Dallas Bar Association Bankruptcy and Commercial Law Section

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Chapter 11 Confirmation and Recent Issues

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PLAN CONFIRMATION REQUIREMENTS

INTRODUCTION[1]

To confirm a plan of reorganization, the Court must find that each of the requirements of Section 1129(a) of the Bankruptcy Code have been satisfied.[2] Generally speaking, plans of reorganization generally fit in the following categories: (i) operational and balance sheet reorganization plan with emerging reorganized debtors, (ii) plan of liquidation following sale of substantially all assets with liquidating trust for excluded assets, or (iii) plan with integrated sale process of substantially all assets or equity in reorganized debtors coupled with liquidation trust for excluded assets. In the event all requirements of Section 1129(a) are met with the exception of subsection (a)(8), the Court may confirm the plan if the requirements of Section 1129(b) of the Bankruptcy Code are satisfied.[3] These plan confirmation requirements are set forth in more detail below.

Bankruptcy Code § 1129(a) Confirmation Requirements

Compliance with Bankruptcy Code (11 U.S.C. § 1129(a)(1) and (2))

Section 1129(a)(1) requires that the plan comply with the "applicable provisions" of the Bankruptcy Code.[4] The debtors must comply with all applicable provisions of the Bankruptcy Code, including §§ 1121 (who may file a plan), § 1122 (classification of claims or interests), § 1123 (contents of plan), § 1125 (disclosure and solicitation), § 1126 (acceptance of plan), § 1127 (modification of plan), and § 1128 (confirmation of plan). The legislative history of Section 1129(a)(1) also explains that this provision encompasses the requirements of Sections 1122 and 1123 of the Bankruptcy Code, which govern classification of claims and equity interests and the contents of the plan, respectively.[5] Section 1129(a)(2) requires that each proponent of the plan comply with the applicable provisions of the Bankruptcy Code, example, acting in good faith and meeting other applicable requirements.[6]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge, the case record and pleadings, and the solicitation agent (if applicable). If the court permits, the use of written proffers can be

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[1] Thanks to Brad Foxman, Associate of Vinson & Elkins LLP for his contribution in the drafting of these materials.

[2] *See In re 203 N. Lasalle St. P'ship*, 126 F.3d 955, 960 (7th Cir. 1997) (the plan's proponent must show that the plan satisfies the thirteen requirements of § 1129(a)) *rev'd on other grounds*, 526 U.S. 434 (1999); *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 648 (2d Cir. 1988).

[3] *See* 11 U.S.C. § 1129(b)(1).

[4] 11 U.S.C. §1129(a)(1).

[5] *See* S. Rep. No. 95-989, at 126 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5912; H.R. Rep. No. 95-595, at 412 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6368; *See Mabey v. Southwestern Elec. Power Co. (In re Cajun Elec. Power Coop., Inc.)*, 150 F.3d 503, 512-13 n.3 (5th Cir. 1998).

[6] 11 U.S.C. § 1129(a)(2).

beneficial. Also if the court permits, the claims agent can present evidence by affidavit to save travel costs, but should be available by phone if needed.

Plan Proposed in Good Faith (11 U.S.C. § 1129(a)(3))

Section 1129(a)(3) of the Bankruptcy Code provides that the Court shall confirm a plan of reorganization only if the plan has been "proposed in good faith and not by any means forbidden by law."[7] "Though the term 'good faith,' as used in Section 1129(a)(3), is not defined in the Bankruptcy Code . . . the term is generally interpreted 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."[8]

To evaluate good faith for plan confirmation purposes, the requirement of good faith must be viewed in light of the totality of the circumstances surrounding the formulation of a Chapter 11 plan, considering the underlying goal of the Bankruptcy Code to encourage a debtor's rehabilitation.[9] In determining whether a plan will succeed and accomplish goals consistent with the Bankruptcy Code, courts look to the terms of the reorganization plan and determine, in light of the particular facts and circumstances, whether the plan will fairly achieve a result consistent with the Bankruptcy Code.[10] The plan proponent must show, therefore, that the plan has not been proposed by any means forbidden by law and that the plan has a reasonable likelihood of success.[11]

The primary goals of Chapter 11 are to promote the restructuring of the obligations of a debtor to enable the continued existence of an entity that provides jobs and a tax base to the

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[7] 11 U.S.C. § 1129(a)(3).

[8] *203 N. LaSalle*, 126 F.3d at 969, (quoting *In re Madison Hotel Assocs.*, 749 F.2d 410, 424-25 (7th Cir. 1984)); *see also In re Zenith Elecs. Corp.*, 241 B.R. 91, 107 (Bankr. D. Del. 1999) ("The good faith standard requires that the plan be 'proposed with honesty, good intentions and a basis for expecting that a reorganization can be effected with results consistent with the objectives and purposes of the Bankruptcy Code."' (citations omitted)).

[9] *See Ronit, Inc. v. Stemson Corp. (In re Block Shim Dev. Co.-Irving)*, 939 F.2d 289, 292 (5th Cir. 1991) (finding that the focus of a court's inquiry is the plan itself, and courts must look to the totality of the circumstances surrounding the plan, keeping in mind the purpose of the Bankruptcy Code is to give debtors a reasonable opportunity to make a fresh start); *In re Sun Country Development, Inc.*, 764 F.2d 406, 408 (5th Cir. 1985); *In re The Landing Assoc., Ltd.*, 157 B.R. 791, 812 (Bankr. W.D. Tex. 1993).

[10] *203 N. LaSalle*, 126 F.3d at 969; *Madison Hotel Assocs.*, 749 F.2d at 410; *see also In re Sound Radio, Inc.*, 93 B.R. 849, 853 (Bankr. D.N.J. 1988) (concluding that the good faith test provides the court with significant flexibility and is focused on an examination of the plan itself, rather than other, external factors), *aff'd in part, remanded in part on other grounds*, 103 B.R. 521 (D.N.J. 1989), *aff'd*, 908 F.2d 964 (3d Cir. 1990).

[11] *See 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) (finding that a court may only confirm a plan for reorganization if the plan has been proposed in good faith and not by any means forbidden by law and where the plan is proposed with the legitimate and honest purpose to reorganize and has a reasonable hope of success, the good faith requirement of Section 1129(a)(3) is satisfied); *Koelbl v. Glessing (In re Koelbl)*, 751 F.2d 137, 139 (2d Cir. 1984).

communities in which it operates, as well as the provision of goods and services to those communities. Congress has thus recognized the primacy of the goal of rehabilitating viable businesses.[12] Furthermore, the Fifth Circuit has held that "where the plan is proposed with the legitimate and honest purpose to reorganize and has a reasonable hope of success, the good faith requirement of section 1129(a)(3) is satisfied."[13] A plan of liquidation is within the scope of good faith as one of the ways to exit chapter 11 is via a 363 sale and a plan of liquidation.

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge and others who can support this (e.g. financial advisors, CRO, etc.). If the court permits, the use of written proffers can be beneficial.

Payment for Services or Costs and Expenses (11 U.S.C. § 1129(a)(4))

Section 1129(a)(4) of the Bankruptcy Code provides:

> Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or 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.[14]

In essence, this subsection requires that any and all fees promised or received in connection with or in contemplation of a Chapter 11 case must be disclosed and approved, or be subject to approval, by the court.[15]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge and others who can support this (e.g. financial advisors, CRO, etc.). If the court permits, the use of written proffers can be beneficial.

Officers and Insiders (11 U.S.C. § 1129(a)(5))

Section 1129(a)(5) requires that the debtors disclose the identity of certain Persons who will hold positions with the Reorganized debtors after Confirmation of the plan.[16] This provision focuses on the methods by which the management of a reorganized corporation is to be chosen,

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[12] *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

[13] *In re Sun Country Development, Inc.*, 764 F.2d 406, 408 (5th Cir. 1985); *Heartland Federal Savings & Loan Assoc. v. Briscoe Enterprises, Ltd., II, d/b/a Regalridge Apartments*, 994 F.2d 1160, 1167 (5th Cir. 1993); *In re The Landing Assoc., Ltd.*, 157 B.R. 791, 812 (Bankr. W.D. Tex. 1993) (stating that "the Fifth Circuit had adopted a two-part standard for determining if a plan has been proposed in good faith").

[14] 11 U.S.C. § 1129(a)(4).

[15] *See In re Johns-Manville Corp*, 68 B.R. 618, 632 (Bankr. S.D.N.Y. 1986); *In re Chapel Gate Apartments, Ltd.*, 64 BR. 569, 573 (Bankr. N.D. Tex. 1986).

[16] *See* 11 U.S.C. § 1129(a)(5).

requiring adequate representation of those whose investments are involved in the reorganization -- *i.e.*, creditors and equity holders.[17] In determining whether the post-confirmation management of a debtor is consistent with the interests of creditors, equity security holders, and public policy, a court must consider proposed management's competence, discretion, experience, and affiliation with entities having interests adverse to the debtor.[18]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge, the case record and pleadings, and the disclosure statement. If the court permits, the use of written proffers can be beneficial.

Governmental Regulatory Approval (11 U.S.C. § 1129(a)(6))

Section 1129(a)(6) requires, with respect to a debtor whose rates are subject to governmental regulation following confirmation, that appropriate governmental approval has been obtained for any rate change provided for in the plan, or that such rate change be expressly conditioned on such approval.[19]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge and present applicable regulations. If the court permits, the use of written proffers can be beneficial.

Best Interests of Creditors (11 U.S.C. § 1129(a)(7))

Through the "best interest of creditors" test of Section 1129(a)(7), the Bankruptcy Code protects dissenting members of impaired, accepting classes by ensuring that such creditors or equity holders receive at least what they would receive if the debtor were liquidated under chapter 7 of the Bankruptcy Code.[20] The best interest test focuses on individual dissenting creditors, rather than Classes of Claims.[21] Bankruptcy Code § 1129(a)(7) requires that each holder in an impaired class of claims or interests receive or retain under the plan, on account of such claim or interest, property of a value that is not less than the amount that such holder would receive or retain if the applicable debtor were liquidated under chapter 7 of the Bankruptcy Code on such date.

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge, the case record and pleadings, financial advisors,

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[17] *See* 7 *Collier on Bankruptcy* ¶ 1123.01 [7], at 1123-16 (Lawrence P. King ed., 15th ed. rev. 1996).

[18] *See In re Sherwood Square Assocs.*, 107 B.R. 872, 878 (Bankr. D. Md. 1989); *see also In re W.E. Parks Lumber Co.*, 19 B.R. 285, 292 (Bankr. W.D. La. 1982) (a court should consider whether "the initial management and board of directors of the reorganized corporation will be sufficiently independent and free from conflicts and the potential of post-reorganization litigation so as to serve all creditors and interested parties on an even and loyal basis").

[19] 11 U.S.C. § 1129(a)(6).

[20] *203 N. LaSalle*, 126 F.3d at 969; *In re Keck, Mahin & Cate*, 241 B.R. 583, 590 (Bankr. N.D. Ill. 1999).

[21] *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 761 (Bankr. S.D.N.Y. 1992).

sources and uses analysis, and a liquidation analysis. If the court permits, the use of written proffers can be beneficial.

Acceptance by Impaired Classes (11 U.S.C. § 1129(a)(8))

Bankruptcy Code §1129(a)(8) requires that, with respect to each class of claims or interests, such class has accepted the plan or such class is not impaired under the plan.[22]

Practice Tip: Evidence should be presented from the solicitation agent. If the court permits, the claims agent can present evidence by affidavit to save travel costs, but should be available by phone if needed.

Treatment of Administrative, Priority, and Tax Claims (11 § U.S.C. § 1129(a)(9))

Bankruptcy Code §1129(a)(9) requires payment of administrative, priority, and tax claims is comprised of four subparts.[23]

Section 1129(a)(9)(A) requires that, with respect to a claim of a kind specified in Section 507 (a)(2) or 507 (a)(3), on the effective date of the plan the holder of such claim will receive cash equal to the allowed amount of the claim.

Section 1129(a)(9)(B) requires that, with respect to a class of claims of a kind specified in Section 507 (a)(1), 507 (a)(4), 507 (a)(5), 507 (a)(6), or 507 (a)(7), each holder of a claim of such class will receive (i) if a 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 the claim; or (ii) if a class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of the claim.

Section 1129(a)(9)(C) requires that, with respect to a claim of a kind specified in Section 507 (a)(8), the holder of such claim will receive regular installment payments in cash (i) of a total value, as of the effective date of the plan, equal to the allowed amount of the claim; (ii) over a period ending not later than 5 years after the date of the order for; and (iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan (other than cash payments made to a class of creditors under Section 1122 (b)).

Section 1129(a)(9)(D) requires that, with respect to a secured claim which would otherwise meet the description of an unsecured claim of a governmental unit under Section 507 (a)(8), but for the secured status of that claim, the holder of that claim will receive cash payments, in the same manner and over the same period, as prescribed in Section 1129(a)(9)(D).

Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge, the case record and pleadings, financial advisors,

[22] *See* 11 U.S.C. 1129(a)(8).

[23] *See* 11 U.S.C. 1129(a)(9).

and sources and uses analysis. Testimony may be necessary from the solication agent if priority claimants are entitled to vote as required by Section 1139(a)(9)(C). If the court permits, the use of written proffers can be beneficial.

Acceptance by Impaired Class (11 U.S.C. § 1129(a)(10))

Section 1129(a)(10) requires that at least one of the impaired classes accept the plan.[24] Impairment is defined and discussed in Section 1124 of the Bankruptcy Code.

Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge and from the solicitation agent to prove this element. If the court permits, the claims agent can present evidence by affidavit to save travel costs, but should be available by phone if needed.

Feasibility (11 U.S.C. § 1129(a)(11))

Section 1129(a)(11) of the Bankruptcy Code provides that a plan of reorganization may be confirmed only if "[c]onfirmation 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."[25] One commentator has stated that this section "requires courts to scrutinize carefully the plan to determine whether it offers a reasonable prospect of success and is workable."[26] In order to satisfy Section 1129(a)(11), the debtors need not warrant, or prove to a mathematical certainty, the future success of the plan.[27] Rather, a plan is feasible and should be confirmed if it "offers a reasonably workable prospect of success and is not a visionary scheme."[28]

The key question is whether there is a reasonable probability that the provisions of the plan can be performed. Factors include the economic conditions of the debtors' businesses, the debtors' earning power, the ability of management, the probability of continuation of management, and any other factor which determines the probability of a successful operation that

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[24] 11 U.S.C. § 1129(a)(10).

[25] 11 U.S.C. § 1129(a)(11); *see also 203 N. LaSalle*, 126 F.3d at 969.

[26] 7 *Collier on Bankruptcy* ¶ 1129.03 [11], at 1129-74; *see also Mut. Life Ins. Co. of New York v. Patrician St. Joseph Partners Ltd. P'ship (In re Patrician St. Joseph Partners Ltd. P'ship)*, 169 B.R. 669, 674 (D. Ariz. 1994); *In re Cellular Info. Sys., Inc.*, 171 B.R. 926, 945 (Bankr. S.D.N.Y. 1994); *In re Rivers End Apartments, Ltd.*, 167 B.R. 470, 476 (Bankr. S.D. Ohio 1994); *Johns-Manville*, 68 BR. at 635.

[27] *203 N. LaSalle*, 126 F.3d 955 at 962 (the court overruled an objection which was based upon a different interpretation of the real estate market in Chicago stating that "[a] plan need not be assured of success to be confirmed").

[28] *In re Merrimack Valley Oil Co.*, 32 B.R. 485, 488 (Bankr. D. Mass. 1983) (citing *In re Landmark At Plaza Park Ltd.*, 7 B.R. 653 (Bankr. D.N.J. 1980)); *Kane*, 843 F.2d at 649 (a plan may be feasible although its success is not guaranteed); *In re Henke*, 90 B.R. 451, 456 (Bankr. D. Mont. 1988); Texaco, 84 B.R. at 910 ("All that is required is that there be reasonable assurance of commercial viability."); *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 § 1129(a)(11).").

enables the performance of plan provisions.[29] As such, feasibility is an issue that calls for the exercise of judicial discretion.[30] If a debtor's financial projections "are credible, based upon the balance of all testimony, evidence, and documentation, even if the projections are aggressive, the court may find the plan feasible."[31] Many of these elements fall to the wayside when a liquidating plan is involved.

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge, the case record and pleadings, financial advisors, sources and uses analysis and projections. If the court permits, the use of written proffers can be beneficial.

Payment of Fees (11 U.S.C. § 1129(a)(12))

Bankruptcy Code §1129(a)(12) requires the payment of all U.S. Trustee fees either on the effective date of the plan or throughout the case.[32]

> Practice Tip: Evidence should be presented from a debtor representative with the requisite personal knowledge and sources and uses analysis. If the court permits, the use of written proffers can be beneficial.

Retiree Benefits (11 U.S.C. § 1129(a)(13))

The plan must provide for the continuation after its effective date of payment of all retiree benefits at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.[33]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge, plan requirements, sources and uses analysis and projections. If the court permits, the use of written proffers can be beneficial.

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[29] *In re The Landing Assoc., Ltd*., 157 B.R. 791, 812 (Bankr. W.D. Tex. 1993); *In re Swiftco, Inc.*, 1988 Bankr. LEXIS 2251, *16 (Bankr. S.D. Tex. 1988).

[30] *See In re Schoeneberg*, 156 B.R. 963, 973 (Bankr. W. D. Tex. 1993).

[31] *In re T-H New Orleans*, 116 F.3d at 802 (quoting *In re Lakeside Global II, Ltd.*, 116 B.R. 499, 508 n.20 (Bankr. S.D. Tex. 1989)); *see also In re F.G. Metals, Inc.*, 390 B.R. 467, 476 (Bankr. M.D. Fla. 2008) ("The bankruptcy court is only required to find that a plan offers a reasonable probability of success, and a plan may be confirmed even if the debtor's projections are aggressive and do not view all business prospects in the worst possible light.") (emphasis added).

[32] *See* 11 U.S.C. 1129(a)(12).

[33] *See* 11 U.S.C. 1129(a)(13).

Domestic Support Obligations (11 U.S.C. § 1129(a)(14))

If the debtor is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amounts payable under such order or such statute for such obligation that first become payable after the date of the filing of the petition.[34]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge. If the court permits, the use of written proffers can be beneficial.

Cases of Individuals (11 U.S.C. § 1129(a)(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, 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 the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor 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.[35]

> Practice Tip: The debtor or an expert must be prepared to show that the distributions under the plan are, where payments over time will not equal the allowed amount of all such claims, equal to or greater than the projections of disposable income which the individual would generate over a 5 year period. Knowing a good chapter 13 practitioner to help prepare this projection is quite helpful.

Transfers of Property (11 U.S.C. § 1129(a)(16))

All transfers of property must be made in accordance with any applicable provisions of non-bankruptcy law that govern the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust.[36]

> Practice Tip: Evidence should be presented from a debtor representative with requisite knowledge or an expert witness. If the court permits, the use of written proffers can be beneficial.

11 U.S.C. § 1129(b) Cramdown Requirements

Section 1129(b) of the Bankruptcy Code provides that if all of the applicable confirmation requirements of Section 1129(a) other than subsection (8) are met, the court, on request of the plan proponent, shall confirm the plan if it does not "discriminate unfairly" and is

[34] *See* 11 U.S.C. 1129(a)(14).

[35] *See* 11 U.S.C. 1129(a)(15).

[36] *See* 11 U.S.C. 1129(a)(16).

"fair and equitable" with respect to each class of claims or interests that is impaired under, and that has not accepted, the plan.[37] This cramdown provision allows a court to confirm a reorganization plan even if all of the necessary consents of each class are not obtained. The policy behind the cramdown provision is that the public is well-served by company rehabilitations, and a plan that prevents creditors from getting immediate satisfaction, but provides creditors with the same amount as they would receive upon a company's liquidation, is just to force upon the creditors.[38]

Unfair discrimination "is best viewed as a horizontal limit on nonconsensual confirmation …. [j]ust as the fair and equitable requirement regulates priority among classes of creditors having higher and lower priorities, creating inter-priority fairness, so the unfair discrimination provision promotes intra-priority fairness, assuming equitable treatment among creditors who have the same level of priority."[39] The "unfair discrimination" standard "is not derived from the fair and equitable rule or from the best interests of creditors test. Rather it preserves just treatment of a dissenting class from the class' own perspective."[40] To prevent "unfair discrimination" the plan must "allocate value to the class in a manner consistent with the treatment afforded to other classes with similar legal claims against the debtor."[41] The Bankruptcy Code is based on the idea of "equality of treatment" and so "creditors with claims of equal rank are entitled to equal distribution."[42] The "unfair discrimination" standard of Section 1129(b) does not prohibit all types of discrimination among holders of claims and equity interests, it merely prohibits unfair discrimination.[43]

Courts typically examine the facts and circumstances of the particular case to determine whether unfair discrimination exists.[44] At a minimum, however, the unfair discrimination standard prevents creditors and interest holders with similar legal rights from receiving materially different treatment under a proposed plan without compelling justification for doing so.[45]

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[37] *See* 11 U.S.C. § 1129(b)(1).

[38] *Heartland Federal Savings & Loan Assoc. v. Briscoe Enterprises, Ltd., II, d/b/a Regalridge Apartments*, 994 F.2d 1160, 1162 (5th Cir. 1993), *citing* Daniel R. Cowans et al., *Cowans Bankruptcy Law and Practice* § 20.26 at 419 (1989 edition).

[39] *In re Sentry Operating Co. of Tex.*, 264 B.R. 850, 863 (S.D. Tex. 2001).

[40] *In re MCorp Financial, Inc*., 137 B.R. 219, 225 (Bankr. S.D. Tex. 1992); *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 416-17 (1977), reprinted U.S.C.C.A.N. 6372, 6373 (1978).

[41] *See* Collier on Bankruptcy ¶ 1129.03 at 1129-69 (15th ed. 1991).

[42] *In re Sentry Operating Co. of Texas*, 264 B.R. 850, 863 (Bankr. S.D. Tex. 2001).

[43] *See In re Leslie Fay Cos. Inc.*, 207 B.R. 764, 791 n.37 (Bankr. S.D.N.Y. 1997).

[44] *See, e.g., In re Freymiller Trucking, Inc.*, 190 B.R. 913, 916 (Bankr. W.D. Okla. 1996) (holding that a determination of unfair discrimination requires a court to "consider all aspects of the case and the totality of all the circumstances"); *In re Aztec Co.*, 107 B.R. 585, 589 (Bankr. M.D. Tenn. 1989) (noting that courts "have recognized the need to consider the facts and circumstances of each case to give meaning to the proscription against unfair discrimination").

[45] *See, e.g., In re Ambanc La Mesa Ltd. P'ship*, 115 F.3d 650, 656 (9th Cir. 1997).

In accordance with Section 1129(b)(2), a plan will be found to be fair and equitable with respect to a the relevant classes if it complies with one of the following conditions: (a) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (b) the holder of any interest that is junior to claims of such class will not receive or retain under the plan on account of such junior claim or interest any property… the interests of such class will not receive or retain under the plan on account of such junior interest any property.[46]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge, the case record and pleadings, interest rate expert, financial advisors, sources and uses analysis, projections and valuations. If the court permits, the use of written proffers can be beneficial.

Other Provisions of Bankruptcy § 1129(c) – (e)

The court may confirm only one plan, unless the order of confirmation in the case has been revoked.[47] In addition, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933, and the governmental unit has the burden of proof on the issue of avoidance and principal purpose.[48] Section 1129(e) requires the court to confirm a plan that complies with the applicable provisions of the Bankruptcy Code in a small business case that is filed in accordance with Section 1121(e) not later than 45 days after the plan is filed unless the time for confirmation is extended in accordance with Section 1121(e)(3).[49]

> Practice Tip: Evidence should be presented from a debtor representative with requisite personal knowledge and the ballot agent as to voting preferences. If the court permits, the use of written proffers can be beneficial.

RECENT CONFIRMATION ISSUES CASELAW

Post Confirmation Standing of the Debtors

In re Dynasty Oil & Gas, 540 F3d 351 (5th Cir. 2008)

In this case, the Court held that Dynasty, a reorganized debtor, did not have standing to pursue claims based on pre-confirmation management of the estate's assets. The court reasoned that upon confirmation of the plan, the estate ceased to exist, and Dynasty lost its status as a

[46] 11 U.S.C. § 1129(b)(2)(B).

[47] 11 U.S.C. § 1129(c).

[48] 11 U.S.C. § 1129(d).

[49] 11 U.S.C. § 1129(e).

debtor in possession. At that time, Dynasty's authority to pursue claims as though it were a trustee also expired.

The court acknowledged that in some cases the Code allows a reorganized debtor to bring a post-confirmation action on a claim or interest belonging to the debtor or to the estate. A debtor may preserve its standing to bring such a claim but only if the plan of reorganization expressly provides for the claim's retention and enforcement by the debtor. 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. If a debtor has not made an effective reservation, the debtor has no standing to pursue a claim that the estate owned before it was dissolved.

The debtor must also put its creditors on notice of any claim it wishes to pursue after confirmation. Such notice allows creditors to determine whether a proposed plan resolves matters satisfactorily before they vote to approve it — "absent 'specific and unequivocal' retention language in the plan, creditors lack sufficient information regarding their benefits and potential liabilities to cast an intelligent vote." Nor can the bankruptcy court's retention of jurisdiction over a given type of claim preserve a debtor's standing to pursue it. The court held that if Dynasty had wanted to bring a post-confirmation action for maladministration of the estate's property during the bankruptcy, it was required to state as much clearly in the Plan.

The Court found that neither the plan's blanket reservation of any and all claims arising under the Code, nor its specific reservation of other types of claims under various Code provisions are sufficient to preserve the common law claims of fraud, breach of fiduciary duty, and negligence that Dynasty brought in state court.

Pay to Play and Gift Plans

The absolute priority rule states that "the holder of any claim or interest that is junior to the claims of [an impaired dissenting] class will not receive or retain under the plan on account of such junior claim or interest any property."[50] The language of the statute makes it clear that a plan cannot give property to junior claimants over the objection of a more senior class that is impaired. Despite the plain language of the absolute priority rule, several cases have followed the "MCorp-Genesis" rule that allows creditors to distribute proceeds from the bankruptcy estate to other claimants without violating the absolute priority rule.[51] In addition, frequently senior secured creditors will "pay to play" by giving a distribution to junior claimants in the context of a sale under Bankruptcy Code § 363 in order to ensure the success of the sale.

In re World Health Alternatives, 344 B.R. 291 (Bankr. Del. 2006)

The debtors in a chapter 11 case moved for entry of an order approving a settlement agreement among the official committee of unsecured creditors, debtors, and a pre-petition lender with a first lien on all of the debtors' assets. The U.S. Trustee (UST) opposed the motion. None of the priority creditors, nor any other party in interest other than the UST, objected to the settlement. The court held that it had the authority to approve a compromise or settlement pursuant to Fed. R. Bankr. P. 9019(a) and that whether to approve a settlement was within its discretion. To approve the settlement, the court needed to conclude that the settlement was within the reasonable range of litigation possibilities. The principle motivating the UST's two objections was the same—the committee was not authorized to borrow and/or compromise estate claims and causes of action at the expense of priority creditors in chapter 11. The court held that the payout to the general unsecured creditors was a carve-out of the secured creditor's lien and not estate property. It therefore found that the Bankruptcy Code did not prohibit this arrangement. Overall, it found that the record as a whole suggested that only the lender would have benefited if the letter agreement was not approved. The court acknowledged that the UST raised valid questions. Nevertheless, it concluded that the settlement was in the interest of the estate, and the motion for entry of an order approving the settlement agreement was granted.

In the matter of Genesis Health Ventures, Inc., 266 B.R. 591 (N.J. 2001)

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[50] 11 U.S.C. § 1129(b)(2)(B)(ii).

[51] *See In re SPM Manufacturing Corp*., 984 F.2d 1305 (1st Cir. 1993)(permitting senior secured creditors to share bankruptcy proceeds with junior unsecured creditors while skipping over priority tax creditors in a chapter 7 liquidation*); In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 602, 617-18 (D.Del. 2001) (allowing senior secured lenders to (1) give up a portion of their proceeds under the reorganization plan to holders of unsecured and subordinated claims, without including holders of punitive damages claims in the arrangement, and (2) allocate part of their value under the plan to the debtor's officers and directors as an employment incentive package); *In re MCorp Fin., Inc*., 160 B.R. 941, 948 (S.D.Tex. 1993) (permitting senior unsecured bondholders to allocate part of their claim to fund a settlement with the FDIC over the objection of the junior subordinated bondholders).

Genesis Health held that a plan did not violate the absolute priority rule when it provided for a distribution to certain equity holders and unsecured creditors. This plan provided for the officers and directors of the debtor to receive a distribution of stock, forgiveness of loans, waivers, releases, and exculpations "in essence on account of their prepetition equity." The court held that the plan did not violate the absolute priority rule because the court had already approved various management benefits and the additional management benefits were derived from value otherwise allocable to senior lenders. The court also allowed the secured lenders to give up a portion of their proceeds under the reorganization plan to holders of unsecured and subordinated claims without including holders of punitive damages claims in the arrangement.

In re Armstrong World Industries, Inc., 432 F.3d 507 (3rd Cir. 2005).

In *Armstrong*, the plan provided for the transfer of warrants (to purchase the new equity of the debtor) from a class of unsecured creditors to the equity holders over the objection of another class of unsecured creditors. The plan proposed that the class of unsecured creditors would automatically receive and transfer the warrants to the former equity holders should the other unsecured class fail to vote for the plan. The court distinguished cases following the MCorp-Genesis doctrine and held that the plan violated the absolute priority rule. The *Armstrong* court distinguished *SPM*[52] in three ways: (1) *SPM* involved a distribution under chapter 7, which did not trigger 11 U.S.C. § 1129(b)(2)(B)(ii); (2) the senior creditor in *SPM* had a perfected security interest, meaning that the property was not subject to distribution under the Bankruptcy Code's priority scheme; and (3) the distribution was a "carve out," a situation where a party whose claim is secured by assets in the bankruptcy estate allows a portion of its lien proceeds to be paid to others. Similarly, the *Armstrong* court distinguished *Genesis Health* because *Genesis Health* involved property subject to the senior creditors' liens that was "carved out" for the junior claimants. In addition, *Armstrong* distinguished *MCorp* on its facts because the senior unsecured creditor transferred funds to the FDIC to settle pre-petition litigation, and there was not an equivalent settlement of prepetition litigation in *Armstrong*. The *Armstrong* court held that the MCorp-Genesis line of cases does not stand for the proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive and that creditors must also be guided by the statutory prohibitions of the absolute priority rule. The court held that the plan at issue violated the absolute priority rule.

In re OCA, Inc., 357 B.R. 72 (E.D. La. 2006)

OCA followed a similar line of reasoning as *Armstrong*. In *OCA*, the plan provided for payment in full to the secured creditor. The plan also provided for payments to general unsecured creditors, potentially 100% over time, but the plan did not provide for any interest on the allowed general unsecured claims and thus general unsecured claims were not paid in full. The issue was a proposed settlement that the senior lender extended to the equity holders in the

[52] *See In re SPM Manufacturing Corp*., 984 F.2d 1305 (1st Cir. 1993)(permitting senior secured creditors to share bankruptcy proceeds with junior unsecured creditors while skipping over priority tax creditors in a chapter 7 liquidation).

form of certain participation rights. The plan provided that the senior lender waived its right to receive up to 15% of the new common stock that it was entitled to receive under the plan in favor of the equity holders in exchange for their agreeing not to raise objections to the plan and to issue a press release setting forth their support of the plan. The court held that the participation rights were similar to the warrants in *Armstrong*, and that granting participation rights to the equity holders violated the absolute priority rule.

In re Journal Register Co, 2009 Bankr. Lexis 1737 (Bankr. S.D.N.Y. 2009)

The debtor proposed a reorganization plan which provided a means for payment of a gift from secured lenders to unsecured trade creditors, and provided for an incentive plan which permitted bonuses to employees who achieved stated goals. The debtors moved for confirmation of the plan, and certain creditors objected to confirmation. An unsecured creditor contended that the gift to trade creditors unfairly discriminated against other unsecured creditors, and other creditors argued that the incentive plan was an impermissible payment of unreasonable administrative expenses. Holders of stock in the debtors also asserted that the plan was not feasible nor in the best interests of creditors. The bankruptcy court first held that the gift payment was not improper since the payment was from a trade account which was property of the lenders rather than the estate, the payment was to be made outside the plan, unsecured creditors otherwise shared equally in the estate distribution, and the gift was warranted to ensure the post-confirmation goodwill of the trade creditors. Further, the incentive plan provided for performance bonuses rather than prohibited retention incentives, the bonus payments were not being paid as administrative expenses to preserve the estate, and the secured lenders would pay the bonuses with no effect on unsecured creditors. Also, credible financial projections indicated that the plan was feasible, and all creditors would receive more under the plan than in a liquidation of the debtors. Therefore, the objections were overruled, and the debtors' reorganization plan was confirmed.

Releases

Bank of New York Trust Co. v. Official Unsecured Creditors' Committee (In re Pacific Lumber Co.), 584 F.3d 229 (5th Cir. 2009)

The plan released various creditors from liability—other than for willfulness and gross negligence—related to proposing, implementing, and administering the plan. Bankruptcy Code states, however, that "discharge of a debt of the debtor does not affect the liability of any other entity on . . . such debt." 11 U.S.C. § 524(e). The court stated that "in a variety of contexts, this court has held that Section 524(e) only releases the debtor, not co-liable third parties." The court further stated that "[t]hese cases seem broadly to foreclose non-consensual nondebtor releases and permanent injunctions."

The court distinguished the two cases that cast doubt on this categorical prohibition against non-debtor releases by stating that "these cases are distinguishable because they concern

the res judicata effect of non-debtor releases, not their legality." In *In Republic Supply Company v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987), the court had previously ruled that res judicata barred a debtor from bringing a claim that was specifically and expressly released by a confirmed reorganization plan because the debtor failed to object to the release at confirmation. The court distinguished the current case as an appeal of the confirmation order, not a separate action barred by the exculpation provision, collaterally attacking the legality of the release.

Similarly, the court held that their opinion in *Applewood Chair Co. v. Three Rivers Planning & Development District*, 203 F.3d 914, distinguished *Shoaf* by holding that the release at issue there was not specific. *Applewood* did not find specific releases satisfy § 524(e), instead it held that the court would only give res judicata effect to specific clauses. The court further reasoned that other cases permitting third party releases all concerned global settlements of mass claims against the debtors and co-liable parties, and that now the Bankruptcy Code permits bankruptcy courts to enjoin third-party asbestos claims under certain circumstances which suggests non-debtor releases are most appropriate as a method to channel mass claims toward a specific pool of assets.

The court agreed, however, with courts that have held that 11 U.S.C. § 1103(c), which lists the creditors' committee's powers, implies committee members have qualified immunity for actions within the scope of their duties. The court found that the scope of protection in the plan, which does not insulate them from willfulness and gross negligence, was adequate. Consequently, the court required that the non-debtor releases must be struck except with respect to the creditors committee and its members.

In re Pilgrim's Pride Corporation, Case No. 08-45664-DML-11 (2010)

Upon review of the *Pacific Lumber* case, the court held that the holding in *Pacific Lumber* could not reasonably be read to limit its ruling to the facts of that case. In this case, the court held that the plan could not bar claims against co-liable third parties, even where the debtors indemnified the third party. The court qualified its holding by stating that while the court may not prevent suits against third parties even if the debtors have indemnified them, the court could provide relief from such suits where the debtors accept liability and wish to avoid or minimize the cost of defense. The court ruled that it should channel to itself claims that may be asserted against the debtors' management (including its board of directors and chief restructuring officer) and professionals based on their conduct in pursuit of their responsibilities during the chapter 11 cases.

The court also held that the plan's releases of the committee and its professionals complied with the law because they do not extend to immunity from liability for willful misconduct or ultra vires activity.

In re Crusader Energy Group Inc. Case No. 09-31797-bjh-11 (2009)

In this case, the co-proponents of the plan (including the debtors, the debtors' first and second lien lenders, and the official committee of unsecured creditors) proposed a plan with releases of third parties whereby creditors could chose to "opt-out" of the release on their ballot. The court raised *Pacific Lumber* issues regarding "opt-out" releases, and the co-proponents modified the plan so that creditors had to "opt-in" on their ballot to release the third parties from liability. The court confirmed the plan with the "opt-in" provisions.

The plan included a finding that any causes of action under the first lien credit facilities are property of the debtors' bankruptcy estates, and by the terms of the release such causes of action are barred from being asserted in any manner by the debtors, reorganized debtors, buyers, holders of claims against the debtors, or the current or former holders of equity interests of the debtors. This finding could have the practical effect of preventing any creditors or former equity holders from bringing derivative claims against the first lien creditors without constituting a release that could be barred by the Pacific Lumber decision.

A TIMELY (PERHAPS) NON-CONFIRMATION ISSUE

Assignment of Rents

In re Las Torres Development, L.L.C., 408 BR 876 (Bankr. S.D. Tex 2009)

In this case, the debtors in jointly administered chapter 11 cases requested permission to use one debtor's cash collateral, consisting of rental income, to pay both debtors continuing obligations during the pendency of the cases. A secured creditor objected that the rents were not property of the estate under an absolute assignment of rent contained in their loan documents. The court held that the deed of trust and assignment of rents were ambiguous under Texas law as to whether assignment of rents was intended to be an absolute assignment (transferring the fee ownership of the rents to the creditor upon the debtor's default) or a collateral assignment (the debtors owned the fee interest in the rents and the creditor retained a security interest). The court held that the deed of trust and the assignment, taken together, created a collateral assignment such that the debtors owned the fee interest to the rents and the creditor retained a security interest. The court reasoned that the deed of trust contemplated a collateral assignment while the assignment contemplated an absolute assignment. The court then used rules of contract construction to hold that the rents were collaterally assigned to the letter. Therefore, these rents were held to be property of the estate and the debtor's physical possession of the rents made the rents estate property even if, under state law, rents were absolutely assigned to the creditor.

In re Amaravathi Limited Partnership, 416 BR 618 (Bankr. S.D. Tex. 2009)

In this case, the chapter 11 debtors-in-possession moved to use cash collateral generated from post-petition rents collected from their apartment properties. Secured creditors opposed the motion. The court held that as a matter of first impression, pursuant to Bankruptcy Code § 541(a)(6) post-petition rents generated by apartment properties that were estate property were

themselves property of the estate, noting that Congress had the power, under combination of the Supremacy Clause and the Bankruptcy Clause of the Constitution, to override state law which may hold to the contrary.[53] The court further distinguished between collateral assignments, absolute assignment and true assignments and held that regardless of whether the assignment was an absolute or collateral assignment of rents, the post-petition rents are also property of the estate under Texas law and Bankruptcy Code §541(a)(1). Only a true assignment of rents, for which value is given for that projected future stream of income, can deprive a debtor of rents from such property (all equitable and legal interests must be acquired). The court therefore ordered that these rents were cash collateral and the secured creditor was entitled to adequate protection of its interest in the rents.

In re Four Bucks, LLC, Case No. 09-42629 (2009)

In this case, the chapter 11 debtors-in-possession moved to use cash collateral generated from post-petition rents collected from their apartment properties. Secured creditors opposed the motion. The court held that the lender and the debtor created an absolute assignment of rents for the benefit of the lender. The court then held that since absolute assignment of rents revoked the revocable license of the debtor to collect the rents, the debtor did not have any interest in the rents that passed to the debtors' estates and the debtors could not properly use the rents as cash collateral.

[53] "Given these broad Constitutional powers, it is no surprise that the *Butner* Court recognized Congress's ability to supersede state law in the bankruptcy arena….Congress's decision to do so in the case at hand was a wholly rational exercise of its expansive authority." *Id* at 625(internal citations omitted).

Bankruptcy Code Confirmation Requirements Summary

Code Section	Confirmation Requirement Name
§ 1129(a)(1)	Plan complies with the Bankruptcy Code.
§ 1129(a)(2)	Proponents comply with Bankruptcy Code.
§ 1129(a)(3)	Good faith.
§ 1129(a)(4)	Payments for services/costs and expenses approved by the Court.
§ 1129(a)(5)	Identity/affiliations of individuals to serve as Ds/Os must be disclosed.
§ 1129(a)(6)	Rate approvals by governmental regulatory commission obtained.
§ 1129(a)(7)	Best interest of creditors test, must receive not less than Chapter 7.
§ 1129(a)(8)	Class has accepted or is unimpaired under the plan.
§ 1129(a)(9)	Payment of administrative, priority and tax claims.
§ 1129(a)(10)	At least one impaired class (excluding insiders) has accepted the plan.
§ 1129(a)(11)	Feasibility, liquidation or further financial reorganization not likely.
§ 1129(a)(12)	All fees payable under 28 U.S.C. § 1930 paid as of plan effective date.
§ 1129(a)(13)	All retiree benefits (if applicable) to be paid as under § 1114.
§ 1129(a)(14)	All post-petition domestic support obligations must be paid.
§ 1129(a)(15)	Individual debtor, if plan objection, pays disposable income for plan period.
§ 1129(a)(16)	All property transfers for “non-moneyed” entities per applicable law.
§ 1129(b)	Cramdown, secured claims, unsecured claims, equity, absolute priority.
§ 1129(c)	Only one plan may be confirmed, consider creditors and equity preferences.
§ 1129(d)	Principal purpose of plan cannot be tax avoidance.
§ 1129(e)	Small business case, generally, confirm the plan within 45 days of filing.