retain all property of the estate even though their unsecured creditors rejected the plan.[457] The debtors argued that they satisfied the new value exception because they would be contributing money in the form of future salary earned by one of the debtors over the term of the plan. However, the court rejected this

[449] *Id.* at 48.
[450] No. 12-30525, 2013 WL 237812 (Bankr. W.D.N.C. Jan. 22, 2013).
[451] *Id.* at *7.
[452] *Id.* at *2.
[453] *Id.* at *7.
[454] *Id.*
[455] No. 10-67281, 2011 WL 5926757 (Bankr. D. Ore. 2011).
[456] *Id.* at *2.
[457] *Id.* at *1.

argument and held that "[t]he Debtor's unsecured promise of future payments out of anticipated future salary does not meet the requirement that the value given be in 'money or moneys [sic] worth,' because it cannot be exchanged in any market for something of value to the creditors at the time the plan is confirmed."[458]

In *In re Draiman*,[459] the Bankruptcy Court for the Northern District of Illinois also applied the new value exception in an individual debtor's case.[460] In that case, a creditor objected to a debtor's plan where the debtor would retain his non-exempt assets.[461] However, the debtor argued that a cash contribution, funded by one of his business associates, was sufficient to satisfy the new value exception.[462] The court agreed, finding that the contribution was "reasonably equivalent to the value" of the assets the debtor sought to retain because the value of those assets was $30,350, and the contribution was $100,000.[463] The court also found that the new value was cash, so it satisfied the requirement that the new value be money or money's worth.[464] Further, the court found that the new value was necessary for the debtor's reorganization because it would help fund the liquidation of certain assets and could provide funding for litigation brought by the liquidation trustee.[465] The court did note, though, that other courts that addressed this same issue have found that it is difficult for individual Chapter 11 debtors to satisfy the new value exception "because the new value must come from a source other than the debtor."[466]

[458] *Id.* at *2.

[459] 450 B.R. 777 (Bankr. N.D. Ill. 2011).

[460] *Id.* at 822.

[461] *Id.* at 821.

[462] *Id.* at 822.

[463] *Id.*

[464] *Id.*

[465] *Id.*

[466] *Id.*

VII. CONCLUSION

The Chapter 11 process is undoubtedly complicated, especially when it comes to proposing and confirming a plan. This is especially true with respect to small business and individual debtors. Even a plan proponent with the best of intentions will be left with an unconfirmable plan if it does not strictly comply with the Code.