COMMENTARY

It's Not Over Until It's Over: Chapter 11 Plan Confirmation

By David S. Kupetz, Esq.*

Overview of Chapter 11

Chapter 11 of the Bankruptcy Code provides a framework for the reorganization (Chapter 11 may also be used for liquidation) of eligible entities.[1] Upon the filing of a voluntary Chapter 11 petition, a reorganization case is commenced. Contemporaneously with the commencement of the case, the debtor (the entity filing the voluntary petition) becomes a debtor in possession.

The filing of a bankruptcy petition creates a bankruptcy estate that includes "all legal or equitable interests of the debtor in property as of the commencement of the case." The debtor continues to control and possess property of the estate and is authorized to manage and operate its business unless and until otherwise ordered by the court.[2]

The primary goals of Chapter 11 are rehabilitation of the debtor, equality of treatment of creditors holding claims of the same priority, and maximization of the value of the estate.

Plan of Reorganization

In General — Reorganization and Liquidation Plans

A plan of reorganization is generally the vehicle for achieving the goal of rehabilitation of the debtor under Chapter 11 of the Bankruptcy Code. Confirmation (approval) of a Chapter 11 plan binds the debtor, any entity acquiring property under the plan, creditors and equity security holders of the debtor. Subject to certain limited exceptions, confirmation discharges the debtor from preconfirmation claims and such obligations are replaced by the obligations under the plan. The plan is, in effect, a new court-sanctioned contract among the reorganized debtor, its creditors and other parties to the plan.

While Chapter 11 is titled "Reorganization," Chapter 11 plans may also be used for liquidation. For example, it is not uncommon for a Chapter 11 debtor in possession, based on a "sound business purpose," to sell substantially all of its assets prior to confirmation of a Chapter 11 plan pursuant to Section 363(b) of the Bankruptcy Code. Many courts have followed the leading case of *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983), in holding that a debtor in possession may sell substantially all of the assets of the bankruptcy estate when a sound business reason supports such a sale.

Several courts have identified that the following four requirements must exist in order to satisfy the "sound business purpose" test: sound business reasons, accurate and reasonable notice, adequate price, and good faith.[3] The driving force behind a court's willingness to approve a sale of substantially all assets of the estate outside of a plan of reorganization is the desire to maximize the value of the estate.

It is not uncommon that following a sale of substantially all of the assets of a Chapter 11 bankruptcy estate pursuant to Section 363(b) a liquidating Chapter 11 plan will be filed providing for the distribution of the sale proceeds. In other instances, a Chapter 11 plan itself may provide for a sell-off of or establish a liquidation procedure for the debtor's assets.

Exclusivity

Following the filing of the debtor's Chapter 11 petition, unless the court orders otherwise, the debtor in possession has the exclusive right to file a plan of reorganization for 120 days.[4] If the debtor files a plan during this initial 120-day period, unless the court orders otherwise, no other party may file a plan for an additional 60 days beyond the conclusion of the 120-day period during which time the debtor may attempt to obtain approval of its plan.

The exclusivity periods may be extended or terminated by the court for "cause."[5] In determining whether "cause" for extension exists, courts look at factors such as whether:

- Prior extensions have been requested;
- The case is complicated;
- The case has been pending for a long time, relative to its size and complexity;
- The debtor appears to be proceeding in good faith;
- The debtor's operations are improving and it is paying its expenses on a current basis;

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- The debtor has shown a reasonable prospect for filing a viable plan;
- The debtor is making satisfactory progress negotiating with key creditors;
- The debtor appears to be seeking an extension of exclusivity for purposes other than to pressure creditors; and
- The debtor has been providing the creditors committee and other key creditors with relevant information.[6]

Disclosure Statement

Before a plan of reorganization can be disseminated to the debtor's creditors for their consideration and vote, a disclosure statement must be approved by the court. The disclosure statement is required to contain adequate information to allow creditors to evaluate the plan and determine how they will vote on the plan. The disclosure statement is frequently referred to as the equivalent of a prospectus in a stock offering. Section 1129(a)(2), discussed below, requires that, in order to obtain approval of the plan, the plan proponent must comply with the adequate disclosure requirements of Section 1125.[7]

Plan Confirmation Requirements

In General

Section 1129 contains the standards for confirmation of a plan under Chapter 11. Section 1129(a) lists 13 prerequisites for confirmation; Section 1129(a)(8), however, need not be satisfied if the requirements of Section 1129(b) are met. Section 1129(b) sets out the standard for "cramdown" on a non-consenting impaired class. "Cramdown" simply means obtaining the approval of the plan over the objections of a class of nonconsenting creditors or interest holders.

Section 1129(c) states the general rule that the court may only confirm one plan. If more than one plan is proposed and more than one plan satisfies the confirmation requirements contained in subsections (a) and (b) of Section 1129, the court must consider the preferences of creditors and equity security holders in determining which plan to confirm.

When a plan of reorganization satisfies each of the requirements contained in Section 1129(a), the court shall confirm the plan without considering Section 1129(b). Specifically, Section 1129(b) only applies if a class whose claims or interests are impaired does not accept the plan as required by Section 1129(a)(8). Moreover, a plan of reorganization need only satisfy the requirements of Section 1129(b) with respect to classes that vote against the plan.[8]

Classification of Claims

Section 1129(a)(1) permits the court to confirm a plan only if the plan complies with the applicable provisions of the Bankruptcy Code. Sections 1122 and 1123 are the substantive provisions that are most relevant in satisfying Section 1129(a)(1). Section 1122 governs classification of claims and interests and Section 1123 sets forth the provisions that are required to be included, and those that may be included, in a plan of reorganization.

Section 1123(a)(1) requires that a plan designate, subject to Section 1122, classes of claims, other than claims of kind specified in Sections 507(a)(1) (administrative expenses), 507(a)(2) (involuntary case gap claims), or 507(a)(8) (unsecured priority tax claims) and classes of interests.

It is not clear from the language of the statute nor from its legislative history whether Section 1123(a)(1) prohibits the classification of Section 507(a)(1), (a)(2) and (a)(8) priority claims or merely makes such classification permissive.[9] The reason that it is unnecessary to classify such claims is that a majority of a class composed of creditors holding such priority claims cannot bind the minority to a treatment at variance with Section 1129(a)(9).

Bankruptcy Code Section 1122 contains two rules applicable to classification of claims and a single rule concerning classification of interests. Under Section 1122(a), a claim or interest may be placed in a particular class under a plan only if such claim or interest is substantially similar to the other claims or interests of such class. 11 U.S.C. § 1122(a). Section 1123(b) provides that a plan may designate a separate class of claims consisting of unsecured claims that are less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

The Bankruptcy Code does not require that similar claims necessarily be placed in the same class. Congress intended to afford bankruptcy judges broad discretion to decide the propriety of plans in light of the facts of each case.[10] Moreover, Congress intended that the proponent of a plan have flexibility in classifying claims.[11]

Bankruptcy Code Section 1123 describes mandatory and permissive plan provisions. Section 1123(a) sets forth required provisions of a plan. Section 1123(b) suggests certain discretionary plan provisions. Under Section 1123(a)(1), a plan must designate, subject to Section 1122, classes of claims, other than claims for administrative expenses (Section 507(a)(1)), gap claims in involuntary cases (Section 507(a)(2)), and certain unsecured tax claims (Section 507(a)(8)), and classes of interests.

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Impairment

Section 1123(a)(2) requires that a plan specify any class of claims or interests that is not impaired under the plan. Section 1124 sets forth two ways by which a claim can be left unimpaired under a plan. Accordingly, Congress defined impairment in broad terms and then carved out two narrow exceptions to that expansive definition.

The two exceptions are important because, under subsection 1126(f), a class that is not impaired under a plan is deemed to have accepted the plan. Under the first exception to impairment, any alteration of the creditor's legal, equitable or contractual rights constitutes impairment.[12] The second exception to impairment allows a debtor pursuant to a Chapter 11 plan to reverse the acceleration of an obligation caused by its default.

Impairment results from what the plan does, not from the impact of other provisions of the Bankruptcy Code on a particular claim. For example, pursuant to Section 502(b)(6) a landlord's claim for lease termination damages are capped. A Chapter 11 plan that leaves unaltered the legal, equitable and contractual rights of the landlord with respect to its capped claim does not impair the landlord's claim.

In *In re PPI Enterprises (U.S.) Inc.*, 324 F.3d 197, 204 (3d Cir. 2003), the U.S. Court of Appeals for the 3d Circuit stated that "a creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we [the court] must examine whether the plan itself is a source of limitation on a creditor's legal, equitable or contractual rights."

Treatment

Section 1123(a)(3) requires that a plan specify the treatment of any class of claims or interests that is impaired under the plan. As discussed above, with the exception of claims falling within Bankruptcy Code Sections 507(a)(1), (a)(2) and (a)(7), every claim and interest in a Chapter 11 case must be placed in a class and every class must be designated as impaired or unimpaired.

Section 1123(a)(4) requires that a plan provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment. Thus, once a plan has classified creditors, it must provide the same treatment for each claim or interest of a particular class, unless the holder agrees to less favorable treatment. However, Section 1123(a)(4) only requires equality of treatment of claims or interests placed in the same class.

Adequate Means for Implementation

Section 1123(a)(5) requires that a plan provide adequate means for the plan's implementation and provides a number of examples of methods for doing so. The alternatives set forth in Section 1123(a)(5) may be proposed by a plan proponent notwithstanding non-bankruptcy law or agreements. One of the alternatives is that the plan provide for the "curing or waiving of any default."[13] The examples of adequate means for implementation of a plan provided in Section 1123(a)(5) are illustrative and the section does not exclude or limit any other means.

As discussed above, a Chapter 11 plan may be a liquidating plan. Section 1123(a)(5) includes as a possible suggested means for the plan's implementation a "sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property estate among those having an interest in such property of the estate."

Corporate Charter

Section 1123(a)(6) requires that a plan provide for the inclusion in the charter of the debtor, if the debtor is a corporation, of a provision prohibiting the issuance of non-voting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default and the payment of such dividends.[14]

Appointment or Continuance Of Directors and Officers

Section 1123(a)(7) states that a plan shall contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director or trustee under the plan and any successor to such officer, director or trustee.

Section 1129(a)(5), which is discussed below, augments Section 1123(a)(7) and requires, as a condition of confirmation, that the proponents of the plan disclose the identity and affiliation of any individuals proposed to serve, after confirmation of the plan, as directors, officers or voting trustees of the debtor, or of an affiliate of the debtor participating in a joint plan with the debtor, or of a successor to the debtor under the plan. In addition, Section 1129(a)(5)(A)(ii) requires that the appointment or continuance of any director, officer or voting trustee be consistent with "the interests of creditors and equity security holders and with public policy."

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Permissive Plan Provisions

Section 1123(b) suggests certain permissive plan provisions, such as:

- Impairing or leaving unimpaired any class of claims, secured or unsecured, or of interests;
- Providing for the assumption, rejection or assignment (subject to Section 365) of any executory contract or an expired lease of the debtor not previously rejected under Section 365;
- Providing for the settlement or adjustment of any claim belonging to the debtor or the retention and enforcement by the debtor or a representative of the estate of any such claim;
- Providing for the sale of all or substantially all of the property of the estate, and the distribution of the sale proceeds among holders of claims or interests; or
- Modifying the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is an individual debtor's principal residence, or of holders of unsecured claims, or leaving unaffected the rights of holders of any class of claims.

Finally, Section 1123(b)(5) also permits a plan to contain "any other appropriate provision not inconsistent with the applicable provisions of this title."

While Section 1123(b)(3)(A) states that a plan may provide for "the settlement or adjustment of any claim or interest belonging to the debtor or to the estate," there is no parallel authorization regarding the determination of claims against the estate pursuant to a plan.[15] In this regard, one court recently held as follows:

> While we do not hold that a plan can never be used to object to a claim of a creditor who does not actually consent to such objection, by holding that the essence of [Bankruptcy] Rule 3007 must be complied with, we are holding that considerations of due process mandate great caution and require that the creditor receive specific notice (not buried in a disclosure statement or plan provision) of at least the quality of specificity, and be afforded the same opportunity to litigate one-on-one, as would be provided with a straightforward claim objection under Rule 3007. In many Chapter 11 cases, the only way to proceed will be by way of the separate claim objections that the rules of procedure and the Bankruptcy Code contemplate.[16]

Plan Proponent Compliance With the Code

Section 1129(a)(2) states that the court shall confirm a plan only if the proponent of the plan complies with the applicable provisions of the Bankruptcy Code. The principal purpose of Section 1129(a)(2) is to require, as a condition of confirmation, that the court ascertain whether the proponent of the plan under consideration has complied with the requirements of Section 1125 in the solicitation of acceptances of the plan.

Under Section 1125, a post-petition solicitation of votes on a plan is improper unless the court has approved a written disclosure statement filed with the plan. The primary purpose of a disclosure statement is to give creditors and interest holders the information they need to decide whether to accept the plan. A disclosure statement need not comply with the disclosure standards of the federal securities laws. Bankruptcy judges have broad discretion in reviewing disclosure statements, and what constitutes adequate information in any particular instance will develop on a case-by-case basis.

Good Faith

Section 1129(a)(3) requires that a plan be proposed in good faith and not by any means forbidden by law. This requirement is to be read restrictively.[17] The term "good faith" is not specifically defined in the Bankruptcy Code. However, in the context of Section 1129(a)(3), some courts have interpreted "good faith" to mean that there exists "a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code."[18]

Other courts have held that the good-faith test of Section 1129(a)(3) requires that "the plan was proposed with honesty and good intentions and with a basis for expecting a reorganization can be effected."[19] The court's determination of the "good faith" proposal of a plan under Section 1129(a)(3) must be made in light of "the totality of the circumstances surrounding confirmation" of the plan.[20]

Courts have held that there is no lack of good faith when the primary purpose of the debtor's Chapter 11 filing and plan is to take advantage of a specific Bankruptcy Code provision.[21] In *In re Sylmar Plaza L.P.*, the 9th Circuit found that a Chapter 11 plan was proposed in good faith where its sole purpose was to enable the debtors to "cure and reinstate" an obligation and thereby avoid an approximate $1 million contractual liability for default interest.

Analogously, in *In re PPI Enterprises*, the 3d Circuit held that a Chapter 11 petition and plan filed for the primary

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purpose of capping a landlord's lease termination damage claim against a solvent debtor do not constitute bad faith.

If no timely objection to the plan raising Section 1129(a)(3) is filed, the court may determine that the plan has been proposed in good faith and not by any means forbidden by law without receiving evidence on such issues.

Fees and Costs in Connection With the Case or the Plan

Section 1129(a)(4) requires that any payment made or to be made by the proponent, the debtor, or by a person issuing securities, or acquiring property under the plan, for services or for costs and expenses in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of the court, as reasonable.

Disclosure Regarding Continuing Or New Officers and Directors

Section 1129(a)(5)(A) requires the proponents of a plan to disclose the identity and affiliations of any individual proposed to serve after confirmation as a director, officer or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor of the debtor under the plan, and requires the appointment or continuance of such individual to be consistent with the interest of creditors and equity security holders and with public policy. This section augments Section 1123(a)(7).

Disclosure Regarding Connection with Insider

Section 1129(a)(5)(B) requires the proponent of the plan to disclose the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider. The term insider is defined in Section 101(31).

Rate Changes

Section 1129(a)(6) requires as a condition precedent confirmation that any governmental regulatory entity with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

'Best Interest of Creditors' Test

Section 1129(a)(7) sets forth the "best interest of creditors" test. This test requires that with respect to each impaired class of claims or interests, each holder of a claim or interest of such class has accepted the plan *or* will receive or retain under the plan property of a value, as of the effective date of the plan, not less than the amount that such holder would receive or retain if the debtor were liquidated under Chapter 7 of the Bankruptcy Code on such date.

"The court must independently determine the value of the distributions under the plan in order to ascertain whether this requirement is satisfied, utilizing information that the proponent must provide."[22] This is done through the submission of testimony and/or other evidence constituting a liquidation analysis demonstrating that the plan provides creditors with more than what they would get in a Chapter 7 liquidation of the debtor.

The "best interest of creditors" test requirement is a separate requirement independent from whether the class has voted to accept the plan. "The focus under this section [1129(a)(7)] is upon each holder of a claim, as distinguished from the class in which the claim is placed."[23]

Acceptance of Plan

Section 1129(a)(8) requires that each class of claims or interests either accepts the plan or is not impaired under the plan.[24] The requirement of Section 1129(a)(8) is the only condition precedent included in Section 1129(a) that is not only absolutely necessary for confirmation. "If a plan satisfies the confirmation criteria set forth in Section 1129(a), including the requirement that if a class of claims is impaired, at least one impaired class of claims accepts the plan, the plan may be confirmed notwithstanding the opposition of one or more impaired classes of claims or interests, provided the plan satisfies Section 1129(b)."[25]

Whether a class has accepted the plan is determined by reference to Section 1126. Under Section 1126(f) any class that is not impaired under the plan is conclusively presumed to have accepted the plan.[26]

Treatment of Unsecured Priority Claims

Section 1129(a)(9) states the rules applicable to payment of those unsecured claims entitled to priority in distribution in Chapter 11 cases. With respect to priority claims of the kind specified in Section 507(a)(1), (2), or (7), Section 1129(a)(9) constitutes the only essential confirmation requirement, since there is no reason to create a class or classes for Sections 507(a)(1), (2) and (7) claims in light of the fact that a majority of such classes cannot bind a minority to less favorable payment terms than those provided under Section 1129(a)(9).

Unless the holder of such a priority claim agrees to less favorable treatment of its claim, Section 1129(a)(9) requires the payment of first (Section 507(a)(1)) and second

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(Section 507(a)(2)) priority claims in full in cash on the effective date of the plan.

Section 1129(a)(9)(B) requires that holders of Section 507(a)(3), (4), (5) or (6) priority claims receive, if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim, or, if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim.

Section 1129(a)(9)(C) requires that holders of Section 507(a)(8) priority claims receive on account of such claims deferred cash payments, over a period not exceeding six years after the date of assessment of such claims, of a value, as of the effective date of the plan, equal to the allowed amount of such claims.

Consenting Impaired Class

Section 1129(a)(10) requires as a condition of confirmation that if a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.[27] As discussed above, Section 1126 provides the requirements for determining acceptance. Section 1129(a)(10) requires affirmative acceptance of a plan by at least one impaired class of claims, unless all classes of claims are left unimpaired.[28]

Feasibility

Section 1129(a)(11) requires as a condition of confirmation that the court find that confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.[29] The feasibility standard is whether the plan offers a reasonable assurance of success. Success need not be guaranteed.[30]

Fees

Section 1129(a)(12) mandates the payment of all fees required under 28 U.S.C. § 1930, including filing fees and U.S. trustee quarterly fees.

Retiree Benefits

Section 1129(a)(13) requires that the debtor comply with Section 1114 with regard to retiree benefits.

Cramdown

If one impaired class accepts the plan, the debtor may obtain confirmation of the plan over the objection of an impaired class of claims or interests if the plan satisfies the "cramdown" requirements of Section 1129(b). To satisfy the cramdown test, the plan must not "discriminate unfairly" and must be "fair and equitable" with respect to each class of impaired claims and interests that has not accepted the plan.

Courts have uniformly held that a plan of reorganization discriminates unfairly if it singles out the holder of a claim for disfavorable treatment.[31] However, separate classification and distinctive treatment do not constitute unfair discrimination if there are reasonable, nondiscriminatory reasons for the separate classification and treatment of a claim under the plan.[32]

The Bankruptcy Code's provision for "fair and equitable" treatment of unsecured creditors codifies the judicially developed absolute priority rule.[33] That general rule prohibits confirmation of a reorganization plan if any of the debtor's equity holders (shareholders or partners) retains an equity interest in the debtor on account of its old interest in the debtor without the plan also providing each class of objecting creditors cash or other property equal to the present value of the creditors' claims.[34]

The exception or corollary allows old equity to retain an interest and not violate the absolute priority rule if the former equity holders provide new value to the reorganized debtor.[35] "The new value corollary requires that former equity holders offer value under the plan that is (1) new, (2) substantial, (3) in money or monies' worth, (4) necessary for a successful reorganization, and (5) reasonably equivalent to the value or interest received."[36]

The question of whether the Bankruptcy Code contains a new value corollary or exception to the absolute priority rule has not been conclusively settled.[37] In *203 North LaSalle*, the U.S. Supreme Court addressed the issue of "whether a debtor's pre-bankruptcy equity holders may, over the objection of a senior class of impaired creditors, contribute new capital and receive ownership interest in the reorganized entity, when the opportunity is given exclusively to the old equity holders under a plan adopted without consideration of alternatives."[38]

The Supreme Court found that the plan at issue was "doomed ... by its provision for vesting equity in the reorganized business in the debtor's partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan."[39] The Supreme Court found that the exclusiveness of the equity holders' opportunity, with no provision for competing bids or competing plans, rendered the plan fatally flawed.

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The Supreme Court stated:

> If the price to be paid for the equity interest is the best obtainable, old equity does not need the protection of exclusiveness (unless to trump an equal offer from someone else); if it is not the best, there is no apparent reason for giving old equity a bargain. ... [T]he exclusiveness of the opportunity, with its protection against the market's scrutiny of the purchase price by means of competing bids or even competing plan proposals, renders the partners' right a property interest extended "on account of" the old equity position and therefore subject to an unpaid senior creditor class's objection. ... Whether 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, is a question we do not decide here. It is enough to say, assuming a new value corollary, that plans providing junior interest holders with exclusive opportunities free from competition and without the benefit of market valuation fall within the prohibition of Section 1129(b)(2)(B)(ii).[40]

Accordingly, the Supreme Court, as of this time, has left unanswered the question of whether the new value corollary to the absolute priority rule survives. However, at least by implication, it appears the court views the new value corollary as having continued vitality under circumstances (which the court has not specifically identified) where there is an opportunity for competing bids or competing plans to be presented in connection with the plan that provides for the retention of equity by or the issuance of new equity to the pre-bankruptcy equity holders of the debtors.

A cramdown plan may allow the debtor to retain and use a secured creditor's collateral over the creditor's objection if the creditor receives present value at least equal to its secured claim. Because courts evaluate the appropriate discount rate on a case-by-case basis, even a plan providing for negative amortization may be approved under certain circumstances.

Post-Confirmation

As discussed above, confirmation of a Chapter 11 plan binds the debtor, any entity acquiring property under the plan, creditors and equity security holders of the debtor. Subject to certain limited exceptions, confirmation discharges the debtor from pre-confirmation obligations and such obligations are replaced by the obligations under the plan (generally there is no discharge in connection with the liquidating plan). The plan is, in effect, a new court-sanctioned contract among the reorganized debtor, its creditors and other parties to the plan.

Once the plan is confirmed (assuming the plan is not a liquidating plan), the debtor generally becomes a "reorganized debtor" and, depending upon the terms of the plan, may be free from the requirements of the Bankruptcy Code and the restrictions and oversight of the Office of the U.S. Trustee and the bankruptcy court.

Frequently, however, matters involving the debtor may continue in the bankruptcy court for a significant period of time after plan confirmation, including matters such as objections to and resolution of claims against the debtor, avoidance actions brought on behalf of the bankruptcy estate and, possibly, litigation of other claims held on behalf of the bankruptcy estate. Professionals employed by the debtor or a creditors committee continuing post-confirmation to render services in connection with the Chapter 11 case will continue to be subject to the employment and compensation requirements of the Bankruptcy Code, unless the confirmed plan provides otherwise.

An appeal from a plan confirmation order may be moot if the appellant fails to obtain a stay of the execution of the plan and the plan is substantially consummated. A bankruptcy court can revoke a plan confirmation order, but only on a request of a party in interest made before 180 days after the date of entry of the order of confirmation and after notice and hearing and, if and only if, such order was procured by fraud. Once a Chapter 11 estate is fully administered, the court will enter a final decree closing the case.

Notes

[1] All references to sections in this article are the sections contained in the Bankruptcy Code, which is found at Title 11 of the U.S. Code. Under 11 U.S.C. § 109 in combination with 11 U.S.C. §§ 101(9), (13), (15) and (41) entities eligible to be debtors under Chapter 11 are set forth. "Persons" eligible to commence Chapter 11 cases include individuals, partnerships and corporations, but not governmental units (governmental units may be eligible to file municipal debt adjustment cases under Chapter 9 of the Code). 11 U.S.C. §§ 101(41), 109.

[2] 11 U.S.C. §§ 1107, 1108, 1104(a). Although the presumption in Chapter 11 is that a debtor will continue to control and possess its assets and manage and operate its business, a creditor or other party in interest can request that the bankruptcy court appoint a trustee for "cause" or if it is in the best interest of creditors for an independent fiduciary to take over control and management of the debtor's affairs. 11 U.S.C. § 1104(a). Examples of "cause" for the appointment of a Chapter 11 trustee include fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor by current management. 11 U.S.C. § 1104(a)(1). "The estate is represented by a trustee [debtor in possession] who acts as a fiduciary for the debtor's creditors and shareholders." *Hillis Motors Inc. v. Hawaii Auto. Dealers' Ass'n*, 997 F.2d 581, 585 (9th Cir. 1993), citing 11 U.S.C. § 323(a) and *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352-53, 105 S. Ct. 1986, 1992-94, 85 L. Ed. 2d 372 (1985).

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[3] *Titusville Country Club v. Penn Bank (In re Titusville Country Club)*, 128 B.R. 396, at 396 (Bankr. W.D. Pa. 1991); *In re Plabell Rubber Prods. Inc.*, 149 B.R. 475, 479 (Bankr. N.D. Ohio 1992); *In re Weatherly Frozen Food Group Inc.*, 149 B.R. 480, 483 (Bankr. N.D. Ohio 1992); *In re Delaware & Hudson Ry. Co.*, 124 B.R. 169 (Bankr. D. Del. 1991); *In re Industrial Valley Refrigeration & Air Conditioning Supplies Inc.*, 77 B.R. (Bankr. E.D. Pa. 1987).

[4] 11 U.S.C. § 1121(a). In a case in which the debtor is a "small business" and elects to be considered a small business, the 120-day exclusivity period is 100 days and a plan must be filed no later than 160 days after the date of the order for relief. The Bankruptcy Code defines "small business" to mean a person engaged in commercial or business activities (not including a person whose primary activity is the business of owning or operating real property) whose aggregate noncontingent liquidated secured and unsecured debts do not exceed $2 million. 11 U.S.C. § 101(51C).

[5] 11 U.S.C. § 1121(d). Under Section 1121(e) the 100-day period and the 160-day period may be reduced by the court and the 100-day period may be increased, but there is no provision for an extension of the 160-day deadline. 11 U.S.C. § 1121(e).

[6] See *Official Comm. of Unsecured Creditors v. Henry Mayo Newhall Mem'l Hosp. (In re Henry Mayo Newhall Mem'l Hosp.)*, 282 B.R. 444, 452 (B.A.P. 9th Cir. 2002), citing *In re Dow Corning Corp.*, 208 B.R. 661, 664-65 (Bankr. E.D. Mich. 1997); *In re Express One Int'l Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996). "[T]he question of Section 1121(d) 'cause' is subject to *de novo* [appellate court] review as a mixed question of law and fact." *In re Henry Mayo Newhall Mem'l Hosp.*, 282 B.R. at 452, citing *Murray v. Bammer (In re Bammer)*, 131 F.3d 788, 792 (9th Cir. 1997) (*en banc*).

[7] In order to have standing to contend that a plan should not be confirmed because of a lack of adequate disclosure, the creditor will have to show that it was personally aggrieved by the alleged failure to disclose. *In re PWS Holding Corp.*, 228 F.3d 224, 247 (3d Cir. 2000). "We do not foreclose the possibility that ... a creditor objecting to a plan for lack of disclosure that actually had the information it complains is missing from the disclosure might nevertheless have standing if it could show that there is a possibility that other creditors would have acted differently (thus benefiting the protesting creditor) if they had the same information." *Id.*, citing *In re Perez*, 30 F.3d 1209, 1217 (9th Cir. 1994).

[8] *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 650 (2d Cir. 1988).

[9] The court in *In re Sullivan*, 26 B.R. 677, 678 (Bankr. W.D.N.Y. 1982), held that classification of such claims was prohibited.

[10] *See Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co. Inc.)*, 800 F.2d 581, 584-86 (6th Cir. 1986) (discussing the legislative history of Section 1122).

[11] *See* 7 COLLIER ON BANKRUPTCY, ¶ 1122.03[1][a], p. 1122-7 (15th ed. rev. 2003).

[12] The 9th Circuit has held that even an alteration of a creditor's rights enhancing the value of the rights constitutes "impairment" under a plan, stating:

> At first blush the idea that an improvement in one's position as a creditor might constitute "impairment" seems nonsensical. It must be recognized, however, that "impairment" is a term of art adopted by Congress to replace the old "material and adverse effect" standard of the old Bankruptcy Act. *See* former 11 U.S.C. § 507 (repealed 1979). Under the old standard, a creditor was entitled to vote on a proposed plan only if it was negatively affected by the plan. This inevitably fostered uncertainty, and invited litigation over whether the value of a creditor's interest would be diminished by a plan. Section 1124 of the Code was enacted to do away with these problems.
>
> [T]he plain language of Section 1124 says that a creditor's claim is "impaired" unless its rights are left "unaltered" by the plan. There is no suggestion here that only alterations of a particular kind or degree can constitute impairment.

L&J Anaheim Assocs. v. Kawasaki Leasing Int'l Inc. (In re L&J Anaheim Assocs.), 995 F.2d 940, 943 (9th Cir. 1993). Further, addressing the concern that "impairment" may be abused in order to gerrymander voting on a plan, the 9th Circuit stated:

> [A]buses on the part of a plan proponent ought not affect application of Congress' definition of impairment. The Bankruptcy Court can and should address such abuses by denying confirmation on the grounds that the plan has not been "proposed in good faith." 11 U.S.C. § 1129(a)(3).

Id. at 943 n. 2.

[13] 11 U.S.C. § 1123(a)(5)(G). This section goes hand-in-hand with Section 1124(2).

[14] The 9th Circuit stated "Section 1123(a)(6) only prohibits the issuance of *new* non-voting securities." *In re Acequia Inc.*, 787 F.2d 1352, 1361 (9th Cir. 1986).

[15] *In re Dynamic Brokers Inc.*, 293 B.R. 489, 496-97 (B.A.P. 9th Cir. 2003).

[16] *Id.* at 497.

[17] *In re Victory Constr. Co.*, 42 B.R. 145, 149 (Bankr. C.D. Cal. 1984).

[18] *In re Nite Lite Inns*, 17 B.R. 367, 370 (S.D. Cal. 1982); *see Hanson v. First Bank of South Dakota N.A.*, 828 F.2d at 1315 (8th Cir. 1987); *In re Madison Hotel Assocs.*, 749 F.2d at 425 (7th Cir. 1984); *In re Costal Cable T.V. Inc.*, 709 F.2d 762, 764 (1st Cir. 1983); *In re Sound Radio Inc.*, 145 B.R. 193 (D.N.J. 1992); *In re Texaco Inc.*, 84 B.R. at 907 (Bankr. S.D.N.Y. 1988); *In re Future Energy Corp.*, 83 B.R. 470, 486 (Bankr. S.D. Ohio 1988).

[19] *Koebel v. Glessing*, 751 F.2d 137, 139 (2d Cir. 1984), *quoting Manati Sugar Co. v. Mock*, 75 F.2d 284, 285 (2d Cir. 1935); *see Kane v. Johns-Manville Corp.*, 843 F.2d at 649.

[20] *In re Jasik*, 727 F.2d 1379, 1383 (5th Cir. 1984), *citing Public Fin. Corp. v. Freeman*, 712 F.2d 219, 221 (5th Cir. 1983); *see In re Madison Hotel Assocs.*, 749 F.2d at 425; *In re Sound Radio Inc.*, 93 B.R. at 53; *In re Texaco Inc.*, 84 B.R. at 907; and *In re Future Energy Corp.*, 83 B.R. at 486.

[21] *See In re PPI Enterprises (U.S.) Inc.*, 324 F.3d 197 (3d Cir. 2003), and *In re Sylmar Plaza L.P.*, 314 F.3d 1070 (9th Cir. 2002).

[22] *In re Genesis Health Ventures Inc.*, 266 B.R. 591, 612 (Bankr. D. Del. 2001).

[23] *In re Genesis Health Ventures Inc.*, 266 B.R. at 610.

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[24] *See In re Texaco Inc.*, 84 B.R. 893, 909.

[25] 7 COLLIER ON BANKRUPTCY, ¶ 1129.03[8], p. 1129-53 (15th ed. rev. 2003).

[26] *See In re Victory Constr. Co. Inc.*, 42 B.R. 145, 152. A creditor who is conclusively presumed to have accepted a plan pursuant to Section 1126(f) has no standing to raise other objections with respect to the plan. *See In re Sylmar Plaza L.P.*, 314 F.3d at 1075.

[27] *See In re Texaco Inc.*, 84 B.R. at 910.

[28] 7 COLLIER ON BANKRUPTCY, ¶ 1129.03[10], p. 1129-63 (15th ed. rev. 2003), *citing In re Russell*, 12 Bankr. Ct. Dec. (CCR) 571 (Bankr. E.D.N.C. 1984).

[29] *See Kane v. Johns-Manville Corp.*, 843 F.2d at 649; *In re Sound Radio Inc.*, 93 B.R. at 855-56; *In re Texaco Inc.*, 84 B.R. at 910.

[30] *Kane v. Johns-Manville Corp.*, 843 F.2d at 649; *Prudential Ins. Co. v. Monnier (In re Monnier Bros.)*, 755 F.2d 1336, 1341 (8th Cir. 1985); *In re American Solar King Corp.*, 90 B.R. at 892-893 (W.D. Tex. 1988); *In re Prudential Energy Co.*, 58 B.R. 857, 862 (Bankr. S.D.N.Y. 1986).

> Guaranteed success in the stiff winds of commerce without the protection of the Code is not the standard under Section 1129(a)(1). Most debtors emerge from reorganization with a significant handicap. But a plan based on impractical or visionary expectations cannot be confirmed.

In re Prudential Energy Co., supra, at 862, *citing In re Clarkson*, 767 F.2d 417, 420 (8th Cir. 1985); *see also In re Acequia Inc.*, 787 F.2d 1352; *In re American Solar King Corp.*, 90 B.R. at 833.

[31] *Oxford Life Ins. Co. v. Tucson Self-Storage Inc. (In re Tucson Self-Storage Inc.)*, 166 B.R. 892, 898 (Bankr. 9th Cir. 1994) (The plan discriminates unfairly if it singles out the holder of some claim or interest for a particular treatment."); *In re Johns-Manville Corp.*, B.R. 618, 636 (Bankr. S.D.N.Y. 1986), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd*, 843 F.2d 636 (2d Cir. 1988) ("[A] plan proponent may not segregate two similar claims or groups of claims in two separate classes and provide disparate treatment for those classes."); *In re Pine Lake Village Apartment Co.*, 19 B.R. 819, 831 (Bankr. S.D.N.Y. 1982) (Plan cannot place a secured creditor's deficiency claim in a separate class receiving different treatment from other unsecured claims.); *In re Toy & Sports Warehouse Inc.*, 37 B.R. 141, 151-52 (Bankr. S.D.N.Y. 1984).

[32] In *In re Johnston*, 21 F.3d at 328 (1994), the 9th Circuit addressed this issue, stating:

> Nor do we find any merit to Steelcase's argument that its separate classification in Class 23 constitutes unfair and discriminatory treatment. Steelcase apparently bases this argument on the requirements of 11 U.S.C. § 1129(b)(1). That section of the Code prohibits unfair discrimination and requires that a plan for reorganization be "fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the plan." The plan's classification scheme satisfies this requirement because ... there were reasonable, non-discriminatory reasons for it [footnotes omitted].

[33] 11 U.S.C. § 1129(b)(2)(B). Section 1129(b)(2)(B) provides that the condition that a plan be fair and equitable with respect to a class of unsecured claims includes the following requirements:

> (i) The plan provides that each holder of a claim of such class receive and retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) The holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B).

[34] *Id.* In applying the present value test "one does not look at the characteristics of the creditors in determining the interest rates. Rather, the debtor's capacity to borrow a single amount on like terms in the market place is the appropriate focus of inquiry." *In re McCombs Properties VIII Ltd.*, 91 B.R. 907, 910 (Bankr. C.D. Cal. 1988), *citing In re Camino Real Landscape Maint. Contractors*, 818 F.2d 1503, 1506 (9th Cir. 1987). In *In re Camino Real Landscape*, the 9th Circuit adopted and quoted language from a standard bankruptcy treatise explaining what the present value analysis entails, as follows:

> The appropriate discount rate must be determined on the basis of the rate of interest which is reasonable in light of the risks involved. Thus, in determining the discount rate, the court must consider the prevailing market rate for a loan of a term equal to the payment, with due consideration of the quality of the security and the risk of subsequent default.

818 F.2d at 1505, *quoting* 5 COLLIER ON BANKRUPTCY ¶ 1129.03[4][f][i], at 1129-65 (15th ed. 1987). *In re El Camino Landscape* involved the question of what rate of interest on deferred payments of federal taxes would provide the government with payments having present value equal to the allowed amount of its claim pursuant to Section 1129(a)(9)(C). 818 F.2d at 1504. Courts have adopted the same approach when determining discount rate for Section 1129(b)(2). *See, e.g., In re McCombs Properties VIII Ltd.*, 91 B.R. at 910 ("Although the issue in *Camino Real* involved a calculation of the Section 1129(a)(9)(C) rate, the present value analysis is the same and the court's reasoning and holding are likewise applicable here.").

[35] *See* 11 U.S.C. § 1129(b)(2)(B)(ii) with particular attention to whether the holder of any junior claim or interest receives or retains property under the plan *on account of such junior claim or interest.*

[36] *Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. Partnership (In re Ambanc La Mesa Ltd. Partnership)*, 115 F.3d, 650, 654 (9th Cir. 1997); *see also In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), *motion to vacate denied and cert. dismissed*, 515 U.S. 18, 115 S. Ct. 386 (1994). The 9th Circuit has stated that the new value corollary is not actually an exception to the absolute priority rule, but rather represents "the set of conditions under which former shareholders may lawfully obtain a priority interest in 'the reorganized venture.'" *In re Bonner Mall Partnership*, 2 F.3d at 906. The rationale for this principle is based on the practical necessity that new money frequently could not otherwise be obtained for the reorganized debtor. *Id.* at 915.

In *In re Ambanc La Mesa Ltd. Partnership*, the court held that the relevant amount for the substantiality analysis under the new value corollary is the equity holders' upfront contribution. The court explained that the determination of whether a contribution is substantial is intertwined with the analysis of the "money or monies worth" component of the new value test. *Ambanc*, 115 F.3d at 654. As a threshold matter, in determining whether a contribution

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is substantial, the 9th Circuit approved the comparison of the contribution to such things as the total unsecured claims against the debtor, discharged claims, or paid dividend on unsecured claims by virtue of the contribution. *Id.* at 655. When a proposed contribution amounts to a very small portion (*e.g.*, in *Ambanc* 0.5 percent) of these quantities, the proposed contribution is found to be *de minimis* and the court will reject the plan without the need further valuation analysis. *Id.*

The 9th Circuit acknowledged that the most difficult prong of the new value test would be the value-equivalence analysis, "which likely requires the Bankruptcy Court to determine a value for the reorganized debtor to be compared with the contribution." *In re Ambanc La Mesa Ltd. Partnership*, 115 F.3d at 655. In an exhaustive opinion, one bankruptcy court discussed valuation of the equity interests in a reorganized debtor stating:

> A specific determination of the value of the equity interests of the reorganized debtor is quite complex; indeed, one scholar has noted that such evaluation would usually be "a guess compounded by an estimate." ... Of course, the capitalization of future earnings is accepted to be the appropriate method for determining the value of the equity interest of the reorganized debtor.

In re SM 104 Ltd., 160 B.R. 202, 228 (Bankr. S.D. Fla. 1993) (citations omitted). The requirements of the new value corollary are intended to protect creditors from collusion between the reorganization plan's proponent and the old equity owners (these parties will frequently be, in essence, one and the same). This intent is honored if former equity holders obtain an interest in the reorganized debtor for legitimate business reasons. *In re Bonner Mall Partnership*, 2 F.3d at 909; *In re SM 104 Ltd.*, 160 B.R. at 226 ("[T]he purchase price paid by old equity for some or all of the equity in the reorganized debtor must be reasonably equivalent to the value of the new equity; that is, old equity must pay a fair price for the right to participate in the reorganized debtor."). In *Ambanc*, *citing Northern Pac. Ry. First Boyd*, 228, U.S. 482 (1913), the 9th Circuit found that there is a presumption against former equity holder's continued participation in the reorganized debtor that endures as a primary component of the absolute priority rule and that a *de minimis* contribution is insufficient to overcome that presumption. 115 F.3d at 656.

[37] *Bank of America Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. Partnership*, 526 U.S. 434, 199 S. Ct. 1411, 143 L. Ed. 2d 607 (1999) (the U.S. Supreme Court declined to determine whether the new value corollary/exception to the absolute priority rule survives under the existing Bankruptcy Code).

[38] *Id.* at 1414.

[39] *Id.* at 1422.

[40] *Id.* at 1422-24; *see also In re PWS Holding Corp.*, 228 F.3d 224, 237-39 (3d Cir. 2000).

* *David S. Kupetz, a partner in the law firm Sulmeyer Kupetz in Los Angeles and Menlo Park, Calif., specializes in crises avoidance consultation and in workouts, reorganizations, bankruptcies, receiverships, assignments for the benefit of creditors and other insolvency situations. He can be reached at dkupetz@sulmeyerlaw.com.*

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