AMERICAN BANKRUPTCY INSTITUTE

New York City Bankruptcy Conference

Recent Confirmation Developments

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Hon. Christopher S. Sontchi
U.S. Bankruptcy Court (D. Del.)

CONCURRENT SESSION

2022

AMERICAN BANKRUPTCY INSTITUTE NYC CONFERENCE

Confirmation Panel #1*

Panelists

Hon. Christopher S. Sontchi
U.S. Bankruptcy Court (Del.)

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June 10, 2022
New York, NY

* The views expressed in this presentation do not necessarily represent the views of the judges, the moderator or the facilitator or their respective institutions. Nothing the judges say today may be construed as binding them to any legal position or commentary on the direction their courts may take in the future.

AMERICAN BANKRUPTCY INSTITUTE NYC CONFERENCE

Confirmation Panel #2*

Panelists

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Kathryn A. Coleman
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Today's Topics

- Impairment Issues
  - Code v. Plain Impairment
  - Artificial Impairment
  - Improvement as Impairment
- Consensual Third Party Releases
- Plan Confirmation Tactics
  - Gifting
  - Appropriate Classification v. Gerrymandering
  - Death Traps

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Impairment Issues
Code v. Plan Impairment

- **Issue** – Under Bankruptcy Code Section 1124(1), a class of claims is impaired "if the plan alters the legal, equitable, or contractual rights to which the holders of such claims are otherwise entitled."
  - However, since claims can be altered by provisions of the Bankruptcy Code—e.g., 502(b)(2) disallows claims for unmatured interest—a creditor may be rendered unimpaired by a plan but receive less than it would otherwise be entitled to receive outside of bankruptcy.
- **Question** – Is a claim unimpaired for purposes of Section 1124(1) if the plan provides the claim with a recovery that is consistent with the Code provisions that limit a creditor's claim, but that is less than claim's entitlement outside of bankruptcy?
- **Why it matters** – If a class of claims is unimpaired, it is not entitled to vote to accept or reject a plan. Such a class is deemed to accept the plan under Section 1126. However, if a class of claims is impaired and votes to reject a plan, the debtor must satisfy the Section 1129(a)(7) best interest test and the Section 1129(b) cramdown requirements with respect to such class.

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Impairment Issues
Artificial Impairment

- **Issue** – Bankruptcy Code Section 1129(a)(10) provides that, if there are any impaired classes under a plan, at least one impaired class must vote to accept the plan.
- **Question** – Is it permissible for a plan proponent to impair a class of claims solely for the purpose of satisfying Section 1129(a)(10), even if the plan proponent arguably could have left such class unimpaired?
- **Divergent Authority** – There is a split of authority regarding whether 1129(a)(10) draws a distinction between artificial and economically driven impairment.
  - On the one hand, under the Eighth Circuit's approach, 1129(a)(10) recognizes impairment only to the extent that it is driven by economic "need"
  - On the other hand, the Ninth Circuit held that 1129(a)(10) does not distinguish between discretionary and economically driven impairment
  - However, the Ninth Circuit left open the possibility that discretionary impairment could offend a plan proponent's duty of good faith under section 1129(a)(3)
  - Although the Second and Third Circuits have yet to rule on the issue, lower courts in these circuits have held that artificial impairment is improper when there is no valid business purpose for the impairment
- **Improvement as Impairment** – Can a debtor artificially impair a claim by providing the claimant with more than its entitlement under a plan?

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Consensual Third Party Releases

- **Issue** – Disputes over a bankruptcy court's authority to approve nonconsensual third party releases have dominated the legal landscape. But many of those issues can be avoided if the vast majority of claims sought to be released can be categorized as consensual.
- **Questions** – (1) What is a consensual release? What constitutes consent and what factors will the courts evaluate to determine that a release is consensual?
- **Potential Bases for Determining Consent** -- The debate centers on what standard of consent should apply in the context of third party releases under a plan. For example:
  - Do state-law contract principles apply, requiring claimants to affirmatively express their mutual assent to releases through the return of opt-in forms?
  - Or do creditors have a duty to respond to an opt-out notice, and if they do not, can they be presumed to accept a plan's releases?
  - Another view is that Section 1141(a) places the onus on creditors to object to any releases contained in a plan.

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Consensual Third Party Releases

- **Mutual Assent** – (1) Some courts have held that voting in favor of a plan that contains a release constitutes consent to the release itself; (2) Other courts have held that voting in favor of the plan is not enough and that there must be unambiguous assent to the release itself.
- **Notice and Failure to Act (a.k.a., Deemed Consent)** – Deemed consent contexts arise when a creditor fails to, or is not entitled to, take any action with respect to third party releases – e.g., when a creditor does not respond to a voting deadline (abstention) or is left unimpaired under the plan.
- **What is the appropriate standard for consent? Does it matter how the class is treated under the plan?**
  - Unimpaired classes that are deemed to accept
  - Impaired classes that are deemed to reject
  - Claimants entitled to vote that vote "yes"
  - Claimants entitled to vote that vote "no"
  - Claimants entitled to vote that abstain

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Plan Confirmation Tactics

- **Issue** – There are a number of plan confirmation tactics that a debtor may consider when seeking to achieve a confirmable plan, including:
  - <u>Gifting</u>: A senior creditor provides a portion of its recovery to junior claimants
  - <u>Managing/manipulating classification and voting</u>: Separately classifying similarly situated creditors
  - <u>Death traps</u>: Tying the recovery of a class (or event an individual claimant) to how the class or claimant votes on the plan

  Objecting stakeholders often contest such tactics as running afoul of the Bankruptcy Code.
- **Question** – What are the limits to these tactics? How should the bankruptcy court balance the dual principles underpinning the Bankruptcy Code – (1) the policy of encouraging reorganizations and (2) the fair treatment of similarly situated stakeholders?

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Plan Confirmation Tactics
Gifting

- **Class skipping gifts (i.e., vertical gifts)** – When a class of senior creditors agrees to share a portion of its recovery with a junior class, sometimes even bypassing a class that is in between the transferor and the transferee in priority and that is not paid in full.
- **Class splitting gifts (i.e., horizontal gifts)** – When a class of senior creditors agrees to share a portion of its recovery with a subset of equal-priority creditors without skipping over an intermediate class.
- **Question** – Can gifts potentially conflict with the cramdown requirements under section 1129(b)(1)?
  - Fair and equitable test/absolute priority – a gift that skips over an intermediate, dissenting class could potentially violate the absolute priority rule incorporated by the fair and equitable test.
  - Unfair discrimination – a gift that makes a selective distribution to equal-priority creditors could potentially violate the unfair discrimination test.

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Plan Confirmation Tactics
Appropriate Classification v. Gerrymandering

- **Issue** – Whether a debtor has improperly “gerrymandered” classes under a plan of reorganization in order to obtain the vote of an impaired accepting class.
  - Section 1122 states that plan proponents may place a claim in a particular class only if the claim is substantially similar to other claims in that class.
    - But this provision is silent on whether a claim must be placed in a particular simply because it is substantially similar to other claims in that class.
  - The classic example of gerrymandering arises in single asset real estate cases, where a debtor separately classifies a mortgage lender’s significant deficiency claim from trade claims.
- **Legitimate Business Reason Standard** – Many courts have adopted the standard that a plan proponent must demonstrate a legitimate business reason for separately classifying claims in order to withstand a gerrymandering challenge.

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Plan Confirmation Tactics

Death Traps

- **Types of Death Traps**
  - Traditional – Death traps that apply to a single class and treat all claims within that class the same depending on how the entire class votes
  - Individually Targeted – Death traps that apply to a single class but treat claims within that class different depending on how individual claimants votes
  - Multiple Classes – Death traps that apply to multiple classes with their recoveries dependent on plan acceptance by a single class.
  - External Triggers – Death traps that are triggered if the UCC or claimants within or outside of the class object to the plan.
- **Propriety of Death Traps** – It seems that most courts allow traditional death traps, on the basis that the death trap saves the plan proponent from the expense and uncertainty of a cramdown fight and comports with the Bankruptcy Code's policy of fostering consensual plans without violating the fair and equitable test.
  - However, courts will closely scrutinize and may reject death traps that (1) may treat certain creditors in the same class differently, (2) may violate the absolute priority rule, and (3) may implicate public policy considerations, such as potentially tying the hands of creditors' committees.

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Chapter 11 Plans, Claims, What We're Watching

To Make-Whole … or Not

Jan 22, 2019

Contributor(s)
Alfredo R. Perez

Fifth Circuit Holds that Disallowance of Claim Pursuant to the Bankruptcy Code Does Not Render Such Claim Impaired and Casts Doubt on Creditors' Ability to Recover Make-Whole Amounts or Post-Petition Interest at the Default Contract Rate

Executive Summary

On January 17, 2019, a three-judge panel of the United States Court of Appeals for the Fifth Circuit reversed, in part, and vacated, in part, a bankruptcy court decision in I*n re Ultra Petroleum Corp.*, Case No. 17-20793 (5th Cir. Jan. 17, 2019) ("*Ultra II*"). The bankruptcy court had held that certain creditors (the "*OpCo Creditors*") of a solvent debtor were deemed unimpaired by the Ultra chapter 11 plan and, therefore, entitled to the full $201 million make-whole (the "*Make-Whole Amount*") and post-petition interest at the default contract rate in the aggregate amount of $186 million. *In re Ultra Petroleum Corp.*, 575 B.R. 361, 370–71 (Bankr. S.D. Tex. 2017) ("*Ultra I*"). The Fifth Circuit remanded the case back to the bankruptcy court to consider whether it was the Bankruptcy Code that impaired the creditors' rights, and not the Ultra chapter 11 plan.

In particular, the *Ultra II* opinion:

- Holds that "[Bankruptcy] Code impairment is not the same thing as plan impairment" and, therefore, the bankruptcy court erred when holding that a plan impairs a creditor if the plan "refuses to pay an amount the Bankruptcy Code independently disallows."
- Suggests that make-whole amounts will generally be considered unmatured interest in the Fifth Circuit. Thus, unless the solvent debtor exception

applies, the Debtors can avoid paying the Make-Whole Amount without impairing the OpCo Creditors' Claims.
- States that while OpCo Creditors have no legal right to collect post-petition interest at the default contract rate, the bankruptcy court may award interest (i) pursuant to the post-judgment interest statute (28 U.S.C. § 1961) at the applicable judgment rate or (ii) at a rate supported by the equities of the case.

The bankruptcy court will reconsider these issues in accordance with the Fifth Circuit's opinion. *Ultra II*, however, may have substantial implications beyond this case. The opinion suggests that make-whole provisions may only be enforceable in extremely narrow circumstances. If that ultimately proves to be true, the holding could impact decisions made by future debtors regarding venue, decisions of market participants in connection with financings, as well as the drafting of make-whole provisions in future debt agreements.

Key Takeaways

- The *Ultra II* opinion does not include an explicit declaration that make-whole provisions are always unmatured interest, subject to disallowance under section 502(b); however, it comes very close. The opinion includes very little analysis of the bankruptcy court's contrary determination, and related multi-page discussion, that the Make-Whole Amount is an enforceable liquidated damages obligation under New York state law. See *Ultra I*, at 368–72. In addition, the *Ultra II* court suggests that a make-whole provision may be both a liquidated damages clause and unmatured interest, subject to disallowance under section 502(b). See *Ultra II*, at 22 ("Others have concluded make-whole provisions are better viewed as liquidated damages, rather than unmatured interest. But those categories are not mutually exclusive.") (citations omitted).
- To the extent the bankruptcy court adopts similar treatment, which appears likely in light of the *Ultra II* court's strongly worded opinion, the ability of creditors to enforce a make-whole provision inside the Fifth Circuit could be limited to cases involving a solvent debtor and/or an oversecured creditor. Even with a solvent debtor, however, enforcement is far from guaranteed

given the *Ultra II* court's stated doubt that the solvent debtor exception applies under the Bankruptcy Code. Indeed, the *Ultra II* court explicitly stated that it expects the bankruptcy court to consider whether a creditor's ability to seek dismissal of a bad-faith filing under the Bankruptcy Code impacts the continued application of the solvent debtor exception. *Ultra II*, p. 24 ("We trust the bankruptcy court on remand also will consider what effect (if any) § 1112(b) has on the solvent-debtor exception (if any exists).").

- The inability to enforce make-whole provisions in most circumstances will likely result in various changes in behavior by future debtors, creditors and lenders. For example, potential debtors seeking to avoid make-whole obligations will be more likely to commence cases in the Fifth Circuit. On the other hand, creditors seeking to enforce make-wholes may insist on filing in a different circuit. Such dynamics will certainly affect the negotiation of pre-planned and pre-packaged plans.
- Additionally, lenders and borrowers may begin revising the currently accepted forms of make-whole provisions (e.g., including alternatives to yield maintenance formulas so the terms appear less like the economic equivalent of interest). Lenders may also seek terms that provide increased opportunities/abilities to trigger an event of default before a potential debtor seeks bankruptcy protection.
- The ability of creditors to recover post-petition interest at rates above the federal judgment rate could also be impacted; however, that appears less likely because the *Ultra II* decision leaves the door open for bankruptcy courts to award post-petition interest at the default contract rate based on the equities of the case.

Background

On April 29, 2016, predecessors of reorganized debtors Ultra Petroleum Corp, its operating subsidiary, Ultra Resources, Inc. ("OpCo"), and certain affiliated entities (collectively, the "*Debtors*") commenced chapter 11 cases in the United States Bankruptcy Court for the Southern District of Texas. The Debtors were oil and gas exploration and production companies.

In connection with the Debtors' operations, OpCo incurred direct obligations with respect to approximately $2.5 billion of unsecured debt (the "*OpCo Funded Debt*"), including outstanding principal obligations of (i) approximately $999 million under OpCo's revolving credit agreement (the "*Revolver*") and (ii) approximately $1.5 billion of private, unsecured notes (the "*OpCo Notes*") issued by OpCo under a note purchase agreement ("*NPA*," and together with the OpCo Notes and the Revolver, the "*OpCo Debt Agreements*").

Commencement of the Debtors' bankruptcy cases was an event of default under each of the OpCo Debt Agreements that resulted in all principal amounts outstanding, accrued prepetition interest, and certain other fees and costs, including the Make-Whole Amount owed on the OpCo Notes, becoming immediately due and payable. Thereafter, post-petition interest accrued on each of the foregoing amounts.

During the pendency of their chapter 11 cases, following a rise in commodity prices, the Debtors determined they were solvent and ultimately proposed a plan of reorganization that would pay the OpCo Funded Debt — comprised of the holders of OpCo Notes (the "*OpCo Noteholders*") and the lenders party to the Revolver — in full, thereby rendering the OpCo Creditors unimpaired and without any right to vote to accept or reject the plan [1]. However, because the plan failed to provide for the payment of the Make-Whole Amount or post-petition interest at the default contract rate, the OpCo Creditors objected to the proposed plan and their treatment as holders of unimpaired claims.

On March 13, 2017, the Debtors and an ad hoc committee of OpCo Creditors entered into a stipulation and agreed that arguments regarding the calculation of post-petition interest and allowance of the Make-Whole Amount would be determined after confirmation. The Debtors' plan was confirmed the following day.

The Bankruptcy Court Decision</h2

The bankruptcy court heard arguments regarding the allowance of the Make-Whole Amount and the appropriate rate of post-petition interest in May 2017 and held that:

- The Make-Whole Amount is an enforceable liquidated damages provision under New York law, explaining that contractual provisions requiring payment of the Make-Whole Amount as well as post-petition default interest provided compensation for separate injuries and, therefore, did not result in an improper double recovery or render the Make-Whole Amount an unenforceable penalty, *Ultra I*, at 370–71;

- Non-payment of amounts required under the OpCo Debt Agreements — even if otherwise disallowed by the Bankruptcy Code — would render the affected claims impaired under section 1124(1) of the Bankruptcy Code;[2] and
- When creditors are unimpaired, post-petition interest should be assessed at the default contract rate rather than the legal rate required by section 726(a)(5) of the Bankruptcy Code.[3] *Id*. at 374–75.[4]

Accordingly, the bankruptcy court determined that the OpCo Noteholders were entitled to the Make-Whole Amount of approximately $201 million and the OpCo Creditors were entitled to aggregate post-petition interest of approximately $186 million.

The bankruptcy court rejected the Third Circuit's holding in *In re PPI Enterprises (U.S.) Inc*[5] . that impairment of claims should only be considered with respect to claims "allowed" under the Bankruptcy Code because it failed to analyze the impairment question in the context of the plan discharge rather than Bankruptcy Code allowance. According to the bankruptcy court, the failure to pay the Make-Whole Amount would impair the OpCo Notes because the discharge of such claims is governed by section 1141(d),[6] which provides that the extent of the discharge is governed by the terms of the confirmed plan of reorganization, and the Debtors' plan discharged any liability related to the Make-Whole Amount and post-petition interest.

The Fifth Circuit Decision

The Fifth Circuit panel vacated and remanded the bankruptcy court's decision, stating that: "The key legal question before us is whether the rich man's creditors are 'impaired' by a plan that paid them everything allowed by the Bankruptcy Code," which the bankruptcy court answered in the affirmative. *Ultra II*, at p.2. The *Ultra II* court disagreed, stating that it would "follow the monolithic mountain of authority holding the [Bankruptcy] Code — not the plan of reorganization — defines and limits the claim in these circumstances." *Id*. Moreover, because the bankruptcy court determined that the OpCo Creditors, as unimpaired creditors, must be paid all amounts they were entitled to receive under the OpCo Debt Agreements, regardless of the disallowance provisions of the Bankruptcy Code, the bankruptcy court did not consider whether the Bankruptcy Code disallows or otherwise limits payment of (i) the Make-Whole Amount as unmatured interest or (ii) post-petition interest at the default contract rate. Accordingly, those questions were remanded to the bankruptcy court for reconsideration. *Id*.

In support of its holding that disallowance under the Bankruptcy Code does not result in impairment, the *Ultra II* court pointed to the language of section 1124(1), which provides that "'a class of claims or interests' is not impaired if 'the plan . . . leaves unaltered the [claimant's] legal, equitable, and contractual rights.'" *Id*. at 7. In contrast to the *Ultra I* decision, the *Ultra II* court embraced the Third Circuit's holding in *PPI Enterprises* that disallowance of claims pursuant to one of the enumerated conditions of section 502(b) means it is the Bankruptcy Code rather than the plan that impairs such claims. *Id*. at 10 (citing *PPI Enters*., 324 F.3d at 204).

Next, the *Ultra II* court considered whether the OpCo Creditors' claims for the Make-Whole Amount or post-petition interest at the contract default rate are disallowed under the Bankruptcy Code. The court began by examining pre-Bankruptcy Code law, which allowed a creditor of a solvent debtor or an oversecured creditor to recover unmatured interest that was part of such a creditor's claim, but not post-petition interest on its claim. Section 506(b) of the Bankruptcy Code incorporates a similar exception for oversecured creditors to recover unmatured interest that is part of such creditors' claims, which would otherwise be disallowed under section 502(b). However, according to the *Ultra II* court, the solvent debtor exception (codified in section 726(a)(5)) arguably is not an exception to section 502(b) because it provides for the payment of post-petition interest on a claim.[7] Moreover, the section 726(a)(5) solvent debtor exception is applied to chapter 11 cases through section 1129(a)(7) and, therefore, only applies to impaired creditors in chapter 11.[8]

Although the opinion explicitly refrains from classifying the Make-Whole Amount as unmatured interest, multiple statements strongly suggest that the *Ultra II* court views make-whole payments generally as unmatured interest. The OpCo "[C]reditors can recover the Make-Whole Amount if (but only if) the solvent-debtor exception survives Congress's enactment of § 502(b)(2)." *Id*. at 19; see also *id*. at 20 ("§ 502(b) . . . requires a bankruptcy court to disallow a claim 'to the extent that [it seeks] unmatured interest' . . . [and t]he debtors make a compelling argument the Make-Whole Amount is one such disallowed claim."). "The only question then is whether the pre-Code solvent-debtor exception survives the enactment of § 502(b)(2)." *Id*. at 23. Moreover, the *Ultra II* court noted that the pre-Bankruptcy Code solvent debtor exception was often motivated by concerns over bad-faith filings, but that such concerns have largely been addressed by the procedures for seeking dismissal of a chapter 11 case under section 1112(b). *Id*.

Regarding the payment of post-petition interest, the *Ultra II* court stated "there is no legal right to post-petition interest at the default rates." However, the court leaves open the possibility noting that there are two potential paths.

First, the post-judgment interest statute [9], which allows interest "on any money judgment in a civil case recovered in a district court." Second, because bankruptcy courts are generally considered courts of equity, especially when it comes to awarding interest, equity may provide a basis to pay a higher rate.

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Another One Bites the Dust: How Jevic Curtailed Creditor Rights to Negotiate in and out of Bankruptcy

*Jaden Banks**

I. INTRODUCTION

Gone are the days of bankruptcy where the insolvent debtor faced an ignominious execution or was sentenced to lifelong imprisonment to satisfy a creditor's demand for their pound of flesh. The modern U.S. Bankruptcy System has moved beyond its focus on draconian punishment,[1] instead, its focus is on fairness to the debtor and distribution of assets among creditors.[2] With recent Supreme Court cases such as *Jevic*, significant concerns have been raised about the effectiveness of negotiated agreements, related to, but outside of bankruptcy.[3] These concerns center on the reduction in the fairness of certain debtor tools—namely prepackaged and cramdown plans. These plans put creditors in a constantly inferior bargaining position to the debtor, with whom, creditors must negotiate to obtain payment of outstanding obligations. In contravention of historic fears about bankruptcy's fairness and efficiency, this article addresses a growing concern regarding the treatment of creditors in a debtor-oriented system. This article posits that *Jevic* has detrimentally altered creditor interests in insolvency and bankruptcy because creditors have been severely limited in their ability to negotiate for preferential payment.

There are two concurrent purposes to Chapter 11, which is also known as corporate bankruptcy. First, bankruptcy aims to reduce debt loads for businesses, thereby encouraging continued operation. Second, bankruptcy provides clear guidelines for the collection of debt.[4] This article focuses its attention on this

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* J.D. Candidate May of 2021 at the University of Missouri School of Law. B.A. in Political Science from Brigham Young University–Idaho. I would like to thank Professor Brook Gotberg for her expert advice and patience as she helped me to develop this article. I would also like to thank my wonderful friends and family who have provided some much-needed critical commentary and support.

1. *See* O. O. Vrooman, *Origin and History of the Bankruptcy Law*, 37 COM. L. J. 127, 127-28 (1932) (addressing some of the origins of bankruptcy, such as the execution and slavery systems for debtors in 4th century BCE Rome through the development of the English common law debtor slavery and the debtor prisons of the 17th and 18th centuries).

2. *See generally* Jean Braucher, *Bankruptcy Reorganization and Economic Development*, 23 CAP. U. L. REV. 499 (1994).

3. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017) (holding that secret priority and structured dismissal of a case contrary to the Bankruptcy Code is not permitted.); *see also* Hannah L. Blumenstiel et al., *Skipping Priorities in the Post-Jevic World*, Presentation to the Commercial Law and Bankruptcy Section of the Bar Association of San Francisco (April 2018), http://content.sfbar.org/source/BASF_Pages/PDF/G181904materials.pdf [hereinafter Skipping Priorities].

4. *See* GRANT NELSON, ET. AL., REAL ESTATE TRANSFER, FINANCE AND DEVELOPMENT 772 (9th ed. 2015). It is important to note at this point that bankruptcy originated as a creditor remedy, because it provided creditors with a way to collect on their debts. However, changes over time have created a bankruptcy system which provides preferential treatment to debtors. So, most individuals file for consumer bankruptcy under chapters 7, 12, and 13 of the Bankruptcy Code, because these chapters

second purpose. Bankruptcy encourages businesses to make large scale purchases that they would otherwise be unable to afford, which in turn helps promote manufacturing and economic development all around the world.[5] As a result, bankruptcy facilitates the extension of credit by providing creditors protection for their investments.[6] This article addresses one of the quintessential aspects of bankruptcy that *Jevic* has limited, namely a creditor's ability to negotiate payment terms outside of bankruptcy, contrary to bankruptcy's purposes.

This article has six sections that focus on Chapter 11, addressing the "reorganization" of large multi-state corporate debtors who use this chapter.[7] The first section addresses the legislative history of bankruptcy and provides a brief overview of the changes in bankruptcy's objectives throughout history.[8] In the second section, this Comment addresses the basic operation of a Chapter 11 bankruptcy and provides a simple platform to understand how *Jevic* has altered a significant aspect of bankruptcy.[9] Third, this article examines how pre-bankruptcy agreements illustrate the conflict in negotiations between debtors and creditors.[10] The fourth section examines how a cramdown plan provides debtors with a stronger bargaining position as parties negotiate for both a quick and inexpensive exit from bankruptcy and a maximized payout.[11] The fifth section addresses the Supreme Court's decision in *Jevic*,[12] identifying how creditors have less incentive to bargain because they can no longer negotiate for better priority.[13] Sixth, this article proposes solutions that will restore the status quo disrupted by the Supreme Court's *Jevic* decision. In conclusion, the implementation of *Jevic* places limits on changing priorities which harms creditor interests and such a limit on negotiation is inapposite to the purpose and spirit of bankruptcy.

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provide the most protections to consumers. The typical corporate bankruptcy involves large multi-state organizations, I will not address the small or midsized bankruptcies nor will I address state reorganizations or receivership protections.

5. *See* THOMAS JACKSON & DAVID SKEEL, BANKRUPTCY AND ECONOMIC RECOVERY 103 (Brookings Institute 2013).

6. CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY 1039 (2nd ed. 2009).

7. A vast majority of bankruptcies do not involve large companies, however, large multistate companies that use bankruptcy to reorganize or limit their liabilities account for a large percentage of the money involved in all U.S. bankruptcy filings. Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN L. REV. 751, 756 (2002); *see also* Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L. J. 748 (2010).

8. For a more exhaustive history, *see* David A. Skeel, Jr., *The Genius of the 1898 Bankruptcy Act*, 15 BANKR. DEV. J. 321 (1999); *see also* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. L. REV. 5, 10-11 (1995). Both of which address the development of bankruptcy law within the United States and focus on several of the driving economic and legal factors behind the adoption of each bankruptcy law and amendments.

9. For a comprehensive reading on the practice and nature of bankruptcy law, *see generally* TABB, *supra* note 6.

10. FRANK PERITORE, WORKOUTS AND ENFORCEMENT FOR THE SECURED CREDITOR AND EQUIPMENT LESSOR 15 (2008).

11. Blumenstiel et al., *supra* note 3.

12. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).

13. *Id.*

II. A VERY BRIEF HISTORY OF NEGOTIATION IN AMERICAN BANKRUPTCY LAW

In order to understand the development of bankruptcy law, it is important to have an understanding of its origin and changes in the past few centuries. Negotiation is a central part of the bankruptcy process and so it is important to understand how bankruptcy specific negotiation and the interconnected issue of distribution of bankruptcy assets have changed over time. Bankruptcy originated as a creditor friendly remedy exclusively available to the mercantile elite, over time it became more consumer-friendly.[14] Similarly, the distribution of bankruptcy proceeds has evolved from a piecemeal pro-rata distribution to the modern practice of distributing the value of the bankruptcy company based on textual and public policy reasons.[15]

A. The Early History of Bankruptcy

Insolvency laws date back to around 400 B.C.E and have existed in some form or another since then.[16] Bankruptcy's origin in the United States was derived from the common law traditions of English insolvency law and continued to evolve as colonists developed their legal traditions.[17] Because of this English influence, the drafters of the 1787 United States Constitution included a clause that granted the federal government the power to implement, control, and alter bankruptcy law.[18] The United States' view of bankruptcy was the same as England's, specifically, bankruptcy was a tool for creditors to collect money from indebted merchants.[19] Bankruptcy was not available to the layperson, their alternative was debtors' prison.[20]

Congress first exercised its bankruptcy power through the creation of the Bankruptcy Act of 1800.[21] While it only lasted until 1803, this version formed a basis for all subsequent bankruptcy laws.[22] The Bankruptcy Act of 1800 was fundamentally a creditor collection device; it allowed creditors to bring an involuntary action against debtors who had defaulted on their obligations, essentially dragging the debtor into court.[23] Scathing criticism of the system showed that debtors could repeatedly obtain credit, default, declare bankruptcy, and immediately obtain credit again much to the chagrin of their empty-handed

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14. TABB, *supra* note 6.
15. *Schoenmann v. Bank of the West (In re Tenderloin Health)*, 849 F.3d 1231 (9th Cir. 2017).
16. Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 7 (1995).
17. *Id.*
18. U.S. CONST. art I, § 8, cl. 4.
19. Tabb, *supra* note 16, at 14.
20. *Id.* at 7.
21. *An Act to establish a Uniform System of Bankruptcy throughout the United States*, ch. 19, § 57, 2 Stat. 19, 20 (Apr. 1800) *repealed by Act of Dec. 19, 1803*, ch. 6, 2 Stat. 248.
22. Tabb, *supra* note 16, at 13-16.

[23] *An Act to establish a Uniform System of Bankruptcy throughout the United States*, ch. 19, § 4-6, 2 Stat. 19, 22-23 (Apr. 1800). The process whereby a creditor would bring a bankruptcy proceeding against an unwilling debtor is known as an involuntary bankruptcy because the debtor was virtually dragged into bankruptcy against their will.

creditors.[24] This created a cycle where individuals would borrow without fear of repayment, and so creditors were left footing the bill.

The nation was so disgruntled with federal insolvency law that it took until 1841 for a second bankruptcy act to come into existence.[25] Unlike the Bankruptcy Act of 1800, this act provided for both voluntary and involuntary bankruptcy for real persons.[26] It allowed all consumers and many businesses, except railroads, banks, and corporations, to use bankruptcy to work with their respective creditors which provided a modicum of control over their beleaguered finances.[27] The inclusion of the voluntary bankruptcy petition set the stage for modern bankruptcy negotiation by incentivizing creditors to negotiate with their debtors so the debtor would not use bankruptcy as a weapon to eviscerate the creditor's claim.[28] The Act also provided creditors an opportunity to declare certain debts non-dischargeable to prevent bad actors from escaping their obligation unscathed.[29] However, the Act of 1841 failed to address and fix some of the reasons for its creation, so it was repealed in 1843.[30]

Following the remarkably short tenure of the 1841 Bankruptcy Act, states promoted their own insolvency laws,[31] but the differences between state law protections, in addition to, financial upheavals and a Civil War, convinced Congress to once more promulgate a system of bankruptcy.[32] The third bankruptcy act was enacted in 1867.[33] However, the Panic of 1873[34] motivated state legislatures, trade organizations, and other commercial enterprises to clamor for repeal.[35] By late 1873, Congress recognized substantial flaws in the bankruptcy law, especially among the companies and corporations that had sprung up in the aftermath of the Civil War.[36]

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24. The more unscrupulous debtors would convince a sympathetic creditor to file an action for bankruptcy when the debtors requested, creating the first voluntary bankruptcies, albeit in a roundabout way. Tabb, *supra* note 16, at 18.

25. *See An Act to establish a Uniform System of Bankruptcy throughout the United States*, ch. 9, § 57, 5 Stat. 440, 20 (Aug. 1841), *repealed by Act of Mar. 3, 1843*, ch. 82, 5 Stat. 614.

26. *Supra* note 25. The term 'real' persons is used herein because the Bankruptcy Act of 1841 did not allow corporations to declare bankruptcy. This is a significant distinction because corporations have been afforded most of the same rights as individuals under current United States law. *See generally* Citizens United v. Fed. Election Comm'n, 558 U.S. 310 (2010) (holding that corporations have the constitutional right to free speech, including political speech); Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682 (2014) (holding that corporations and their owners have vast freedom of religion protections); Santa Clara County v. Southern Pacific R. Co., 118 U.S. 394 (1886) (holding that the 14th amendment protections extended beyond real persons).

27. Charles J. Tabb, *The Top Twenty Issues in the History of Consumer Bankruptcy*, 2007 U. ILL. L. REV. 9, 12 (2007).

28. Vrooman, *supra* note 1.

29. Tabb, *supra* note 16, at 17-18.

30. Tabb, *supra* note 27.

31. Tabb, *supra* note 16, at 1-12.

32. *Id.* at 11-12.

33. *See An Act to establish a Uniform System of Bankruptcy throughout the United States*, Ch. 176, 14 Stat. 517 (Mar. 1867), [hereinafter 1867 Act], *repealed by Act of June 7, 1878*, ch. 160, 20 Stat. 99.

34. Gary Richardson & Tim Sablik, *Banking Panics of the Gilded Age*, Federal Reserve Bank of Richmond (Dec. 4, 2015), https://www.federalreservehistory.org/essays/banking_panics_of_the_gilded_age.

35. *Cong. Globe*, 42d Cong., 3d Sess. 34 (1872-73).

36. "A bill to repeal an act entitled 'An act to establish a uniform system of bankruptcy throughout the United States,' approved March 2, 1867, and all laws and parts of laws amendatory thereto." (H. R. No. 792), Congressional Record 2 (Jan. 1874), p. 210. Text from Additional Government Publications Congressional Record.

As a result, Congress passed the 1874 Amendment to the 1867 Bankruptcy Act.[37] The amendment imposed a novel idea which it described as "compositions."[38] Compositions provided new protections for businesses by providing them with an automatic discharge to business debts in exchange for creditors' votes to approve a debtor's proposed payment plan.[39] Therein creditors could meet together to determine how debtor payments would be distributed among themselves while also voicing concerns about whether a debtor's debt would be automatically discharged as was the practice under the 1841 Act.[40] Previously, creditors had to accept a pro-rata distribution, now they could negotiate for a payment based on the priority of their claim and some creditors could receive "full satisfaction" on their claims rather than sharing equally with other creditors.[41] Unfortunately, compositions came into effect too late to meaningfully affect the law because the 1867 Act was fully repealed in 1876.[42] However, the introduction of compositions firmly established negotiation among parties as a core element to modern bankruptcy.[43]

B. *The Foundation of Bankruptcy Law: The 1898 Bankruptcy Act and Subsequent Changes*

The spirit of composition was resurrected with the 1898 Bankruptcy Act and was further institutionalized with the 1938 Chandler Act.[44] Under these acts, compositions became a staple of bankruptcy law and formed the basis for creditor meetings for plans of reorganization.[45]

The Chandler Act of 1938 amended the 1898 Bankruptcy Act to allow corporations to declare bankruptcy.[46] The Chandler Act came about as a response to the Great Depression and large numbers of corporations ceasing operation due to insolvency.[47] The focus of the new and revitalized bankruptcy amendment was to avoid liquidation of struggling businesses and instead promote continued operation through restructuring.[48] This was enthusiastically encouraged by the states, who

37. C. F. Bump, *Composition in Bankruptcy*, 3 S. L. REV. n.s. 507 (1877).

38. *See An Act to establish a Uniform System of Bankruptcy throughout the United States*, ch. 176, 14v Stat. 517-541 (June 1874).

39. *An Act to establish a Uniform System of Bankruptcy throughout the United States*, ch. 176, 14v Stat. 517-541 (June 1874).

40. Vrooman, *supra* note 1.

41. Up until this point, creditors had to share whatever assets the bankruptcy referee could sell which resulted in debtors being paid in percentages of the debtors' assets. With the introduction of composition creditors could fully satisfy their claim based on their priority. As an analogy, it was as if creditors could walk up to a bucket with their measuring cup and take their full measure and once the bucket was empty then there was nothing more to be given to the remaining creditors. Vrooman, *supra* note 1; *see also* Skeel, *supra* note 8.

42. Vrooman, *supra* note 1.

43. *Id.*

44. This is the first permanent bankruptcy legislation because it did not have a sunset date provided in the legislation. Every previous act a statutory sunset date, where if the act was not repealed it would cease to be in effect. Skeel, *supra* note 8.

45. Vrooman, *supra* note 1.

46. The Chandler Act did not allow banks, railroads or brokerage firms to reorganize instead these institutions had to rely on state remedies. John E. Mulder & Charles M. Solomon, *Effect of the Chandler Act Upon General Assignments and Compositions*, 87 U. PA. L. REV. 763 (1939).

47. *Id.*

48. *Id.* at 766.

derived considerable income from incorporation and other business fees.[49] The Chandler Act provided that a debtor business could declare bankruptcy even while solvent, which allowed debtors to use bankruptcy strategically and, in some cases, use it as a threat to encourage creditors to negotiate.[50] As a result, the Chandler Act provided a permanent role for corporations as both debtor and creditor.[51] It further allowed businesses to operate as a "going concern" during their bankruptcy, which permitted stalled negotiation to carry on long after the company would have been liquidated under previous acts.[52]

C. *The Bankruptcy Act Redux: Current Bankruptcy Law–the Bankruptcy Code*

In the early 1970s, Congress realized that the current bankruptcy system was not evolving fast enough to respond to changes in the economic and financial landscape and so it began investigating the possibility of reforming bankruptcy law.[53] Congress established a Commission on the Bankruptcy Laws of the United States to create a report on issues and propose changes to the bankruptcy law.[54] The Commission's proposed changes were consolidated with proposals by the National Conference of Bankruptcy Judges to form the basis for House and Senate bills.[55]

This reform culminated in the passage of the Bankruptcy Code of 1978,[56] which is the platform for the current system of bankruptcy.[57] This new code created several different types of bankruptcies: Chapter 13, available only to consumers; Chapters 7 and 11, available to consumers and businesses; Chapter 9, available only to government entities, such as schools, utility districts, states, and cities.[58] Chapter

49. Mulder, *supra* note 46. States faced significant pressures in providing social welfare programs to unemployed persons at this time and so the idea that businesses might continue to employ people thereby reducing the economic burden on the state was one of the winning arguments by proponents of the Chandler Act. *See generally* Tabb, *supra* note 16.

50. Mulder, *supra* note 46, at 788.

51. Mulder, *supra* note 46.

52. Baird, *supra* note 7, at 756. "Going concern" is an accounting term used in bankruptcy and corporate law as a classification of a company that has the resources necessary to continue operation for the foreseeable future unless evidence arises to the contrary. This typically means the business will continue operating long enough to carry out its obligations and commitments.

53. Martin I. Klein, *The Bankruptcy Reform Act of 1978*, 53 AM. BANKR. L. J. 1, 3 (1979) ("H.R. 8200 is the result of a legislative process which began in 1970 with the congressional establishment of the Commission on the Bankruptcy Laws of the United States. The Commission issued its report, consisting of findings and a proposed new Bankruptcy Act, to Congress on July 30, 1973."). The Commission on the Bankruptcy Law of the United States was established by Public Law 91-354 on July 24, 1970. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (1970). The Commission was formed to study, analyze, evaluate, and recommend changes both in the substance and administration of bankruptcy.

54. Klein, *supra* note 53.

55. *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137 (1st Sess. 1973).

56. This is a change from the previous practice of naming each bankruptcy law as an act rather than the modern practice of classifying modern bankruptcy law as a code.

57. Klein, *supra* note 53, at 1, 3 ("H.R. 8200 is the result of a legislative process which began in 1970 with the congressional establishment of the Commission on the Bankruptcy Laws of the United States. The Commission issued its report, consisting of findings and a proposed new Bankruptcy Act, to Congress on July 30, 1973.").

58. *See* 11 U.S.C. §§ 103,109, 726, 902, 1101, 1303 & 1501 (2018). Chapters 7, 11, 12, and 13 may be used by individuals, while chapters 12 and 13 may not be used by businesses. In contrast, Chapters 7

7 involves the liquidation of the debtor's assets to pay on their debts, for businesses it involves the termination of business.[59] Chapter 11 allows a business to liquidate its assets or reorganize its business as a way of limiting debt.[60] Chapter 13 is only available to individuals, not businesses, and allows the debtor to set up an income-driven repayment plan where all of their disposable income is used to pay down their debt over a five year period.[61] This article will only provide a cursory reference to Chapters 7 and 13 insofar as they relate to Chapter 11.

The new Bankruptcy Code was quickly followed by some piecemeal reform in 1984.[62] Between 1984 and 2020, bankruptcy law has remained relatively unchanged, with the exceptions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") and Small Business Reorganization Act of 2019 ("SBRA").[63] The BAPCPA altered large portions of the 1978 Bankruptcy Code, while it was characterized as a consumer-friendly law, it has actually harmed consumers and greatly expanded the powers of creditors.[64] The SBRA sought to make it easier for small businesses to declare bankruptcy and receive a subsequent discharge, rather than forcing these businesses to comply with the same rules as large organizations.[65]

Over the years there have been some other incremental changes attached to non-bankruptcy laws, such as the Sarbanes Oxley Act which changed some aspects of how securities lawyers proceed in bankruptcy.[66] In the 40 years since the Bankruptcy Code was enacted, bankruptcy professors and practitioners have clamored for even more changes to the code to address the exponential changes in business, finance, real estate, and consumer protection that have developed during that period.[67] However, in 2017, the Supreme Court upended the bankruptcy world with its ruling in *Jevic*, in which it required that debtors and creditors follow bankruptcy priority procedures though they had negotiated a settlement outside of bankruptcy.[68] This ruling limited the ability of creditors and debtors to negotiate, where their problems were unlikely to be resolved in bankruptcy. Such a limitation is contrary to the development and history of bankruptcy law.

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and 11 have significant overlap because the liquidation of 7 and reorganization of 11 so often involve the personal assets of the owners, which results in tangled and interconnected bankruptcy cases.

59. 11 U.S.C. § 726 (2018). (Hereinafter, all citations to United States Code refer to the most recent published version, except where a change has been made since publication.).

60. 11 U.S.C. § 1123 (2018).

61. 11 U.S.C. § 1322 (2018). Most debtors do not complete their chapter 13 plan because it requires all of their disposable income to be directed toward their debts. The average person cannot go for five years without an unexpected bill and so debtors must choose to pay for an emergency hospital bill or to complete their bankruptcy plan.

62. Todd J. Zywicki, *The Past, Present, and Future of Bankruptcy Law in America*, 101 MICH. L. REV. 2016, 2021 (2003).

63. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, PUB. L. NO. 109–8, 119 Stat. 23 (2005).

64. Michelle J White, *Bankruptcy Reform and Credit Cards*, 21 J. OF ECON. PERSP. 175, 185-188 (2007); Michael D Sousa, *The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge*, 58 KAN. L. REV. 553, 558 (2010).

65. Paul W. Bonapfel, *A Guide to the Small Business Reorganization Act of 2019*, UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF GEORGIA 2 (2020), http://www.ganb.uscourts.gov/USCourts/sites/default/files/pdf/SBRA_Guide.pdf.

66. *See generally* Jack Ayer, *Bankruptcy and the Sarbanes-Oxley Act*, 3 U.C. DAVIS BUS. L. J. 4 (2002).

67. Tabb, *supra* note 8, at 37-38.

68. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 978 (2017).

III. A BRIEF BACKGROUND OF NEGOTIATION IN BANKRUPTCY

Bankruptcy usually begins with the filing of a bankruptcy petition, similar to petitions in other courts, the petition describes the factual situation of the debtor that led them to file for bankruptcy.[69] Once the debtor files its petition in Chapter 11 it becomes a "debtor in possession"[70] as it continues operating the business while preparing to liquidate or restructure its enterprise.[71] Simultaneously, the filing institutes an automatic injunction against debt collection efforts by all creditors, whether those creditors know about the bankruptcy or not.[72] Violation of the stay can be extremely injurious to the violating creditor as insignificant actions such as sending an email regarding the balance of an old debt can be viewed as an attempt to collect, which may result in the elimination of any claim to that debt, punitive penalties, and severe sanctions.[73] This injunction, known as the "automatic stay," can also rewind the clock and allow the debtor or their trustee to sue for a return of any debt payment over $600 that was paid within the previous 90 days.[74] So, the "automatic stay" is a powerful tool for struggling businesses to control their entrance into bankruptcy by halting the claims collection process while providing options to negotiate with creditors who worry that they may not be able to collect on their debt.[75]

A. Repayment of Claims

Chapter 11 allows a debtor some flexibility in determining how it will pay back its creditors.[76] In order to have this freedom, a debtor must file a plan of reorganization with the bankruptcy court, which includes a repayment plan, a list of potential creditors, and written disclosure of the debtor's assets.[77] Disclosure statements are essential to a creditor's claim because they provide information about other claims, liabilities, and business affairs that indicate the health of the debtor's business.[78]

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69. *See* FED. R. BANKR. P. 1007 (2018); *see also* 11 U.S.C. §§ 301, 303 (2018).

70. The Debtor in Possession (DIP) is the business debtor that continues its operations while in bankruptcy, often while it prepares to reorganize.

71. 11 U.S.C § 1101 (2018).

72. The automatic stay provides very strict limits on any effort to collect a debt. Creditors who run afoul of the automatic stay may have their claim dismissed and may be charged large punitive damages. Collection attempts can be anything that can be interpreted as an attempt to convince a debtor to relinquish their property. They may be harmless such as the "friendly" reminder notice that a debtor has a current balance of $100. 11 U.S.C. § 362 et seq.

73. A good example of the power of the automatic stay may be found in *In re Dumace Leonard LeGrand*, Case No. 19-21198-C-7 (Bankr. E.D. Cal. Feb. 6, 2020). *See generally* 11 U.S.C. § 362 (2018).

74. 11 U.S.C. § 547(b) (2018); *see also* David I. Swan & Thuc-Doan Phan, *Prepackaged Plans in 24 Hours*, 38 AM. BANKR. INST. J. 28 (Sep. 2019) (advocating for prepackaged plans because debtors can rewind debt collection of any amount over $600 which creates a strong incentive to negotiate with a debtor and prevent lapses into bankruptcy).

75. *See generally* 11 U.S.C. § 362 (2018).

76. Bryant P. Lee, *Chapter 18? Imagining Future Uses of 11 U.S.C. 363 to Accomplish Chapter 7 Liquidation Goals in Chapter 11 Reorganizations*, 2009 COLUM. BUS. L. REV. 520, 523 (2009).

77. Large companies that file for bankruptcy often have thousands of creditors; however, it is rarely worth the creditor's time to file a claim for an insignificant amount. Additionally, because of the complex nature of modern business, debtors may not know who has a claim and so they file only the claims they know about with the court. 11 U.S.C. §§ 1121, 1125 (2018).

78. 11 U.S.C. § 1125 (2018).

Generally, the debtor has two avenues available in a Chapter 11 proceeding.[79] The first provides that a debtor can liquidate its assets and use the proceeds to pay off the claims of creditors.[80] This option almost always results in a cessation of the debtor's business due to the loss of operating capital and loss of collateral which could be used to secure future credit.[81] Secured creditors will be paid the full value of their claim, while unsecured creditors will be paid in a priority schedule from whatever is left over after liquidation.[82] The priority schedule explains what level of importance each claim might have, more important social welfare issues have higher priority and less important issues have lower priority.[83] These priorities dictate that the highest priority creditor gets paid first, then the next and the next until the money runs out or, if there is any money left over after the priority creditors are paid, unsecured creditors are paid pro-rata from the remainder.[84]

Second, the debtor can create a plan of reorganization wherein it proposes ways that it can pay off its creditors using its future income or other financial assets.[85] The plan often includes very detailed information about all facets of the debtor's business, which incentivizes communication between the debtor and creditors because the plan's confirmation requires majority approval of creditors.[86] Few creditors want to vote for a plan that promises delayed returns when a quick sale is sure to get them at least some small return on their investment.[87] This risk of loss compared to possible payout has created a controversial claims trading market where parties with relatively small claims will sell or trade their interests to other parties who in turn will have a say in the reorganization planning process.[88] The risk that a proposed plan of reorganization will fail thus incentivizes creditors to resolve the bankruptcy proceeding as fast as possible.[89] As a result, all parties involved negotiate among themselves to create the most mutually beneficial plan, so they will be paid quicker from the ever-dwindling funds of the debtor's estate.[90]

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79. *See* 11 U.S.C. § 363 (2018); *see also* 11 U.S.C. §§ 1121-1129 (2018).

80. This rarely happens in a Chapter 11 proceeding because the cost of filing and remaining a "debtor in possession" is extremely high. Most debtors who meet the minimum debt qualification will convert bankruptcy into a Chapter 7. The Chapter 7, or "no asset" bankruptcy is often used by small businesses because it tends to eliminate vast swathes of debt liability. *See* Lee, *supra* note 76.

81. Dennis J. Connolly, *Current Issues Involving Prepackaged and Prenegotiated Plans*, 2004 ANN. SURV. OF BANKR. LAW PART I § B (2004).

82. 11 U.S.C. § 507 (2018).

83. *Id.*

84. TABB, *supra* note 6, at 1039.

85. 11 U.S.C. § 1123 (2018).

86. Connolly, *supra* note 81 (explaining that creditors who do not vote are assumed to consent and so they must either voice their concerns at the creditor committee meeting or else they will be considered to have voted in line with the debtor's proposal). *See* 11 U.S.C. § 1129 (2018).

87. Lee, *supra* note 76, at 552.

88. *See* Adam J. Levitin, *Bankruptcy Markets: Making Sense of Claims Trading*, 4 BROOK. J. CORP. FIN. & COM. L. 64 (2010); *but see* Baird, *supra* note 7.

89. Connolly, *supra* note 81.

90. Levitin, *supra* note 88, at 93.

B. Creating a plan to exit bankruptcy

Once a debtor proposes a plan of reorganization the court overseeing the bankruptcy proceeding will schedule a § 341 creditor meeting.[91] At this creditor meeting, the creditors voice their objections and concerns about the plan while putting forward their own proposals for how the debtor's assets should be handled.[92] If the creditors reject the plan the debtor may submit another proposed plan that addresses the concerns of the creditors.[93] A key component of the debtor's plan, arguably the most contentious aspect, is the classification of claims against the debtor.[94] The classification of claims creates groups of creditors with similar claims and proposes how those creditors' claims will be addressed.[95] Because the debtor can control how creditors are classified, the debtor can create classes that operate to their own benefit.[96]

When creating their plan of reorganization, debtors can assign their creditors into different classes to vote on the aforementioned plan.[97] Typically these classes are grouped by the similarities between the creditor claims.[98] For example, trade creditors are placed in the same category as other trade creditors so that the supplier of widgets and the supplier of fidgets share the same class of claims.[99] However, while there may be a class of trade creditors, a creditor with a unique claim may be classified separately since it makes little sense to combine 100 creditors with 100 dollar claims with a creditor with a 1.2 million dollar claim. The large creditor has such a disproportionately large claim that the 100 other creditors would lose all influence over the plan. Because the large claim is so large, its creditor could speak for the entire class which would obviate the concerns and votes that the smaller creditors might have had in their own class.[100] Classification is a powerful debtor tool because debtors can assign creditors into groups so that creditors who would normally vote against the plan of reorganization would be forced into a group of plan proponents.[101] This effectively reduces concerns about a dissenting creditor's vote preventing the confirmation of the debtor's plan.[102].

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91. A § 341 meeting is a mandatory meeting where creditors have their first opportunity to hear the debtors proposed plan and the United States Trustee's scheduling and oversight plan. 11 U.S.C. § 341 (2018).

92. 11 U.S.C. § 1126 (2018).

93. FED. R. BANKR. P. 3017; 11 U.S.C. § 1125 (2018).

94. Connolly, *supra* note 81.

95. 11 U.S.C §§ 1122, 1123 (2018). The classification of claims must be made in good faith. This creates concerns about artificial impairment and claim nullification that operates contrary to the goals of the bankruptcy system. *See In re* Quigley Co., Inc., 437 B.R. 102 (Bankr. S.D.N.Y. 2010); *contra In re* Vill. At Camp Bowie I, L.P., 710 F.3d 239 (5th Cir. 2013).

96. Connolly, *supra* note 81.

97. 11 U.S.C § 1129 (2018).

98. *In re* Bos. Post Rd. Ltd. P'ship, 21 F.3d 477, 480-81 (2d Cir. 1994); *See also* Matter of Greystone III Joint Venture, 995 F.2d 1274, 1281 (5th Cir. 1991), *on reh'g* (Feb. 27, 1992). *Greystone* is one of the most cited cases when courts consider whether a claims classification is proper or improper. The case also serves as the basis behind a circuit split about classification of claims and confirmation of plans under 11 U.S.C §§ 1121-22, 1129 (2018).

99. *See In re* Quigley Co., Inc., 437 B.R. at 102, *contra In re* Vill. At Camp Bowie I, L.P., 710 F.3d 239 (5th Cir. 2013).

100. *In re* Aegerion Pharm., Inc., 605 B.R. 22, 31-32 (Bankr. S.D.N.Y. 2019).

101. *In re* Bos. Post Rd. Ltd. P'ship, 21 F.3d 477, 480-81 (2d Cir. 1994).

102. *In re* Aegerion Pharm., Inc., 605 B.R. 22, 31-32 (Bankr. S.D.N.Y. 2019).

Another tool for the debtor is artificial impairment, which creates a *de minimus* impairment to creditors.[103] The purpose of the impairment is to create an impaired class that consents to the plan.[104] The Bankruptcy Code requires that there be at least one class of impaired creditors who vote to approve the debtor's plan.[105] Section 1129 of the Bankruptcy Code reads:

with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under . . . the plan.[106]

This section allows creditor classes to be separated into different groups and, so long as the debtor can justify their method of classification, the court will force confirmation of the plan over the objections of impaired creditors.[107] The artificial impairment of classes is important because it limits the power of the creditor to negotiate for better terms and instead allows a debtor to neutralize the concerns of some of its creditors.[108] The debtor neutralizes possible objections by creating a class where individuals might object to the plan but the majority will vote in favor of the debtor's repayment plan.

C. *What to Expect Once the Debtor Exits Bankruptcy*

Once a plan has been confirmed, the debtor is on track to exit bankruptcy.[109] The debtor is no longer bound by the debts that it incurred before its bankruptcy, although it is still liable for the repayment terms it negotiated with its creditors or for the debts incurred after the initial bankruptcy filing.[110] The debtor must now file for a final decree, in which the bankruptcy court finalizes the debtor's obligation to current and former creditors.[111] To obtain a final decree, the debtor submits an accounting of their business assets and liabilities, including any other information necessary for the closing of the case.[112] Then the court will issue a discharge order to each of the involved parties.[113] The mailing of the discharge order finalizes the bankruptcy process and allows the debtor to operate its business without some of

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103. Impairment exists where a creditor does not receive full repayment or is harmed in some way that is not essential to the debtors exit from bankruptcy. Some of the most common forms of impairment are partial repayment of claims (i.e., payment of $99 on a debt of $100) or delayed repayment (i.e., payment plan that advocates for repayment over 24 months when it would be possible to pay off the debt in 20 months).

104. Matter of Greystone III Joint Venture, 995 F.2d 1274, 1277 (5th Cir. 1991).

105. 11 U.S.C § 1129(a)(10) (2018) ("If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has [to accept] the plan.").

106. 11 U.S.C § 1129 (providing a detailed list of what is required for the confirmation of a plan, the greatest focus is on the interests of the entire group of creditors rather than those creditors who might be impaired. For an explanation of impairment and classification); *see* 11 U.S.C. §§ 1123, 1124 (2018) (explaining impairment and classification).

107. Matter of Greystone III Joint Venture, 995 F.2d at 1277; *See also In re* Novinda Corp., 585 B.R. 145, 156-57 (10th Cir. BAP (Colo.) 2018).

108. Matter of Greystone III Joint Venture, 995 F.2d 1274 (5th Cir. 1991). *See also In re* Novinda Corp., 585 B.R. 145, 156-57 (10th Cir. BAP (Colo.) 2018); *Cf. In re* Ditech Holding Corp., No. 19-10412 (JLG), 2019 WL 4073378 (Bankr. S.D.N.Y. Aug. 28, 2019).

109. 11 U.S.C § 1141 (2018).

110. 11 U.S.C §§ 524, 1141 (2018).

111. 11 U.S.C § 524 (2018).

112. *Id.*

113. *Id.*

the debt and contractual obligations that had previously restricted its business operation.[114]

Before *Jevic*, debtors could use a structured dismissal[115] to avoid exorbitant bankruptcy costs, therein the debtor and creditors would agree on how each group would be paid and then file a motion to dismiss the bankruptcy case.[116] Structured dismissals have been a relatively untouched area of bankruptcy law until the Supreme Court determined that priority payments also apply to structured dismissals, which operate outside the jurisdiction of the Bankruptcy Code.[117] The structured dismissal shares common features with the prepackaged bankruptcy plans and as such should operate under the same restrictions. It is important to keep this overview of bankruptcy in mind as this article addresses some tools that debtors use to avoid bankruptcy or at least minimize its impact.

IV. THE PBNA: A DEBTOR'S ATTEMPT TO BARGAIN ITSELF AWAY FROM THE CLIFF OF BANKRUPTCY.

The prepackaged plan is a business tool frequently used where a debtor, who anticipates imminent bankruptcy, attempts to negotiate with its creditors to resolve its debts and payment terms before declaring bankruptcy.[118] This section examines the variety of plans that are developed before the debtor files for bankruptcy, these plans will be referred to as Pre-Bankruptcy Negotiated Agreements ("PBNAs") or prepackaged plans.[119] The core elements of these plans are that they are negotiated in anticipation of a bankruptcy filing, they create an agreement regarding the debts of the debtor, and are designed to shorten the time spent in bankruptcy. This can be beneficial to certain creditors involved because they may obtain preferential repayment terms, alternatively it can result in a disagreement that precludes further negotiation, effectively forcing a drawn-out bankruptcy where all parties suffer.[120]

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114. *Id.*

115. A structured dismissal is a dismissal of a bankruptcy case coupled with some or all of the following additional provisions in the dismissal order: releases of certain claims, protocols for combining and paying claims, transfer of funds to unsecured creditors and retained jurisdiction by the bankruptcy court over certain post-dismissal matters. Peter M. Sweeney, *Delaware Views from the Bench–Structured Dismissals*, 4 BLAKELY & BLAKELY Q. 4, 4 (Winter 2014), http://www.bandblaw.com/newsletter/archived/2014WinterBBQuarterly.pdf; *see also* Jay Indyke, et al., *Chapter 11 Structured Dismissals: Viable Exit Strategy Or Impermissible Under Bankruptcy Code?* STRAFFORD (Oct. 28, 2014), http://media.straffordpub.com/products/chapter-11-structured-dismissals-viable-exit-strategy-or-impermissible-under-bankruptcy-code-2014-10-28/presentation.pdf.

116. *In re* Buffet Partners, L.P., No. 14-30699-HDH-11, 2014 WL 3735804, at *4 (Bankr. N.D. Tex. July 28, 2014) (holding that §§ 105(a) and 1112(b) apply to structured dismissals and the remedy "is clearly within the sphere of authority Congress intended to grant to bankruptcy courts in the context of dismissing chapter 11 cases.").

117. Blumenstiel et al., *supra* note 3, at 10-11.

118. Peretore, *supra* note 10, at 15-16, 19.

119. This is an important distinction because there are a number of different classifications including receiverships, state law compositions, etc.; I have lumped them together because of the shared attributes. So, this section addresses methods of resolving insolvency outside of bankruptcy. The vast majority of these types of plans occur prior to bankruptcy, however, the structured dismissal shares certain characteristics as it occurs outside of bankruptcy and involves significant negotiation about the nature of the parties' obligations. So, for the purpose of this section structured dismissals will be treated as PBNAs even though they are Post bankruptcy negotiated agreements.

120. WEIL, GOTSHAL & MANGES LLP., REORGANIZING FAILING BUSINESSES: A COMPREHENSIVE REVIEW AND ANALYSIS OF FINANCIAL RESTRUCTURING AND BUSINESS REORGANIZATION 1-2 (2006).

A. Financial Condition and Positioning in Anticipation of a Pending Bankruptcy

Chapter 11 and the prefiling period function along the lines of a classic economic exchange similar in a sense to the "Lets Make a Deal" approach.[121] The parties to a bankruptcy come primarily to deal and trade, not primarily to fight. The trading is not always gentle, but neither are real markets. [122] Nevertheless, in the Chapter 11 arena, all fighters should look for the opportunity to deal.[123] Ideally, these negotiations occur prior to filing.[124]

At that point, the typical debtor is already in default or is insolvent, so they cannot sustain long term operation because they cannot meet their debts and obligations.[125] Accordingly, management decisions are condensed and the debtor is in a near-constant crisis management mode.[126] This means that if a debtor wishes to continue operating, its options are limited.[127] The debtor can resolve this lack of long term control by using a pre-negotiated plan of reorganization in which they negotiate the terms of their reorganization before filing for bankruptcy under Chapter 11.[128] The business anticipating bankruptcy conducts negotiation and solicitation of their plan using non-bankruptcy law but implements the plan through a Chapter 11 filing.[129] Otherwise, they can enter bankruptcy without a firm plan and spend months or years in limbo as their assets dwindle.[130]

A prepackaged plan offers significant advantages over other options. Some courts have noted that these plans are preferable to other bankruptcy options.[131] The prepackaged plan offers greater control, lower administrative costs, and less business atrophy due to filing.[132] Prepackaged plans tend to spend significantly less time in bankruptcy between the filing date to the entry of a confirmation order.[133] During the 1990s, the time companies with prepackaged plans spent in bankruptcy ranged from 42 to 123 days,[134] compared to the average of non-prepackaged

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121. "Lets Make a Deal" is a television show that first aired in 1963. On the show contestants would be offered something of value and would be given the opportunity to keep the item or trade for another item that might be worth more or might be worth less.

122. William L. Hallam, *Let's Make A Deal: The Third Circuit Approves Structured Dismissals of Chapter 11 Bankruptcy Cases*, Rosenberg Martin Greenberg (Sept. 2016), https://www.rosenbergmartin.com/wp-content/uploads/2016/09/Lets-make-a-deal.pdf.

123. MacDonald, MacDonald & MacLeod, *Pictures Are Worth a Thousand Words: Understanding the Chapter 11 Process Through Models and Simulations*, Advanced Bankruptcy Workshop 453, 462-463 (1990).

124. Mark E. MacDonald & Daren W. Perkins, Prepackaged *Chapter 11 Plans: The Alternative to "Free Fall" Bankruptcy*, 1 J. BANKR. L. & PRAC. 31, 31 (1991).

125. *Id.*

126. *In re* Anicom, Inc., 273 B.R. 756, 762 (Bankr. N.D. Ill. 2002).

127. *Id.*

128. MacDonald & Perkins, *supra* note 124, at 32.

129. 11 U.S.C §§ 101 et seq (2018).

130. MacDonald & Perkins, *supra* note 124, at 32.

131. *Id.*

132. *Id.* at 33.

133. *See In re* Combustion Eng'g, Inc., 391 F.3d 190, 201 (3d Cir. 2004); *In re* J T Thorpe Co., 308 B.R. 782, 791 (Bankr. S.D. Tex. 2003); *see generally* Ronald Barliant, Dimitri G. Karcazes, & Anne M. Sherry, *From Free-Fall to Free-For-All: The Rise of Pre-Packaged Asbestos Bankruptcies*, 12 AM. BANKR. L. REV. 441 (2004) (addressing the changing landscape of asbestos bankruptcies and the successes of prepackaged plans in handling mounting financial pressures from tort litigation).

134. MacDonald & Perkins, *supra* note 124, at 33.

Chapter 11 cases of 450 to 530 days.[135] Generally, the less time spent in bankruptcy the less money there is that goes to lawyers, bankers, and other professionals.

B. Benefits of Prepackaged plans.

As a result of the decreased time spent in bankruptcy, the popularity of prepackaged plans has exploded.[136] The prepackaged plan became the reorganization tool of choice for firms that needed to reorganize in the mid-2000s, with asbestos companies as the leading advocates of prepackaged plans as an alternative to insolvency and liquidation.[137]

Prepackaged plans in anticipation of bankruptcy have been extremely successful.[138] The extrajudicial nature of these solutions promotes greater cooperation and interaction than exists within the judicial oversight of bankruptcy.[139] The cooperative nature of a prepackaged plan increases the communication between parties, however, these plans function as last-ditch solutions.[140] The rules found in the Bankruptcy Code provide a framework for debtors and creditors who fail to negotiate, but most parties know that an unwillingness to work with others will severely harm their interests.[141] One of the most important considerations is that any sort of prepackaged plan is a settlement and is far more preferable than litigation.[142]

The Bankruptcy Committee of 1973, as part of its recommendation for a comprehensive new bankruptcy act, stated that under the new proposed law "[c]reditors . . . will be provided more effective representation and an enhanced bargaining position."[143] The committee's goal was to separate the oversight of the bankruptcy judges and referees[144] and allow debtors and creditors to meet together and prepare a plan of reorganization so that the costs and conflicts of bankruptcy would not interfere with the continued operation of the business.[145] Due in large part to the commission's efforts, reorganization and prepackaged planning were

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135. Richard M. Hynes et. al., *National Study of Individual Chapter 11 Bankruptcies*, 25 AM. BANKR. INST. L. REV. 61, 158-59 (2017).

136. David I. Swan & Thuc-Doan Phan, *Prepackaged Plans in 24 Hours*, AM. BANKR. INST. J., Sept. 2019, at 28, 28. (Showing that some of the largest reorganizations possible occurred in short amounts of time. "Arsenal Energy Holdings completed its reorganization within 11 days in February 2019; Jones Energy emerged from bankruptcy in May 2019 within 33 days of filing for Chapter 11; on Feb. 4, 2019, FullBeauty Brands Holdings Corp. had its plan confirmed within 24 hours; and on May 1, 2019, Sungard Availability Services' plan was confirmed within 19 hours.").

137. Ronald Barliant et. al., *From Free-Fall to Free-For-All: The Rise of Pre-Packaged Asbestos Bankruptcies*, 12 AM. BANKR. INST. L. REV 441, 465 (2004).

138. Swan & Phan, *supra* note 136, at 28.

139. *What Not to Put in a Chapter 11 Plan*, Am. Bankr. Inst.: Midwestern Bankr. Conf., Kansas City, Mo (Oct. 4, 2019).

140. *Id. See also* Interview with Dan Dooley, Financial Advisor, MorrisAnderson, in Kansas City, Mo. (Oct. 4, 2019).

141. *Supra* note 139.

142. PERETORE, *supra* note 10, at 15.

143. Commission on the Bankruptcy Laws of the United States, *Report of the Commission on the Bankruptcy Laws of the United States*, 29 THE BUS. LAW. 75 (1973).

144. Referees are a relic of the past, however, they acted in an administrative capacity controlling the administrative aspects of older bankruptcy cases. *See* David A. Skeel Jr., *The Genius of the 1898 Bankruptcy Act*, 15 BANKR. DEV. J. 321, 338-340 (1999).

145. Commission on the Bankruptcy Laws of the United States, *supra* note 143.

permitted and the goals of the commission were accomplished.[146] As a result, negotiation has become integral to bankruptcy as debtors and creditors utilize it to maximize their returns and minimize the costs involved with insolvency.[147]

That focus on negotiation is nowhere more apparent than with PBNAs, as the "agreement" aspect implies that negotiation between parties prior to the filing of a bankruptcy petition is of the utmost importance.[148] One of the greatest benefits of this cooperation is an acknowledgment of debt.[149] In order to induce the creditor to agree to an altered plan of repayment, the debtor must acknowledge their full debt liability, "including late charges, attorneys' fees, and expenses."[150] It is to the creditor's advantage to enter into a new contract with the debtor that substantially alters the terms of the original debt, doing so may decrease the debtor's debt in the short term but it allows the creditor to collect higher interest for longer periods of time.[151] There may be questions of fairness where a debtor is so desperate for relief that they must accept the unsatisfactory offer of the creditor, however, this unsatisfactory offer benefits both debtor and creditor as it resolves the issue of their debt.[152] Without negotiation between the debtor and its creditors, creditors would institute a "race to the courthouse" competition where the first creditor to file a foreclosure proceeding would triumph over other creditors, essentially dooming the debtor to liquidation and cessation of its business.[153]

Another benefit to the use of prepackaged plans for debtors and creditors is that individuals at any debt level can use them.[154] There are no statutory limits on the amount of debt that can be negotiated, as a result, both the small individual debtor and the multibillion-dollar corporation create workarounds that allow them to avoid the burden of being forced into bankruptcy by their debtors.[155] This is beneficial to the creditor because there is a significant risk that the debtor might liquidate rather than reorganize, which might result in a diminished return. However, a prepackaged plan almost guarantees that there will be continued business and continued payment on the debt.[156] As a result, the creditor has significantly lower upfront costs because they do not need to retain as many professionals and spend as much time and effort working on approving a plan while the parties are outside of bankruptcy.[157] Despite

146. *See In re* Jeppson, 66 B.R. 269, 283, 295-96 (Bankr. D. Utah 1986). *Jepson* provides one of the most comprehensive analysis by a bankruptcy court of the changes to priority under the 1978 Bankruptcy Code compared to the 1898 Bankruptcy Act. The court clarified that disclosure statements were a prerequisite to confirmation of a Chapter 11 plan. Additionally, creditors must solicit acceptance or rejection of a plan form claim holders before court will provide its consent.

147. *Id.* at 286.

148. *Id.* at 288.

149. *In re* Jeppson, 66 B.R. 269 (Bankr. D. Utah 1986).

150. PERETORE, *supra* note 10, at 15-16.

151. PERETORE, *supra* note 10, at 18-19. The contractual nature of the workout can create an entirely new type of debt agreement than existed originally and as a result the creditor can specify terms that the debtor would not have agreed to without the duress of their situation.

152. *See* NELSON, ET. AL., *supra* note 4.

153. *Id.*

154. Prepackaged plans occur outside of bankruptcy and while they need to be confirmed by a bankruptcy court, they do not provide a requirement on the amount of debt that can be negotiated. Whereas Chapters 7, 11, 12, 13 and 15 all provide some sort of debt limit to control who may use each chapter.

155. WEIL, GOTSHAL & MANGES LLP., *supra* note 120, at 10.

156. *Id.* at 7.

157. *Id.* at 10.

some of the hardships, both debtors and creditors benefit from the negotiation prompted by pre-negotiated bankruptcy plans.

C. Problems with Pre-Bankruptcy Negotiated Agreements

A large concern with the prepackaged plan is that this type of workaround is extremely inequitable.[158] PBNAs do not require the unanimous consent of creditors and many creditors will confirm the plan to ensure they receive some payment, although it may be more beneficial for smaller creditors to drag a debtor through litigation.[159] These dissenting creditors may be able to drag their feet long enough that the debtor will sweeten their offer or these creditors may want to harm the debtor by increasing the debtor's costs through a delay.[160] Prepackaged plans require far greater agreement among creditors than a traditional Chapter 11 plan.[161] A plan in bankruptcy requires a § 341 meeting where a majority of creditors participate and confirm the proposed plan, but a PBNA binds the creditors to a contractual agreement that remains valid after the filing.[162] While many creditors may approve of a proposed plan because they would rather get some money rather than risk a zero payout, creditors who are unlikely to be paid in bankruptcy have no incentive to cooperate and confirm the plan.[163] This lack of certainty presents a significant financial risk to debtors and creditors who want a plan to succeed, and can very well scuttle plans of reorganization.[164]

Few if any banks or lending institutions are willing to provide capital to a business that is in the process of failing and those that do provide credit only do so at steep interest rates.[165] The few lending institutions that are willing to provide new credit do so at terms that ensure the debtor will never pay off the debt.[166] While others, like management firms—who control the debtor's operations and provide cashflow while negotiations are ongoing—require an upfront payment and then require additional payment to the extent that most debtors cannot stay solvent for long given their newly acquired debt obligation.[167]

PBNAs lack some of the structure and consistency provided by negotiation in the confines of bankruptcy. Instead, the prepackaged plan operates like the Wild West, where almost anything goes and aggressive underhanded dealing may benefit a party far more than earnest and honest communication.[168] There are limited

158. *Id.* at 10-11.

159. *Id.*

160. *Id.*

161. Pre-packaged plans require that a court approve the final plan, however, the debtor does not face the same burden as a traditional bankruptcy proceeding where they need the approval of a majority of creditors.

162. 11 U.S.C § 341 (2018). Most contracts become part of the estate at filing and can be rejected or affirmed, however, because a PBNA can require court approval it may carry through and may not be rejected by the estate. *See* 11 U.S.C § 365 (2018).

163. MacDonald & Perkins, *supra* note 124, at 34.

164. ABI Panel: *How to get paid ethically*, 404-05, Midwestern Bankruptcy Conference, in Kansas City, Mo (Oct. 4. 2019), https://abi-org-corp.s3.amazonaws.com/materials/ProfessionalFeesGetPaidEthically.pdf.

165. MacDonald & Perkins, *supra* note 124.

166. *Id.*

167. *Id.*

168. *See generally In re* Trico Marine Servs., Inc., 337 B.R. 811, 815 (Bankr. S.D.N.Y.) (examining the effects of deceitful practices to induce acceptance of a prepackaged plan); *see also* Stephen D. Zide

options aside from business liquidation or some state law remedies to resolve business debts.[169] There is no judicial fall back for parties who cannot agree, they cannot petition the court to set the terms of their agreement, instead, their disagreement results in a freefall into bankruptcy.[170]

D. *Prepackaged Example*

Most debtors' rights groups and creditors recognize that the lack of judicial oversight in a prepackaged bankruptcy is a significant issue.[171] Instead of using creditor committees, trustees, bankruptcy judges, and the rest of the judicial system to resolve insolvency issues, debtors and creditors are left to resolve disputes and disagreements among themselves.[172] This is far from beneficial because such disagreements tend to resemble the petty squabbling of children rather than the composed and progressive bargaining of competent and sophisticated parties. For example, *In re Charter Communications* involved one of the largest prepackaged reorganizations ever attempted.[173] Therein the debtors attempted to restructure one of the most complex telecommunication businesses in the United States with a prepackaged plan, restructuring dozens of Charter Communication's internal entities.[174]

Charter and its bondholders were well aware of the impending crisis and engaged in "high velocity negotiation" in an attempt to prevent a long and costly bankruptcy.[175] These efforts were successful as Charter received a confirmation of its prepackaged plan after only 13 days.[176] However, its creditors fought tooth and nail to reject the plan that they had been forced into.[177] They complained that they had too little control in the confirmation process compared to what they would have traditionally had in bankruptcy.[178] Furthermore, they claimed the proposed implementation of the plan lacked oversight by government regulators such that the creditors would be treated worse than if Charter had gone through a true bankruptcy.[179] These types of complaints demonstrate some of the sticking points that make prepackaged plans so dependent on negotiation. While PBNAs reduces transactional costs and may result in a successful reorganization, this result may not be in the best interests of the parties, as such, PBNAs may create some unwanted consequences, a few of which are addressed below.

& Rachel Ringer, *A New Millennium: Bankruptcy Courts May Lack Constitutional Authority to Approve Nonconsensual Plan Releases*, JDSUPRA (Aug. 1, 2017), https://www.jdsupra.com/legalnews/debt-dialogue-july-2017-a-new-69051/.

169. PERETORE, *supra* note 10.
170. *Id.*
171. *Id.*
172. *Id.*
173. *In re* Charter Commc'ns, 419 B.R. 221, 230 (Bankr. S.D.N.Y. 2009).
174. *Id.*
175. *Id.* at 232.
176. *Id.* at 233.
177. *Id.*
178. *Id.* at 234.
179. *In re* Charter Commc'ns, 419 B.R. 221 (Bankr. S.D.N.Y. 2009).

E. Issues That Arise From Prepackaged Plans

The use of prepackaged plans faces significant condemnation by creditors.[180] These plans provide a creditor with two unsavory options: 1) accept longer-term repayment of their loans on possibly poorer terms,[181] or 2) face the expensive Chapter 11 process which will reduce the amount that the creditors can recover from their debtors.[182] This issue is compounded by the lost time value of money as the creditor wait months or years to obtain a pittance of what it lent.[183]

Creditors, especially in small to mid-sized insolvency situations, would be far better off using a PBNA or other state remedies to avoid the skyrocketing costs of the panoply of professionals involved in restructuring.[184] Because of the inherent danger of insolvency, most professionals require payment upfront, otherwise if they wait they will not be paid.[185] This upfront payment to professionals further limits creditor access to the funds they anticipated.[186] Those creditors have no say in the matter and cannot negotiate a payment structure because the services provided by the professionals are essential to the successful payments of the creditors' claims.[187] So the creditors wait and watch as the proceeds they were counting on dwindle as their lawyers, creditor committee lawyers, debtor's lawyer, and the different parties' financial advisors, accountants, investment bankers,[188] and restructuring advisors all take their cut before any resolution happens.[189]

F. Structured Dismissal as a Post-Bankruptcy Negotiated Agreement

A structured dismissal straddles the line between bankruptcy and non-bankruptcy law. It exists because a debtor is trying to avoid the administrative costs of a bankruptcy proceeding, however, unlike the prepackaged plan, it does not take place before the bankruptcy.[190] Rather, the structured dismissal takes place during

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180. ABI Panel, *supra* note 164.
181. *See* NELSON, ET. AL., *supra* note 4.
182. ABI Panel, *supra* note 164, at 406-08.
183. *Id.*
184. ABI Panel, *supra* note 164, at 406-08.
185. *In re* Sillerman, No. 17-13633 (MKV), 2019 WL 5061177 (Bankr. S.D.N.Y. Oct. 8, 2019).
186. 11 U.S.C. § 362(d) (2018) allows the professional to apply for and receive payment before any other claims in the case. These professionals often exclude lawyers and include the more common accountants, debt managers, banking and investment officials, however, as lawyers tend to recognize the need for payment, they tend to demand payment upfront before service is rendered. So, they have been lumped in with other professionals.
187. 11 U.S.C §§ 328(a) (2018) (showing that where a professional has been appointed, they may use that position to require payment before performing services). *See also* 11 U.S.C § 507(a)(1) (2018) (providing the schedule of priorities. Therein administrative expenses will be paid first and the use of professionals qualify as administrative expenses). *See* Department of Justice United States Trustee Program, *United States Trustee Program Policy and Practices Manual: Volume 3 Chapter 11 Case Administration* 96-99, https://www.justice.gov/ust/file/volume_3_chapter_11_case_administration.pdf/download (last visited Dec. 29, 2020).
188. Investment bankers are essential to many insolvency cases because they provide the capital so the company can continue to operate in the interim while it negotiates with parties about restructuring and liquidation. This is often referred to a DIP financing, DIP is the acronym for debtor-in-possession, who is the party responsible for the restructuring of the insolvent company.
189. ABI Panel, *supra* note 164, at 433-34.
190. Alessandra Allegretto, *Overcoming Creditor Misfortune Creatively: Structured Dismissals in Chapter 11 Bankruptcies*, 36 J. L. & COM. 239, 248 (2018).

the bankruptcy proceeding as the debtor attempts to have its case dismissed because it lacks the assets necessary to continue with an expensive bankruptcy case.[191] Structured dismissals are attractive because they are cheaper than Chapter 11 plans, which require costly disclosure and creditor voting.[192] The structured dismissal is essentially an agreement between the debtor and creditors that assigns the rights and responsibilities of each party before the debtor seeks a voluntary dismissal.[193] These agreements generally address consolidation of claims, operations of the business after dismissal, limits of debt acquisition, and other normal corporate transactions.[194]

Structured dismissals are relatively rare, although the consensus among bankruptcy courts is that they are permitted as a non-statutory tool to resolve a debtor's insolvency.[195] Structured dismissals are governed by Bankruptcy Code § 363, which deals with "non-ordinary"-course uses of the property.[196] Generally, before a party may file a motion for a structured dismissal to conclude its bankruptcy case, a § 363 sale occurs.[197] Under § 363, the debtor or trustee may sell any asset in which the debtor has a legal or equitable ownership interest during the bankruptcy case.[198] If there are no objections the sale will typically proceed.[199] If, however, there are objections, the bankruptcy court will determine if the sale is appropriate.[200] There are two types of § 363 sales: 1) those made in the ordinary course of business[201] and 2) those made outside the ordinary course of business.[202]

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191. Jonathan C. Lipson, *The Secret Life of Priority: Corporate Reorganization after Jevic*, 93 WASH. L. REV. 631, 647 (2018).

192. *Id.* at 634.

193. *Id.* at 641.

194. *Id.* at 647.

195. Allegreto, *supra* note 190.

196. To determine if a transaction falls outside the ordinary course of business, courts use both a "horizontal" and "vertical" test. The horizontal test examines whether, from an industry-wide perspective, the transaction at hand is commonly pursued by companies in the industry. The vertical test evaluates whether, from the hypothetical creditor's perspective, if "the transaction subjects a creditor to economic risk of a nature different than those he accepted when he decided to extend credit." *In re* Nellson Nutraceutical Inc., 369 B.R. 787, 797 (Bankr. D. Del. 2007). Failure to satisfy either test may render a transaction outside the ordinary course. *See In re* Roth Am., Inc., 975 F.2d 949, 953 (3d Cir. 1992).

197. John Kane, *Structured Dismissals–How They Work Part I: Court Authority for Alternative Ending*, INSOLVENCY INSIGHTS BLOG (September 22, 2014), https://insolvencyinsights.com/2014/09/22/structured-dismissals-how-they-work-part-i-court-authority-for-an-alternative-ending/.

198. Philip A. Schovanec, Comment, The Sale of Property Under § 363: The Validity of Sales Conducted Without Proper Notice, 46 OKLA. L. REV. 489, 495 (1993).

199. *Id.* at 505.

200. *Id.* at 506.

201. The ordinary course of business doctrine derives the same meaning from contract law, in that it involves the ordinary transactions that a business will enter into as part of its operations. For example, the purchase of inventory, payment of rent, payment of utilities and payment of salary all constitute ordinary course of business transactions, however, new transactions that increase the indebtedness of the debtor and do not fall under this definition. The transfer or sale of encumbered property for less than it is worth is an example of a business transaction that does not fall under the ordinary course of business doctrine. Benjamin Weintraub and Alan N. Resnick, From the Bankruptcy Courts: The Meaning of "Ordinary Course Of Business" Under the Bankruptcy Code-Vertical and Horizontal Analysis, 19 UCC L. J. 364 (1987).

202. Benjamin Weintraub and Alan N. Resnick, *From the Bankruptcy Courts: The Meaning of "Ordinary Course Of Business" Under the Bankruptcy Code-Vertical and Horizontal Analysis*, 19 UCC L. J. 364, 364 (1987).

Sales conducted in the ordinary course of business enable the debtor to continue business operations while in bankruptcy, subject to court approval of the sale.[203] Sale outside the normal course of business requires notice and hearing on the dispensation of the property, this notice and hearing is a prerequisite to a sale because it provides creditors with the opportunity to object.[204] Section 363 sales are increasingly used by debtors that wish to sell substantially all of their assets instead of attempting to restructure through the Chapter 11 process.[205]

Debtors often utilize structured dismissals in one of three scenarios. First, the debtor is unable to pay administrative costs or fund its Chapter 11 plan.[206] Second, the debtor has sufficient funds from the asset sale to fund their plan, but doing so would limit the funds available for creditor distribution.[207] Third, the debtor has unsold assets following the § 363 sale and creditors agree to negotiate an out-of-court agreement to administer these remaining assets.[208] Each scenario demonstrates that there are insufficient sale assets to make necessary payment distributions to creditors and fulfill a Chapter 11 reorganization plan.

In order to receive confirmation of a structured dismissal, the movant must show cause and the three aforementioned scenarios constitute sufficient cause.[209] Whereas the standard Chapter 11 dismissal ends all court proceedings,[210] a structured dismissal ends all court proceedings *and* contains varying "bells and whistles," such as the orders, settlements, and provisions that continue to govern the dismissal.[211]

There are several benefits and concerns associated with these pre-bankruptcy negotiated agreements. Despite concerns about the use of PBNAs, these plans encourage debtors and creditors to negotiate for better terms and lower costs than they would have had in bankruptcy.[212] The use of PBNAs as non-statutory bankruptcy tools allows creditors and debtors to negotiate for favorable terms rather than being forced into and through the bankruptcy process.

V. THE CRAMDOWN PLAN: THE DEBTORS ALTERNATIVE TO UNFAVORABLE TERMS

In contrast to the prepackaged plan, a cramdown plan is a tool for debtors to resolve payment disputes.[213] Several aspects of the two plans are similar, due in

203. *Id.*
204. *Id.*
205. Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative After Asset Sales*, AM. BANKR. INST. J. 1 (June 2010) (noting that, as of 2010, "cases involving structured dismissals ha[d] not yet resulted in memorandum decisions (published or unpublished), [but] there ha[d] been a number of rulings that are useful to understanding how structured dismissals have been . . . viewed by courts.").
206. Sweeney, *supra* note 115; *see also* Jay R. Indyke, et al., *supra* note 115.
207. Indyke et al., *supra* note 115, at 7.
208. *Id.*
209. Kane, *supra* note 197.
210. *Dismissal, Conversion & Closing of a Bankruptcy Case, What are the Differences Between them?*, U.S. BANKR. CT. CENT. DIST. CAL., https://www.cacb.uscourts.gov/faq/dismissal-conversion-closing-bankruptcy-case-what-are-differences-between-them (last visited Oct. 13, 2020).
211. Sweeney, *supra* note 115, at 10.
212. *See generally* Richard F. Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 BUS. LAW. 441, 445, 450 (1984).
213. TABB, *supra* note 6, at 1150.

large part to their shared purpose.[214] The cramdown plan functions exactly as it sounds, it allows a debtor to force down creditor objections and get its plan confirmed by the court.[215] In the early 2000s, many bankruptcy practitioners assumed that the cramdown plan was on the way out as its usage dwindled.[216] However, the mortgage crisis of 2007-09 brought cramdown plans back into focus as competing mortgagees jostled for priority and repayment of very limited funds.[217]

A. The Background and Advantage of the Cramdown Plan.

A brief overview of the operation of a cramdown may be important to understand some of the finer details surrounding debtor and creditor interactions, such as the negotiated interests that this article addresses. A cramdown is a tool used during the restructuring of a debtor's debt load, since restructuring requires confirmation of the debtor's plan by the creditors, agreement between creditors and the debtor is necessary.[218]

Regarding Chapter 11, cramdown is provided in § 1129(b) of the Bankruptcy Code.[219] It provides that for a plan to be confirmed over the valid objections of a creditor the proposed plan must not discriminate unfairly and must be fair and equitable with respect to dissenting classes of creditors.[220] The Bankruptcy Code's language provides for a cramdown of a dissenting class if:

a) All other mandatory confirmation requirements are satisfied except the impaired class requirement, which states that at least one impaired class must have accepted the plan.
b) The plan cannot discriminate unfairly against any impaired, non-consenting class.
c) The plan must be fair and equitable regarding the treatment of the non-accepting class.[221]

To summarize, a class may not receive or retain value under a plan unless all classes that enjoy higher priority are scheduled for payment in full unless they agree otherwise.[222] This has been described as a priority waterfall where the money fills the highest priority creditor's coffers with any remainder trickling down to the next creditor and so on until there is no more money.[223] Because secured creditors have first priority along with contractual protections, they often receive full payment on the portion of their claim secured by collateral with a deferred cash payment on any

214. *See generally* Broude, *supra* note 212, at 441-42; *see also* MacDonald & Perkins, *supra* note 124, at 32.
215. Tabb, *supra* note 6, at 1150.
216. Adam Levitin, *The New Cramdown*, CREDIT SLIPS (June 29, 2012), https://www.creditslips.org/creditslips/2012/06/the-new-cramdown.html.
217. Richard S. Gendler, *Home Mortgage Cramdown in Bankruptcy*, 22 AM. BANKR. INST. L. REV. 329, 331 (2014) (addressing the resurgence of chapter 13 cramdowns). While not exactly the same, chapter 13 and chapter 11 cramdown share similar attributes, as such they provide tremendous insights into the tools, motivations, and successes.
218. *Id.* at 354-55.
219. 11 U.S.C. § 1129(b)(1) (2018).
220. Weil, Gotshal and Manages LLP, *supra* note 120, at 4-5,4-6.
221. 11 U.S.C. § 1129(b)(1)(2018).
222. *Id.*
223. *See generally* Melissa B. Jacoby & Edward J. Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, 96 TEX. L. REV. 673 (2018); Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 UNIV. PA. L. REV. 785 (2017).

portion of their secured claim with an interest rate far lower than their original contract rate.[224]

B. Applying the Cramdown

The Bankruptcy Code provides that a plan may be crammed down on secured creditors if it provides that the holders of the secured claims retain their liens, which secure their claims.[225] If the collateral is retained by the debtor or transferred to another, and the creditor claims and each claim holder receives deferred cash payments, those payments must have a present value equal to the value of their secured collateral.[226] A creditor class[227] may separately make a § 1111(b)(2) election which provides that "[the] electing class is entitled to have the entire allowed amount of the debt related to such property secured by a lien even if the value of the collateral is less than . . . the debt."[228] This complex language has a simple meaning: whoever has a claim in bankruptcy and is subject to cramdown must be offered an amount of money at least equal to the worth of the collateral that secures the debt.[229]

The Supreme Court recently limited some uses of cramdown plans.[230] Due to the nature of their debt, a secured creditor has collateral to back up their claim and that collateral receives an in rem interest rather than in personam interest, which is not discharged with the rest of a debtor's debt.[231] In *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, the debtor's reorganization plan proposed to pay the secured creditors the value of their collateral after an auction to a stalking horse bidder.[232] However, the creditor bank, acting as trustee for the investment fund, funded the

224. Weil, Gotshal and Manages LLP, *supra* note 120, at 4-5.

225. A legal right or interest that a creditor has in another's property, lasting usually until a debt or duty that it secures is satisfied. Typically, the A legal right or interest that a creditor has in another's property, lasting usu. until a debt or duty that it secures is satisfied. Typically, the creditor does not take possession of the property on which the lien has been obtained. LIEN, Black's Law Dictionary (11th ed. 2019). RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 641 (2012); *see also* 11 U.S.C. § 1129(b)(2)(A)(i)(I) (2018).

226. BUSINESS BANKRUPTCY COMMITTEE, REORGANIZING FAILING BUSINESSES, 5.51-52 (Megan M. Adeyemo & Rafael x. Zahralddin-Aravena eds., 3rd ed. 2017) [hereinafter BUSINESS BANKRUPTCY].

227. A creditor class refers to 11 USC § 1122 (2018), which permits debtors to group creditors based on their claims. Such a grouping involves putting similar claims in the same group, while providing slightly dissimilar claims with their own groups. *See* Bankr. Rule 3013 (2018); Matter of Greystone III Joint Venture, 995 F.2d 1274, 1277 (5th Cir. 1991).

228. 124 Cong. Rec. H11, 104 (daily ed. Sept. 28, 1978).

229. It is essential to note the use of the word, worth. The value of collateral could be measured many different ways, however, cramdown evaluates value based on market value. If the collateral were to be replaced, that replacement value is what courts use to determine collateral value. Assoc.'s Com. Corp. v. Rash, 520 U.S. 953, 965 (1997); *In re* Sunnyslope Housing Ltd. P'ship, 859 F.3d 637, 640 (9th Cir. May 26, 2017) (holding that the Rash replacement value standard applies in chapter 11).

230. RadLAX Gateway Hotel, 556 U.S. at 649.

231. The debt is *in rem* because it attaches to the collateral rather than to the person who promises to pay the debt, while the debtor's personal liability may be discharged, failure to make payments may still result in the collateral's seizure and sale to satisfy the debt for the collateral. The creditor cannot satisfy any remaining debt after the sale of the seized collateral and so any resultant debt floats away into the ether.

232. Brian P. Hanley, *Preserving the Secured Creditor's Bargain in Chapter 11 Cramdown Scenarios*, 8 BROOK. J. CORP. FIN. & COM. L. 494, 499 (2014).

purchase of the secured collateral, then objected to the debtor's proposed plan to auction off the property without allowing the bank to credit bid for the collateral.[233]

The Supreme Court, in resolving a circuit split, held that a debtor could not force a creditor to accept the auction proceeds while restricting their participation because doing so would deprive them of the chance to bid which would establish the value of the collateral.[234] This ruling clarified that creditors could use all or part of their collateral to back bids on their collateral, which ensured that the creditor could push the price higher to avoid an unconscionable low price.[235] This "credit bidding" is an essential part of the real estate securitization market because it allows banks, as creditors, to apply bid with the equity they have in a property which allows them to maximize their return.[236]

The advantage of these options is that creditors with a lien securing the full amount of the claim are protected if the value of their collateral increases after the close of the case. That is because the deferred payment acts as additional security on their claim.[237] While a cramdown cannot be used on a fully secured claim, the same protection from cramdown is not available to unsecured and undersecured creditors.[238] Unsecured creditors must rely on other ways of collecting on their debt. The use of a cramdown plan is designed to ensure that the debtor can exit bankruptcy without the secured creditor voting to reject the plan.[239] In practice, this means a debtor can cramdown a secured creditor's claim to the value of their secured collateral, which means a house with a loan balance of $500,000 may be crammed down to its actual value of $375,000, so the debtor would only need to provide $375,000 to the creditor.[240]

C. *Uses of the Cramdown*

The use of a cramdown plan removes the advantage held by a dissenting creditor.[241] Whereas under a prepackaged plan a dissenting creditor's objection provided an additional bargaining chip, under a cramdown plan the debtor can propose to treat the dissenter fairly and the court will confirm the proposed plan over the dissenter's objection.[242] Although this is an oversimplification, it conveys the necessary point. With a cramdown, the debtor shifts onto the objecting creditor

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233. RadLAX Gateway Hotel, 566 U.S. at 641.
234. Ann M. Burkhart, *Fixing Foreclosure*, 36 YALE L. & POL'Y REV. 315, 321 (2018).
235. *Id.* at 351.
236. For a well written explanation of the credit bidding process and its impact on real estate purchase *see* Ann M. Burkhart, *Fixing Foreclosure*, 36 YALE L. & POL'Y REV. 315 (2018).
237. BUSINESS BANKRUPTCY, *supra* note 226, at 5.53.
238. While unsecured creditors are an easily understood concept, undersecured is a little different. Under secured creditors have a portion of their claim secured by collateral but another part does not have any collateral that could be repossessed and sold to pay off a default. Alternatively, an undersecured creditor may have security in collateral, however, that collateral has minimal or no value. *See also* Matter of Transwest Resort Properties, Inc., 881 F.3d 724, 727 (9th Cir. 2018) (discussing the treatment of undersecured creditors, providing that their claims must be bifurcated into a secured and unsecured claim).
239. RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 641-42 (2012).
240. However, the $125,000 from the claim does not disappear, instead it becomes part of the unsecured claims and does not have to be paid in full.
241. 124 Cong. Rec. H11, 104 (daily ed. Sept. 28, 1978). *See also* BUSINESS BANKRUPTCY, *supra* note 226, at 5.53.
242. 11 U.S.C § 1129 (2018).

a requirement that the creditor shows inequitable and unfair treatment so the creditor can obtain a greater payment on their claim.[243] Because the central requirement of a cramdown is that it pays fairly and equitably, all parties receive the same disadvantage, because unsecured claims will be paid out with future cash payments in the amount of the prime rate plus one to three percent.[244] This effectively means that debtors can strip excess liens off of secured collateral where only the value of the collateral remains secured and everything else becomes an unsecured claim.[245] Then the debtor would propose a future payment under the previously mentioned rate, however, that rate does not take into account the lost time value of money or the need for immediate payment.

To illustrate the above concept please consider the following situation. Debbie Debtor purchases a lawnmower from Carl Creditor on credit. The lawnmower serves as collateral securing the loan. After making some payments and reducing the principal of the loan she defaults and subsequently files for bankruptcy. Because of the passage of time and payments on the loan, there is a substantial difference between the loan amount and the value of the lawnmower. Suppose the lawnmower has a fair market value of $10 but the loan is for $25. This difference could be stripped away. Debbie would be required to pay $10, which is the value of the item, while the remaining $15 would become an unsecured debt that unlike the $10, is not guaranteed to be repaid. Carl Creditor would be guaranteed the value of his collateral as a secured creditor, but the excess unsecured amount would be aggregated with the other unsecured claims in Debbie's bankruptcy plan.

Because of the nature of the cramdown plan, the parties who receive the greatest benefit are the debtor and secured creditors.[246] Secured creditors cannot be impaired in the same ways as unsecured creditors because secured creditors have the benefit of collateral to back up their claim.[247] Debtors can provide unsecured creditors with proposed payment terms substantially different than their original contract rate.[248]

To illustrate this point, consider another hypothetical situation where a debtor who purchases widgets from a widget supplier on credit and contracts agrees to pay the supplier over 24 months. When the debtor declares bankruptcy and proposes a cramdown plan with a new repayment schedule of 36 or more months, that extends the life of the debt and reduces the value of the money that the creditor will receive.[249] Additionally, the cramdown allows a change in the interest rate that will

243. *Id.*
244. Till v. SCS Credit Corp., 541 U.S. 465, 471 (2004).
245. *Id.* at 468.
246. Hanley, *supra* note 232, at 512.
247. *Id.*
248. *Id.* at 494. Debtors can provide unsecured creditors with proposed payment terms substantially different than their original contract rate. Bankruptcy as Federal Law allows the rewriting, reaffirmation, or rejection of contracts. This is why it is so useful to large companies, they can reject contracts, which constitutes a breach, but since breach of contract claims are unsecured debts the business can avoid paying the large termination or breach fees that would have occurred outside of bankruptcy.
249. This may not be immediately apparent, but this is an application of some basic financial principles. Money now is worth more than the same sum in the future, this present value of money is calculated using the equation: Present Value =FV/(1+r)n . In other words, present value is equal to the future value divided by one plus the rate of return to the power of the number of periods(time) between now and the future payment. *See* HOWELL JACKSON ET AL., ANALYTICAL METHODS FOR LAWYERS, 199-201 (Foundation Press 3rd ed., 2017); *see also* O'Shea v. Riverway Towing Co., 677 F.2d 1194, 1199-200,

be paid to the creditor, changing the interest rate charged from the contract rate to a prime plus rate.[250] This can result in a change from a contract rate of 12 percent to 5.75 percent, 4.75 for the prime rate with an additional one percent to account for the risk of default.[251]

While cramdowns may seem unfair at first blush they serve an important purpose.[252] The primary purpose of a cramdown is to allow a debtor to confirm their bankruptcy plan over a creditor's objection, it creates a credible threat to the objecting creditor that they may receive less than they would if they accepted the plan.[253] Further, cramdown forces the reluctant creditor to bargain with the debtor or risk being classified contrary to their interest.[254] Debtors also have statutory devices that permit them to obviate the concerns of some of their creditors.[255]

For example, if a debtor anticipates that one of their creditors will object to the terms of the proposed repayment plan, they can neatly classify that creditor's claim the same as other consenting creditors.[256] Because the cramdown plan requires class confirmation and not necessarily an individual debtor's consent, the complacent creditors would stifle the complaints of the one objecting creditor.[257] The premise is that the drowning man cannot be heard over the sounds of the sinking ship. An objecting creditor does not draw much attention when other creditors in the same position are happy about the terms of their repayment.

The use of artificial impairment is a controversial way to defeat creditor objections.[258] There is a well-defined circuit split as different courts have determined that the use of artificial impairment meets the policy objective of the code by complying with the plain language of the statute.[259] Other courts assert that the use of an artificial impairment defeats the spirit of the Bankruptcy Code because it prevents the adversarial process from taking place.[260] Some courts have held that

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(7th Cir. Ill. Apr. 27, 1982) (explaining why it is necessary to calculate present and future value in damage awards, while also showing how to do so).

250. Till, 541 U.S. at 478-79 n. 18 (explaining that the prime rate would be adequate to compensate any creditor if the court could ensure the debtor fulfills their plan). This of course reflects a fundamental misunderstanding by the Supreme Court in how bankruptcy finance works because the prime rate is the rate at which money is exchanged between banks, even the highest credit worthy institution is charged above prime. Lending institutions are not in the business of giving away money, their continued existence requires they charge interest to pay for the fundamental costs of their business, e.g., wages, leases, taxes, etc.

251. *Id.* at 476 n. 14 (questionable commentary where the Supreme Court compared the chapter 13 cramdown with the chapter 11 rate and alluded to the application of a market rate vs the contract rate that might have existed outside of a cramdown).

252. TABB, *supra* note 6, at 1150.

253. Broude, *supra* note 212, at 450-51.

254. TABB, *supra* note 6, at 1151 ("In the 1978 Code, Congress decided to let the different classes of creditors and equity security holders bargain over how to distribute the difference between liquidation and going concern."). *See also* H.R. Rep. No. 595, 95th Cong. Sess.224 (1997).

255. H.R. Rep. No 595, 95th Congr., 1st Sess. 224 (1977).

256. TABB, *supra* note 6, at 1150.

257. *Id.*

258. *Driving the Wedge Deeper: Fifth and Ninth Circuits Unite in Refusing to Condemn "Artificial Impairment" in Cramdown Chapter 11 Plans*, Jones Day (May 2013), https://www.jonesday.com/en/insights/2013/05/driving-the-wedge-deeper-fifth-and-ninth-circuits-unite-in-refusing-to-condemn-artificial-impairment-in-cramdown-chapter-11-plans.

259. *Id.*

260. Fifth Circuit in Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (*In re* Greystone III Joint Venture), 995 F.2d 1274, 1281 (5th Cir. 1991), and the Fourth Circuit in Travellers Ins. Co. v. Bryson Props., XVIII (*In re* Bryson Props., XVIII), 961 F.2d 496, 502 (4th Cir. 1992).

claims that share similar legal characteristics must be treated alike, except in situations where equitable subordination or administrative convenience applies.[261]

Cramdowns are threatened far more than they are used,[262] the chance that they may succeed, contrary to a creditor's interests creates an incentive to negotiate. The greatest imperative of the cramdown is that it must be fair and equitable to the creditors subject to cramdown.[263] In cases where a class of secured claims will be crammed down, the dissenting secured creditors must receive the "indubitable equivalent" of their secured claims.[264] This phrase is a catchall designed to provide flexibility for the court to consider alternatives that satisfy the cramdown standard for a dissenting class of unsecured claims.[265] Congress considered "indubitable equivalent" to mean that the substitute collateral is the equivalent of the amount of the undersecured claim, as opposed to the original collateral.[266]

Abandoning the collateral to the creditor would satisfy indubitable equivalence, as would a lien on similar collateral.[267] However, present cash payments less than the secured claim would not satisfy the standard because the creditor is deprived of an opportunity to gain from a future increase in the value of the collateral. Unsecured notes as to the secured claim or equity securities of the debtor similarly would not be the indubitable equivalent.[268]

Regarding cramdowns, the risks of "failure to reach settlement are so great, and the possible negative impact of the imposition of the cramdown powers so significant, that the cramdown power is used more as a threat than as a club actually employed in confirming a plan of reorganization."[269] Because cramdowns in large bankruptcies are difficult, they are relatively rare, however, they are still successful in convincing creditors and debtors to work together or risk a drag-out slugfest of asset liquidation if the debtor remains in bankruptcy.[270]

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261. *In re* Wolf, 22 B.R. 510, 512 (B.A.P. 9th Cir. 1982).

262. *See generally* Fifth Circuit in *In re* Greystone III Joint Venture, 995 F.2d 1274 (5th Cir. 1991), and the Fourth Circuit in *In re* Bryson Props., XVIII, 961 F.2d 496 (4th Cir. 1992).

263. Nelson, Whitman, Burkhart, & Freyermuth, *supra* note 152.

264. 11 USC § 1129b (2018).

265. RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 647 (2012).

266. *Id.*

267. The term originates from Judge Learned Hands opinion in *In re* Muriel where he opined that a secured creditor could not be deprived of its collateral "unless by a substitute of the most indubitable equivalence." Courts have since determined that this phraseology means that secured creditors must receive at least the value of the secured collateral. *See, e.g.*, RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 641 (2012); *In re* Murel Holding Corp., 75 F.2d 941, 942 (2d Cir. 1935).

268. 124 Cong. Rec. H11, 104 (daily ed. Sept. 28, 1978).

269. Broude, *supra* note 212.

270. *See* Richard M. Hynes, *Reorganization as Redemption*, 6 VA. L. & BUS. REV. 183, 220 (2011) (noting the "observation of empirical researchers that cramdown is extremely rare"); Adam J. Levitin, *Bankruptcy Markets: Making Sense of Claims Trading*, 4 BROOK J. CORP. FIN. & COM. L. 67, 106 (2009) ("Cramdown plans, where a broad negotiated deal could not be reached, continue to remain relatively rare."); John D. Ayer et. al., *The Life Cycle of a Chapter 11 Debtor Through the Debtor's Eyes Part II*, AM. BANKR. INST. J., 32 (2003) ("Cramdown cases are far more often threatened than confirmed"). *See also* Bank of America v. 203 N. LaSalle St. Partnership, 526 U.S. 434, 143 L. Ed. 2d 607, 119 S Ct. 1411, 1415-24 (1999); *In re* Brothy, 303 B.R. 177, 194 (9th Cir. BAP 2003); *In re* One Times Square Assocs. Ltd. Partnership, 159 B.R. 695, 706-08 (Bankr. S.D.N.Y. 1993). *But see* Scott Alberino et al., *Corporate Bankruptcy Panel Hot Chapter 11 Plan Issues*, 28 EMORY BANKR. DEV. J. 283, 297 (2012) ("[M]ost plans have to rely upon the cramdown mechanism . . . to get . . . confirmed.").

VI. WHY WAS THE SUPREME COURT'S DECISION IN *JEVIC* SO HARMFUL?

Prior to *Jevic*, the caselaw surrounding structure dismissals could be best described as confused.[271] Until the *Jevic* decision, some courts were not convinced that structured dismissals were constitutional let alone whether they should be governed by federal bankruptcy or some other law.[272] Scholars and courts had long debated whether priority outside of formal proceedings should be absolute or relative, with most lower courts taking the position that the relative priority was better because it offered closure to a case.[273] This relative priority meant that parties could establish priority through contract rather than by following the guidance of the Bankruptcy Code.[274] The structured dismissal in *Jevic* would have both stripped the employee truck drivers of their priority claims in bankruptcy and forbidden them from pursuing any other remedies against those who allegedly harmed them outside of bankruptcy.

D. *The Scenario leading up to Jevic*

In 2006, Sun Capital Partners ("Sun"), a private equity firm, acquired Jevic Transportation Corporation with money borrowed from the Commercial Investment Trust ("CIT") Group in a leveraged buyout.[275] Two years after the buyout, Jevic filed for bankruptcy under Chapter 11.[276] At the time of filing, Jevic owed $53 million to its senior secured creditors and around $20 million to its general unsecured creditors.[277]

A group of former Jevic truck drivers filed an adversary suit in bankruptcy court against Jevic and Sun alleging WARN Act violations, the truck drivers asserted that they had been fired without proper notice as required by law.[278] The Bankruptcy Court granted summary judgment against Jevic in that action; $8.3 million of that judgment fell into the bucket of "priority wage claims," which were entitled to payment before general unsecured claims but behind secured claims, under the Bankruptcy Code's priority schedule.[279]

A second lawsuit was brought by the official committee of unsecured creditors against Sun and CIT. The committee alleged that the leveraged buyout hastened Jevic's bankruptcy by saddling it with debt that it was unable to pay.[280] In 2011,

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271. Lipson, *supra* note 191.
272. *Id.*
273. *Id.* at 635.
274. *Id.* at 642.
275. CIT Group is a financial holding company that regularly finances corporate acquisitions. *In re* Jevic Holding Corp., 2011 WL 4345204 (Bankr. D. Del. Sept. 15, 2011).
276. *Id.*
277. *Id.*
278. *Id.* The WARN act violation involves the firing of the truck drivers without notice and contrary to the procedures set out by federal law.
279. Joe Riches, *US Supreme Court confirms priority rules apply to a structured dismissal of a chapter 11 bankruptcy case, DLA Piper: Restructuring Global Insights* (2017), https://www.dlapiper.com/en/us/insights/publications/2017/06/restructuring-global-insight-july-2017/us-supreme-court--bankruptcy-case/.
280. *In re Jevic Holding Corp.*, 2011 WL 4345204 (Bankr. D. Del. Sept. 15, 2011).

the Bankruptcy Court held that the committee had adequately pled claims of preferential and fraudulent transfer.[281]

Soon thereafter, the committee, Sun, CIT, and Jevic agreed to a settlement that, among other things, called for a structured dismissal of Jevic's Chapter 11 cases.[282] Under the proposed structured dismissal, the employee petitioners would receive no distribution, but lower priority general unsecured creditors would receive a distribution.[283] The proposed settlement called for a structured dismissal with distributions that did not follow ordinary priority rules.[284] This settlement would mean that the truck drivers who had been fired would be deprived of any compensation, while others with less compelling claims would receive a payout.

B. *The Approach used by the Bankruptcy Court, District Court, and Third Circuit Court of Appeals*

Sun, CIT, Jevic, and the creditor committee asked the Bankruptcy Court to approve the proposed settlement and dismiss the case.[285] The WARN Act employee petitioners and the United States Trustee objected, arguing that the dismissal violated the priority schedule by skipping over the petitioners, who had higher priority claims than general unsecured creditors who were scheduled to receive a distribution.[286]

The Bankruptcy Court held that because the distribution would be conducted via a structured dismissal, as opposed to through a Chapter 11 plan where the ordinary priority rules apply, the distributions were not prohibited.[287] The Bankruptcy Court approved the settlement because under the circumstances, there was "no realistic prospect" of distribution to any unsecured creditors; a plan of reorganization was nearly impossible and funds were too limited to execute a Chapter 7 liquidation.[288]

Contrary to previous rulings, the Supreme Court in *Jevic* held that creditors could not avoid traditional priority rules unless other creditors consented to a change in the distribution scheme.[289] The court explained that though the Bankruptcy Code does not expressly apply priority schemes to structured dismissals, lower courts should apply priority rules to out-of-bankruptcy workouts.[290] The Court's decision transitioned the structured dismissal from a negotiation heavy device like a prepackaged plan into a plan very much like the cramdown, where if a creditor dissents then the planning starts over.

The Bankruptcy Code does not include a provision requiring the rules of bankruptcy to apply to situations outside of bankruptcy.[291] The negotiation that

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281. Riches, *supra* note 279.
282. *Id.*
283. *Id.*
284. *Id.*
285. *Id.*
286. *Id.*
287. Riches, *supra* note 279.
288. *Id.*
289. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 978 (2017).
290. *Id.* at 979.
291. *Gouveia v. Tazbir*, 37 F.3d 295, 300 (7th Cir. 1994) ("The Supreme Court has taught that any grant of authority given to the bankruptcy courts . . . must be exercised within the confines of the Bankruptcy Code.").

goes on in a structured dismissal, takes place outside the confines of bankruptcy. It is instead an alternative to bankruptcy, very much like the use of PBNAs or prepackaged plans to prepare for the filing of bankruptcy, the structured dismissal is used to avoid bankruptcy.[292] Absent any congressional authorization, the Supreme Court in *Jevic* determined that priority schemes apply in and out of bankruptcy.[293] This is an example of overreach where the clear language of the Bankruptcy Code envisions that its provisions apply only in bankruptcy and in select, defined circumstances,[294] the structured dismissal is not included.[295]

C. *Reviewing the Interpretation of Bankruptcy Law.*

The question that must be asked is whether the Court's ruling in *Jevic* adheres to the spirit or the letter of the Bankruptcy Code. The answer is readily apparent, *Jevic* is an aberrational application of the letter of the Bankruptcy Code and such a strict interpretation does not harmonize with the well-established spirit of the Bankruptcy Code.[296] It fails to consider the all-important balance between a debtor's fresh start and a creditor's opportunity to receive just compensation.[297] A structured dismissal pertains to the dismissal of a bankruptcy case, while certain bankruptcy rules and principles apply, its purpose is to provide an escape for debtors and creditors.[298] The purpose of a structured dismissal is substantially diminished through the strict interpretation and application of *Jevic*.[299] It prevents debtors and creditors from negotiating terms during their dismissal and instead forces them to follow the provisions of § 507, even though they are not in bankruptcy.[300]

While seemingly simple, this decision has broad-reaching implications. It severely limits the ability of creditors to negotiate with their debtors or alter their position in bankruptcy such that they receive payment earlier than the priority schedule would traditionally allow.[301] The Bankruptcy Code was created to encourage and facilitate negotiations between parties-in-interest.[302] The existence of prepackaged plans, cramdown plans, and structured dismissals demonstrates that the code anticipated a need to avoid a strict and unyielding distribution schedule,

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292. Lipson, *supra* note 191, at 646.
293. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).
294. Lamie v. U.S. Tr., 540 U.S. 526, 534 (2004) ("[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.").
295. *In re* Biolitec, Inc., 528 B.R. 261, 269 (Bankr. D.N.J. 2014) ("[W]hile not expressly provided for in the Code, a structured dismissal may be an appropriate resolution to a case where the process includes sufficient guarantees that fundamental rules and principles governing the administration and distribution of estate assets are upheld.").
296. Blumenstiel et al., *supra* note 3.
297. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (explaining that the purpose of the bankruptcy law is "it gives to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.").
298. Lipson, *supra* note 191, at 635.
299. Blumenstiel et al., *supra* note 3.
300. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 985 (2017).
301. Lipson, *supra* note 191, at 633-35.
302. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 985 (2017).

and instead allow debtors and creditors to come to some sort of agreement when possible to hasten their discharge from bankruptcy.[303]

One of the core ideas of the Bankruptcy Code is that debtors should receive a fresh start, while their creditors should receive payment on the credit they extended to the debtor.[304] As a result, circuit courts have concluded that the Bankruptcy Code should be construed liberally so that the extensive protections are provided to debtors.[305] This idea can be seen in numerous court cases dating back before the Bankruptcy Act of 1898, where judges consistently stretched beyond the strict language of the law to provide as many rights to debtors as possible.[306] Courts have, without fail, determined that where they had the chance to stretch beyond the strict statutory language that they "should rule in favor of equality for the debtor."[307] Only recently have courts begun to apply a stricter interpretation for bankruptcy law.[308]

D. The Supreme Court's Interpretation: A Canon of Confusion

For most of the nation's history, the Supreme Court has avoided advocating for a particular style of interpretation for bankruptcy cases, rather the court has ruled as the case demands.[309] "Not only does the Court fail to rely on bankruptcy policy expressly in any of its opinions, but it also is readily apparent that the Court's textualist approach is not a mask for a 'hidden agenda' in the bankruptcy area."[310] Bankruptcy courts as courts of equity can interpret the Bankruptcy Code as justice and wisdom demand.[311] However, the Sixth Circuit stated:

> [A court must not] ignore . . . the plain meaning of the Bankruptcy Code. The common theme in the Supreme Court's bankruptcy jurisprudence . . . is that courts must apply the plain meaning of the Code unless its literal application would produce a result demonstrably at odds with the intent of Congress.[312]

303. Jonathon S. Byington, *The Fresh Start Canon*, 69 FLA. L. REV. 115, 133-35 (2017), http://scholarship.law.umt.edu/faculty_lawreviews/141.

304. *Id.* at 116.

305. *Id.* at 124.

306. *In re* Klein, 30 B.R. 727, 729 (Bankr. E.D.N.Y. 1983) (holding the Bankruptcy Code is to be interpreted liberally, with an eye toward giving the debtor a fresh start ... in order to invoke the beneficent spirit of the Code.); Wright v. Union Cent. Life Ins. Co., 311 U.S. 273, 279, 61 S. Ct. 196, 200, 85 L. Ed. 184 (1940) (holding the Act must be liberally construed to give the debtor the full measure of the relief afforded by Congress lest its benefits be frittered away by narrow formalistic interpretations which disregard the spirit and the letter of the Act.); *In re Ciotta*, 222 B.R. 626, 630 (Bankr.C.D.Cal.1998) ("Several bankruptcy courts have held that when Congress' intent is ambiguous, bankruptcy exemptions should be liberally interpreted in favor of the Debtor."); Baldwin v. Wilder, 2 F. Cas. 537, 539 (C.C.W.D. Mich. 1871) (holding that bankruptcy law is "a remedial and beneficient law whose spirit of equality should be extended by liberal constructions"); *In re* Delaney, 251 F. 425, 426 (E.D. Pa. 1918) (The wisdom of the policy of the law ... invites us to construe the act in a liberal spirit.").

307. *See generally*, *In re* Klein, 30 B.R. 727, 729 (Bankr. E.D.N.Y. 1983); Wright v. Union Cent. Life Ins. Co., 311 U.S. 273, 279, 61 S. Ct. 196, 200, 85 L. Ed. 184 (1940); *In re Ciotta*, 222 B.R. 626, 630 (Bankr.C.D.Cal.1998); Baldwin v. Wilder, 2 F. Cas. 537, 539 (C.C.W.D. Mich. 1871); *In re* Delaney, 251 F. 425, 426 (E.D. Pa. 1918).

308. *See generally* Carlos J. Cuevas, *The Rehnquist Court, Strict Statutory Construction and the Bankruptcy Code*, 42 CLEV. ST. L. REV. 435, 438 (1994).

309. *Id.*

310. *Id.*

311. 11 U.S.C. § 105 (2018).

312. *In re* Lee, 530 F.3d 458, 470 (6th Cir. 2008).

This new trend toward strict interpretation is perhaps best demonstrated by the Rehnquist Court.[313] The Rehnquist Court relied on the text of the statute to render its determination.[314] Then under a holistic approach, the Court analyzed the structure of the Bankruptcy Code and made a determination consistent with the text of a specific section and the structure of the entire Bankruptcy Code.[315] Both methods focused on the clear language of the Bankruptcy Code to analyze bankruptcy questions, equity played no part in the decision.[316]

Congress quickly followed on the heels of the Rehnquist Court's interpretations to ensure that this particular interpretation continued.[317] Congress's response to perceived liberal interpretations by courts was to pass the BAPCPA designed to curb the latitude of the court in making key decisions.[318] "Consumer Protection" was a misrepresentation as BAPCPA provided significant advantages to creditors, these included strict tests that removed traditional judicial discretionary decision making and instead increased the power of government organizations, like the United States Trustee office, in making critical decisions.[319] Furthermore, BAPCPA altered one of the fundamental negotiating points of large reorganizations, it allowed the court or a committee of creditors the ability to reverse modifications of retirement benefits in contravention of any negotiated agreements prior to or in anticipation of bankruptcy.[320]

While there are several concerns regarding the use of strict interpretation, there is something to be said for the reliability that such an interpretive scheme provides.[321] Debtors and creditors alike can rely on the text of a statute rather than worrying that the court will look into the murky waters of legislative history and policy to create their own radical and potentially ever-changing policy.[322] This very possibility was one of the reasons Congress passed BAPCPA, it was concerned that courts had too much latitude and were using that discretion to allow debtors a discharge where there should not have been one.[323] While there certainly are valid reasons to use strict interpretations, such interpretation should not exist where it conflicts with the well-established purpose of a law, especially where it creates a crumbling foundation from which courts will create new law. Such is the case with *Jevic*, the court used a strict interpretation to apply an unprecedented change in priority payment in structured dismissals, which in turn crippled incentives to negotiate for preferential treatment and altered claims.[324]

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313. *Id.*
314. Cuevas, *supra* note 308, at 440.
315. *Id.*
316. *Id.*.
317. Kara J. Bruce, *Rehabilitating Bankruptcy Reform*, 13 NEV. L. J. 174, 189 (2012).
318. *Id.* at 192.
319. Robert J. Landry III and Nancy Hisey Mardis, *Consumer Bankruptcy Reform: Debtors' Prison without Bars or "Just Desserts" For Deadbeats?*, 36 GOLDEN GATE U. L. REV. 91, 107 (2006).
320. BAPCPA § 437, "In large reorganizations, where debtors and committees are grappling with such complex issues as collective bargaining agreements, pension and retiree benefits, or mass tort liability, limitations on exclusivity may be detrimental to the negotiation of consensual plans." See also Elizabeth J. Futrell, *Chapter 11 Of The Bankruptcy Code After BAPCPA: It's More Than Consumer Changes*, Jones Walker, at 14, (2006).
321. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 987 (2017).
322. *Id.*
323. 151 Cong. Rec. H2063-01, 151 Cong. Rec. H2063-01, H2066 (daily ed. Apr. 14, 2005) (statement of Rep. Sensenbrenner).
324. Lipson, *supra* note 191, at 642.

The Supreme Court acknowledged that there were significant potential side effects to its decision, however, it wanted to apply the letter of the Bankruptcy Code to an area of law outside of what the strict language of the code covered.[325] Justice Clarence Thomas, in his dissent, decried the intervention by the Supreme Court in such a complex bankruptcy case of which it had limited practical experience and lamented that this case could have been better adjudicated by experts with experience in the field before it ever made its way to the Supreme Court.[326] Scholars have noted that there were repercussions in the bankruptcy system post-*Jevic* with increased difficulties financing plans and conflicts between lenders and creditors concerning the use of money to continue the operation of the going concern debtor.[327]

The ruling by the Supreme Court in *Jevic* negated a large incentive to negotiate, and where negotiation occurs both parties benefit because it provides an opportunity for both or all parties to obtain relief on terms amenable to their position. Where a debtor will receive a discharge of $50,000 and the creditor will obtain $10,000, the creditor will always negotiate with the debtor because there is a clear benefit to the negotiation. *Jevic* is a perfect example of why negotiation is important to bankruptcy, the Supreme Court's decision, applied retroactively, would have ensured that Jevic would have been administratively dissolved without any payout to its creditors. However, if the structured dismissal had proceeded then at least some creditors would have received payment, which goes to show even tiny bankruptcy dollars are better than nothing.

VII. SOLUTIONS FOR JEVIC'S PRIORITY CLASSIFICATION CONUNDRUM

The Court's interpretation in *Jevic* has led to numerous issues for creditors as they attempt to navigate an already complicated landscape of creditor and debtor interactions. Yet Congress has not stepped up to clarify and resolve the issue, though there has been some interest in resolving the issue through legislation.[328] Senator Elizabeth Warren has proposed a new form of bankruptcy that would substantially alter how debtors are discharged from debt, presumably altering priority rules to favor the insolvent debtor.[329] This proposal makes a legislative solution a very good possibility, however, the Supreme Court might once more review priority distribution and come to a different conclusion, failing that, the bankruptcy community can ignore the Court and continue operating as if *Jevic* never happened.

A. Introduction of Legislation Clarifying Priority Claims

With the recent amendment to the Bankruptcy Code through the passage of the SBRA,[330] creditors could very well promote a new bill that clarifies issues that will

325. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 987 (2017).
326. *Id.* at 988.
327. Lipson, *supra* note 191, at 708.
328. Kevin Lewis, *Making It a Priority: What Happens to Employee Claims When a Business Declares Bankruptcy?*, Congressional Research Service (2019).
329. Elizabeth Warren, *Fixing Our Bankruptcy System to Give People a Second Chance*, Warren Democrats (2020), https://elizabethwarren.com/plans/bankruptcy-reform.
330. H.R. 3311 Small Business Reorganization Act of 2019, PL 116-54 (2019).

arise with the SBRA and at the same time fix priority distribution issues created by *Jevic*. The SBRA is a response to bankruptcy's inaccessibility to small businesses.[331] The amendment provided a new subchapter to Chapter 11, titled Subchapter V.[332] The key provisions of Subchapter V seek "to increase a debtor's ability to negotiate a successful reorganization while retaining control of the business; to reduce 'unnecessary procedural burdens and costs' by eliminating the creditors' committee and disclosure statement requirements for the plan of reorganization; and to increase oversight and ensure quick reorganizations."[333]

Under a proposed amendment to the Bankruptcy Code, Congress can provide limits to where priority will apply. Instead of the current situation where bankruptcy priority rules apply in and out of bankruptcy, Congress can clarify that priority only applies while *in* bankruptcy rather than near bankruptcy. In terms of bankruptcy planning, having a clear delineation of where priority rules apply saves substantial hardship and expense for debtors and creditors.[334] Such a change is not uncommon as Congress has repeatedly edited and altered the Bankruptcy Code to reflect issues that have arisen.[335]

In addition to the minor adjustments, Congress should provide guidance on the interpretation of Chapter 11, as is found in numerous pieces of state legislation.[336] Such a provision should include language that states that the statute will be subject to a liberal construction that is consistent with the nature of bankruptcy, in that the bankruptcy exists for dual purposes. The courts must balance the interests of both creditors and debtors to create a system of bankruptcy that provides for easy access to credit while also protecting the right of creditors to collect on the credit they extend.[337] Furthermore, the first and most important canon of statutory construction asserts that "courts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, this first canon is also the last: judicial inquiry is complete."[338] A change in legislation would provide the impetus necessary to resolve priority issues and provide courts a platform to rule according to the intent of Congress.

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331. Paul W. Bonapfel, *A Guide To The Small Business Reorganization Act Of 2019*, United States Bankruptcy Court for the Northern District of Georgia (2020). https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf

332. *Handbook for Small Business Chapter 11 Subchapter V Trustees*, U.S. Department of Justice Executive Office for United States Trustees, at 1-1, (2020), https://www.justice.gov/ust/file/subchapterv_trustee_handbook.pdf/download.

333. *Id.*

334. Saul Levmore & Hideki Kanda, *Explaining Creditor Priorities*, 80 VA. L. REV. 2103 (1994).

335. N.L.R.B. v. Bildisco and Bildisco, 465 U.S. 513 (1984) (*abrogated by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, tit. III, § 541(a), 98 Stat. 333, 390 (codified at 11 U.S.C. § 1113)); Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552 (1990) (*abrogated by* Crime Control Act of 1990, Pub. L. No. 101-647, § 3103, 104 Stat. 4789, 4916); U.S. v. Nordic Village, Inc., 503 U.S. 30 (1992) (*abrogated by* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, tit. I, § 113, 108 Stat. 4106, 4117 (codified at 11 U.S.C. § 106)); Fid. Fin. Services, Inc. v. Fink, 522 U.S. 211 (1998) (*abrogated by* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, tit. XII, § 1222, 119 Stat 23, 196 (codified at 11 U.S.C. § 547(c)(3)(B))).

336. *See* RSMo § 213.010 (2017).

337. Karen Gross, *Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments*, 135 U. PA. L. REV. 59, 60 (1986).

338. Conn. Nat. Bank v. Germain, 503 U.S. 249, 253-54 (1992); *see also* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A, 530 U.S. 1, 6 (2000), U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241 (1989).

Otherwise, significant policy issues exist where creditors lose the incentive to lend freely or at low rates, while debtors are crippled by high-interest rates and limited access to credit.[339] Such a stricture on credit will have a simultaneously large impact on the economy as consumers are forced to spend within their means, limiting the flow of commerce.[340] Additionally, stricter construction of such a vital aspect of daily life reduces the incentive to negotiate.[341] As creditors are no longer incentivized to negotiate with debtors for reduced or reaffirmed debts, the debtors are forced to fight their way out of debt in bankruptcy which creates substantial financial burdens on already insolvent businesses and consumers.

B. *The Jacksonian Alternative: Treat Jevic as if it Never Happened*

There is a substantial pattern of disobedience within the bankruptcy community, as they ignore the directions and rulings of the Supreme Court and instead carry on business as if the court had made a mere recommendation rather than a ruling.[342] The lines of demarcation are clear among other federal courts, there is a well-defined hierarchy proceeding from the district court up to the circuit court and ending with the Supreme Court as the ultimate arbiter.[343] However, the line is blurred with respect to bankruptcy courts, they are not Article III courts and do not fit within the traditional hierarchy.[344] Bankruptcy courts tend to observe stare decisis, however, they usually view decisions by courts outside of their circuit as merely persuasive without any binding authority.[345] Requiring bankruptcy courts to blindly follow the precedent set by district courts is a terrible policy.[346] Bankruptcy courts exist because they are the experts in the field, they have

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339. Samuel Bentolila, Marcel Jansen & Gabriel Jimenez, *When Credit Dries Up: Job Losses In The Great Recession*, 16 J. OF THE EUROPEAN ECON. ASS'N. 650, 653 (2017); *see also* Peter J. Leo, *The Case for "Cramdown": Eliminating the Practical and Ideological Barriers to Pure Mortgage Modification*, 18 U. MIAMI BUS. L. REV. 257, 265 (2010) (explaining that bankruptcy encourages modification by lenders).

340. Samuel Bentolila, Marcel Jansen & Gabriel Jimenez, *When Credit Dries Up: Job Losses In The Great Recession*, 16 J. OF THE EUROPEAN ECON. ASS'N 650, 653 (2017).

341. Gross, *supra* note 337.

342. *In re* Romano, 350 B.R. 276 (Bankr. E.D. La. 2005), *See also* Singerman, Paul and Avron, Paul, *Of Precedents and Bankruptcy Court Independence: Is a Bankruptcy Court Bound by a Decision of a Single District Court Judge in a Multi-Judge District?*, 22 ABI Journal 1 (2003). CF. *First of America Bank v. Gaylor (In re Gaylor)*, 123 B.R. 236 (Bankr.E.D.Mich. 1991); *In re Villarreal*, 413 B.R. 633, 641 (Bankr.S.D.Tex. 2009). *See also, In re* Silverman, 616 F.3d 1001, 1005 n. 2 (9th Cir. 2010). (Even the courts who have determined that a bankruptcy court is bound by district court decisions within the same district have made such a determination only with respect to published decisions within the district.).

343. Paul Singerman & Paul Avron, *Of Precedents and Bankruptcy Court Independence: Is a Bankruptcy Court Bound by a Decision of a Single District Court Judge in a Multi-Judge District?*, 22 ABI Journal 1 (2003).

344. Jeffrey J. Brookner, *Bankruptcy Courts and Stare Decisis: The Need for Restructuring*, 27 U. MICH. J. L. REFORM 313, 326 (1993). "The Supreme Court has taught that any grant of authority given to the bankruptcy courts . . . must be exercised within the confines of the Bankruptcy Code." *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 77 n.29 (1982) (quoting *Crowell v. Benson*, 285 U.S. 22, 51 (1932)).

345. *Id.*

346. Singerman, *supra* note 343.

experience with the strengths and weaknesses of the system and have experience applying the nuanced bankruptcy rules.[347]

Bankruptcy courts are not alone in their disregard for Supreme Court decisions, contrary to common belief there is no correlation between the unanimity of the court and lower court treatment of the Supreme Court decision.[348] Rather, evidence indicates that lower courts are more likely to agree with and uphold Supreme Court decisions on policy grounds rather than on factual or legal grounds.[349] As an example of the bankruptcy court's reluctance to adopt the directions of the Supreme Court, the Bankruptcy Court and Second Circuit in *In re Anderson* decided contrary to the Supreme Court's decision that the arbitration of the debtor's automatic stay claim would not necessarily jeopardize or inherently conflict with the Bankruptcy Code.[350] Bankruptcy courts regularly ignore Supreme Court decisions and instead determine what rate they will use in a cramdown contrary to the Supreme Court's direction on the matter.[351]

Bankruptcy courts are reluctant to ignore Supreme Court and other higher court decisions because they dislike being overturned and fear some of the social stigma and repercussions that may occur.[352] Considerable time and effort go into their decisions and since they are the experts in their field, overturning a decision without any change in statutory authority or circumstance is an arrogant disregard for the role and practice of bankruptcy. Bankruptcy courts are often deeply involved in the negotiation and planning involved in restructuring and have first-hand knowledge of the available facts which puts them in the best position to promote an ongoing dialog between creditors and the debtor.[353] As a result, the decision by a court without that experience to overturn or remand a decision creates a conservative attitude toward interpretation and application of the law.

Instead, according to the Supreme Court in *Stern v. Marshall*, bankruptcy courts, while in possession of statutory authority to adjudicate the claims and issues that come before them, do not have the constitutional authority because that authority is reserved under Article III.[354] The Supreme Court explained that bankruptcy courts could only hear cases that include core proceedings which are those that arise in a bankruptcy case or under Title 11, i.e. the Bankruptcy Code.[355] There is no such thing as a "core" proceeding that does not arise under Title 11 or

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347. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017) (Thomas, J., Dissenting) (stating that the court would greatly benefit from the views of additional courts on this question in addition to a full adversary hearing before a bankruptcy court before addressing the issue.).

348. Charles A. Johnson, *Lower Court Reactions to Supreme Court Decisions: A Quantitative Examination*, American Journal of Political Science, Vol. 23, No. 4, 792, 802-03 (1979). This study is particularly relevant because it took place prior to the Supreme Court Case Selection Act. The act changed significantly increased the number of cases published and relied on by lower courts, so it made it more difficult to ascertain effects of Supreme Court decisions on lower courts.

349. *Id.* at 803.

350. *In re* Anderson, 884 F.3d 382, 392 (2nd Cir. 2018).

351. *In re* Texas Grand Prairie Hotel Realty, 710 F.3d 324 (5th Cir. 2013).

352. Cynthia Norton (taking the place of Chief Judge Brian Fenimore), Case Law Update and Current Developments, 2020 Annual Bankruptcy Practice Institute, Columbia, Missouri (Mar 2020).

353. Government Accountability Office, *Bankruptcy Complex Financial Institutions and International Coordination Pose Challenges*, GAO-11-707, at 106, (2011), https://www.gao.gov/new.items/d11707.pdf.

354. Stern v. Marshall, 564 U.S. 462, 503 (2011).

355. *Id.* at 473.

in a Title 11 case.[356] Further, the list of core proceedings in § 157(b)(2) of Title 28 of the United States Code serves as an example to illustrate what constitutes a core proceeding.[357] Section 157, among other examples, identifies "counterclaims by the estate against persons filing claims against the estate" as being within the bankruptcy court's core jurisdiction.[358] Accordingly, it seems that since the bankruptcy court is the expert in bankruptcy and the Supreme Court has directed them to practice only what they know, the Supreme Court would be wise to rely on the experience of the bankruptcy court that it views as an expert in the matter of bankruptcy.

Following the above reasoning, a structured dismissal as a bankruptcy specific tool, should be adjudicated according to the bankruptcy court's established practice and rules.[359] Bankruptcy courts should continue to act as experts in the field of bankruptcy while rendering decisions on their cases. Only after there is substantial disagreement between the circuits and Congress has not resolved an issue should the Supreme Court step in. As such, bankruptcy practitioners should ignore the Supreme Court since the Court has limited experience with bankruptcy law, so bankruptcy courts would be better suited to ignore the ill-informed rulings of the Supreme Court. In the words of Andrew Jackson, the Court has made its decision now let it enforce it.[360] And so bankruptcy courts could follow the example of President Jackson and ignore the ruling in *Jevic* where the circumstances of the case and equity demand it.[361]

C. *Return of Supreme Court Harmonization.*

The Supreme Court should overturn *Jevic* and provide clear guidance about the relationship between extrajudicial solutions, specifically that as a freely negotiated contract a structured dismissal falls outside the scope of the Bankruptcy Code.[362] The majority opinion recognized that it might cause substantial harm through its decision.[363] They recognized that changes in the bargaining power of different classes of creditors existed outside of bankruptcy and would not end with structured dismissals.[364] The concerns in *Jevic* also included the risk that they would upset the balance of settlements in bankruptcies, potentially reducing the amount and creating

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356. *Id.* at 476.
357. *Id.* at 474.
358. Ben Rosenblum, *Stern v. Marshall* - Shaking Bankruptcy Jurisdiction to Its Core?, Jones Day Publications (2011), https://www.jonesday.com/en/insights/2011/08/istern-v-marshall-i-shaking-bankruptcy-jurisdiction-to-its-core. This is another example of the Supreme Court involving itself in a matter that it does not understand. And because of its uninformed opinion it upends the practice and policy of an area of law where over $52,000,000,000 in debt is discharged yearly. This doesn't include the billions involved in corporate restructuring and reaffirmed consumer debts. *See* Table BAPCPA 2X—Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) (December 31, 2018), https://www.uscourts.gov/sites/default/files/data_tables/bapcpa_2x_1231.2018.pdf.
359. Allegretto, *supra* note 190, at 248.
360. *See generally* Jacob A. Esher, *Alternative Dispute Resolution in U.S. Bankruptcy Practice*, 4 MASS. L. REV. 76 (2009).
361. This is merely an academic possibility; I do not propose that the courts do such a thing in real life.
362. This would be a return to a policy of the Supreme Court where they would take up cases that caused splits among circuits or resulted in contentious or discordant rulings by lower courts on a single issue.
363. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 986-87 (2017).
364. *Id.* at 987.

more expensive litigation.[365] The court freely acknowledged that a priority-skipping dismissal might be in the best interest of the parties, however, it would not permit such a tool to exist even if it were rarely used.[366] As Justice Thomas said in his dissent, the Supreme Court could benefit from the experience of bankruptcy courts and should not have taken up this appeal without letting some of the more complicated and troublesome issues work themselves out.[367] Under his reasoning, it appears he would be willing to readdress *Jevic*, or at least the issue posed within, once a clear circuit disagreement existed regarding priority skipping.[368]

In the past, the Supreme Court often resolved issues of interpretation and application of the law to provide a predictable legal landscape.[369] However, in recent years the court has taken a more political approach to the cases it takes up, rather than removing the shadows and ambiguities of the law, it selects cases that reflect political issues of the day.[370] Given the limited number of cases that the Court can hear in a given year, its decision to avoid circuit splits demonstrates a departure from a longstanding, albeit unstated, policy of the court.[371] The Court has taken up some recent bankruptcy-related circuit splits, focusing on student loan discharge and good faith as a defense to the discharge injunction.[372] As such it is well within the Court's power to take up the *Jevic* issue once again, as it does not make any particular habit of avoiding bankruptcy-related cases.

The Court may also reverse its previous decision, as it has done on several occasions.[373] The court explains that it does so hesitantly, for good reason, it is the highest court in the land and so what it says is binding on lower courts.[374] However, when the court creates bad law or circumstances change, the court freely reverses itself. [375] When it does change its mind on an issue, such a change has a tremendous impact.[376] Regarding *Jevic* the Court should grant certiorari to restore negotiation to its pre-*Jevic* status as the catalyst to shorter bankruptcies.

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365. *Id.*
366. *Id.*
367. *Id.* at 988 (Thomas, J., Dissenting).
368. *Id.* at 987-88 (Thomas, J., Dissenting).
369. *See generally* Deborah Beim & Kelly Rader, *Legal Uniformity in American Courts*, 16 J. OF EMPIRICAL LEGAL STUD. 448 (2019) (Finding that most circuit splits are not resolved by the Supreme Court).
370. *See* Christopher W. Schmidt & Carolyn Shapiro, *The Supreme Court and American Politics: Symposium Introduction*, 93 CHI. KENT L. REV. 315 (2018).
371. Elizabeth A. Lane & Ryan C. Black, *Agenda Setting and Case Selection on the U.S. Supreme Court*, OXFORD RESEARCH ENCYCLOPEDIA (Dec. 2017) https://oxfordre.com/politics/view/10.1093/acrefore/9780190228637.001.0001/acrefore-9780190228637-e-91 (demonstrating that the court has reviewed fewer cases as time progresses).
372. *See generally* Rodriguez v. Fed. Deposit Ins. Corp., 140 S. Ct. 713 (2020); Taggart v. Lorenzen, 139 S. Ct. 1795 (2019). The discharge injunction prevents creditors from attempting to collect on debt that had been discharged by bankruptcy.
373. *See generally, Brown v. Board of Education*, 347 U.S. 483 *(1954) (overturning Plessy v. Ferguson*, 163 U.S. 537 *(1896) (addressing school segregation)); Lawrence v. Texas*, 539 U.S. 558 (2003) *(overturning Bowers v. Hardwick*, 478 U.S. 186 (1986) *(addressing same sex activity)); South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) *(overturning Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) *(addressing changes to state taxing powers)). These cases demonstrate that the court is not a stranger to reversing itself in different areas of life and law.*
374. Brandon J. Murrill, *The Supreme Court's Overruling of Constitutional Precedent*, CONGRESSIONAL RESEARCH SERVICE (Sep. 14, 2018) https://crsreports.congress.gov/product/pdf/R/R45319.
375. *Id.*
376. *Id.*

VIII. CONCLUSION: NEGOTIATION IN THE PAST AND FUTURE.

The change in priority from the conventional rules that bankruptcy courts had observed for years prior to *Jevic* substantially decreased the effectiveness and bargaining imperative that existed in bankruptcy.[377] Once the Court established that unsecured creditors could not negotiate for better positioning in a structured dismissal, one of the key tools in bankruptcy disappeared.[378] If creditors are to face the same treatment in and out of bankruptcy, then there is much less incentive to work with the debtor and other creditors to end the bankruptcy quickly. They will receive virtually pennies on the dollar in either circumstance.[379] *Jevic* applied the Bankruptcy Code and applied a priority scheme where one did not exist, which in turn prevented one of the essential parts of a structured dismissal. It ensured that creditors could not negotiate to release their claim against the debtor if the debtor's case was dismissed from its bankruptcy filing, instead, the same rules that applied in bankruptcy applied outside of bankruptcy which defeats the purpose of a structured dismissal and creditor release of claims. As such the courts or Congress should take action to fix the priority issues created by *Jevic*, doing so would ensure that negotiation remains a valid and integral part of the bankruptcy process.

377. Lipson, *supra* note 191.
378. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 986-87 (2017).
379. TABB, *supra* note 6.

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Third-Party Releases in Chapter 11 Plans: Key Considerations and Recent Developments

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I. OVERVIEW

There is little controversy that, upon confirmation of a chapter 11 plan, the federal U.S. Bankruptcy Code (the "Code") allows the release of claims held by the debtor or the estate against other non-debtor parties who contributed to the reorganization (§ 1123(b)(3)). *See, e.g.*, *Comm. of Unsecured Creditors of Tower Auto. v. Debtors & Debtors in Possession (In re Tower Auto. Inc.)*, 241 F.R.D. 162 (S.D.N.Y. 2006) (laying out several factors for the court to consider in determining whether a debtor release is fair and equitable to the estate).

However, "third-party releases," which seek to extinguish claims held by *non*-debtor third parties against other non-debtor third parties, tell a different story. Such releases attract more scrutiny and judicial review, but are also prevalent in plans of reorganizations and serve as valuable tools during negotiation.

The increased scrutiny and debate around third-party releases arise from how such releases may allow non-debtor third parties (the "Released Parties") to benefit from the chapter 11 process without having to file for bankruptcy or otherwise operate through the safeguards of the Code. Typically, debtors wish to provide such releases to incentivize Released Parties to settle claims, support the plan, provide funding, or otherwise contribute to the reorganization. Debtors also provide releases to parties that may later assert post-confirmation indemnification claims against the debtors. Numerous permutations of third-party releases are available, including variations based on: (1) the Released Parties[2]; (2) which parties are deemed to grant the third-party release and how such parties are notified; (3) the breadth and types of claims released (*i.e.*, claims arising before or during the chapter 11 case); and (4) what kind of contribution from those receiving the release is deemed sufficient to justify releases.

Accordingly, non-debtors may effectively receive a bankruptcy discharge from other non-debtors, sometimes without affirmative consent from those providing the release. This reality no doubt exacerbates the tension between the goals of the Code (*i.e.*, to relieve debtors) and the equitable goals of the court and corporate regulatory laws (*i.e.*, to seek accountability and achieve maximum investor recovery from the debtor and related parties). The tension is amplified by how broadly third-party

2. The "Released Parties" are often defined broadly and may include, in addition to the debtors: direct or indirect equity holders of the debtors, the DIP agent, any indenture and prepetition trustees, members of any lender or debtholder committees, the committee of unsecured creditors and its members, any other funding entities, and related professionals, predecessors, successors, and assigns.

releases can be written. For example, a third-party release may seek to discharge the Released Parties, as they are defined in the plan, from *any and all* claims, obligations, and liabilities by any creditor who vote to accept the plan, who are presumed to accept the plan, who reject the plan, or who abstain from voting but who do not affirmatively opt out of the third-party releases on their ballots. *See, e.g.*, Joint Plan of Reorganization of Indianapolis Downs, as confirmed by *In re Indianapolis Downs*, 486 B.R. 286 (Bankr. D. Del. 2013).

This article discusses three major points that practitioners must keep in mind when drafting third-party releases in order to ensure a smooth path to plan confirmation. First, how does the particular federal court of appeals or court within the circuit interpret the Code with respect to third-party releases? Second, has the court of appeals or court within the circuit addressed subject matter jurisdiction with respect to third party releases? Finally, under what circumstances has the court (or particular judge) found consent or a lack thereof on the part of the releasing party?

Moreover, debtors can provide further clarity and comfort by relying on exculpation provisions, in addition to and separate from third-party releases. Whereas third-party releases contemplate the release of pre-confirmation claims held by a non-debtor against another non-debtor, exculpation provisions release claims held by both debtors and non-debtors against professionals and other fiduciaries related to the bankruptcy case. Exculpations are generally limited to reasonable acts and conduct — including post-petition conduct — related to the bankruptcy, and are more routinely approved by courts.

II. CIRCUITS ARE SPLIT ON WHETHER THE BANKRUPTCY CODE PERMITS THIRD-PARTY RELEASES

Two sections of the Code are the subject of ongoing disagreement among circuit courts as to how these two statutes interact with respect to the permissibility of third-party releases:

- Section 524(e) of the Code provides that the "discharge of a debt of a debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."
- Section 105(a) states that a bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

Interpretations of the interplay between sections 524(e) and 105(a) of the Code group roughly, on one hand, by those circuit courts that do not permit third-party releases except under narrow circumstances (the "Non-Permissive Circuits," comprising the Fifth, Ninth, and Tenth Circuits) and, on the other, those circuit courts that permit third-party releases when certain factors are met (the "Permissive Circuits," comprising the Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits, with lower court decisions in the First and Eighth Circuits agreeing with the permissive view).

A. Non-Permissive Circuits

The Fifth, Ninth, and Tenth Circuits take the minority view, interpreting the specific language of section 524(e) as a bar to discharging non-debtor liabilities, including those contemplated by third-party releases, and a limitation on the court's general equitable powers under section 105(a).

i. Fifth Circuit

The Fifth Circuit has traditionally held that a bankruptcy court does not have authority to issue and enforce third-party releases. *See In re Pac. Lumber Co.*, 584 F.3d 229, 252–53 (5th Cir. 2009) (finding that the fresh start provided debtors under § 524(e) is not intended to absolve non-debtors from negligent conduct occurring during the course of the bankruptcy); *In re Patriot Place, Ltd.*, 486 B.R. 773, 822 (Bankr. W.D. Tex. 2013) ("The Fifth Circuit takes a very restrictive approach to non-debtor releases in bankruptcy cases ... non-consensual, non-debtor releases in bankruptcy proceedings in [the Fifth Circuit] have been 'explicitly prohibited,' this circuit has 'firmly pronounced its opposition to such releases,' and the 'Bankruptcy Code precludes non-consensual, non-debtor releases.' ") (quoting *In re Vitro S.A.B. de CV*, 701 F.3d 1031, 1051–53, 1054–55, 1058–89 (5th Cir. 2012)). The *Pacific Lumber* opinion expressly declined to adopt the more lenient approach taken in the Permissive Circuits, observing that, not only do the other circuits conflict with Fifth Circuit precedent, cases in other circuits concerned "global settlements of mass claims against the debtors and co-liable parties." 582 F.3d at 252. The Fifth Circuit found further support for its position with the addition of section 524(g) under the Bankruptcy Reform Act of 1994. Section 524(g) permitted the court, when specific conditions are met, to issue an injunction enjoining other parties from bringing claims against a trust established specifically to assume the liabilities of a debtor in connection with damages caused by asbestos. *See id.* (finding that section 524(g) "suggests non-debtor releases are most appropriate as a method to channel mass claims toward a specific pool of assets") (citing *MacArthur Co. v. Johns–Manville Corp.*, 837 F.2d 89, 90 (2d Cir.1988)).

ii. Ninth Circuit

The Ninth Circuit has also read section 524(e) to preclude the approval of third-party releases. *See In re Lowenschuss*, 67 F.3d 1394, 1401-02 (9th Cir. 1995) (striking down a global release that broadly released the debtor and related third parties from all claims, reasoning that "the specific provisions of section 524 displace the court's equitable powers under section 105 to order the permanent relief [against a non-debtor] sought by [the debtor].") (quoting *In re Am. Hardwoods, Inc.*, 885 F.2d 621, 625-26 (9th Cir. 1989)). As in the Fifth Circuit, the Ninth Circuit recognized the exception in section 524(g) for releases granted in asbestos-related bankruptcies. *See id.* at 1402 n.6 (finding section 524(g) to be a narrow exception "specifically designed to apply in asbestos cases only, where there is a trust mechanism and the debtor can prove, among other things, that it is likely to be subject to future asbestos claims").

In a more recent case, the Ninth Circuit extended *Lowenschuss* to prohibit even temporary, post-confirmation injunctions against a third-party creditor's right to collect from another non-debtor. *See In re Regatta Bay, LLC*, 2009 WL 5730501, at *4 (D. Ariz. Oct. 30, 2009) (reversing bankruptcy court and finding that a post-confirmation injunction included in the reorganization plan that prohibited, for five years, the collection by a third party of debt from other non-debtors was not permitted because such injunction "affect[ed] the liability," in contravention of section 524(e), of the non-debtors who hoped to obtain the injunction); *see also In re Am. Hardwoods, Inc.*, 885 F.2d 621, 624-27 (9th Cir.1989) (prohibiting permanent post-confirmation injunctions, *i.e.*, a "discharge," meant to protect non-debtors from third-party creditors, but allowing preliminary and temporary injunctions for third-party creditors from enforcing judgment against non-debtors *prior* to confirmation of a plan, and clarifying that section 105 also "permits the court to issue both preliminary and permanent injunctions after confirmation of a plan to protect the debtor and [the estate]").

iii. Tenth Circuit

The leading case in the Tenth Circuit is *In re Western Real Estate Fund, Inc.*, which involves a complicated set of facts that are key to understanding the current Tenth Circuit position on third-party releases. 922 F.2d 592 (10th Cir. 1990).

In *Western Real Estate,* the debtor, Landing Diversified Properties, II ("LDP"), hired an attorney, Abel, under a retainer agreement to pursue a pre-petition litigation against the Public Service Company of Oklahoma ("PSO") after two transformers maintained by PSO exploded and damaged an LDP facility. Abel was able to obtain a $3 million settlement offer and secured his contractual attorneys' fees by filing an attorneys' lien under state law. LDP then filed for chapter 11 bankruptcy and Abel filed a proof of claim for attorneys' fees. LDP also initiated an adversary proceeding against a bank that held the mortgage against the damaged LDP facility from the PSO explosion. Abel's proof of claim was consolidated into this adversary proceeding. In the adversary proceeding, LDP rejected the retainer agreement with Abel pursuant to section 365 of the Code and a portion of Abel's fees remained unsatisfied due to LDP's bankruptcy. In the meantime, the pre-petition litigation between LDP and PSO settled, with LDP agreeing to indemnify PSO should PSO be held liable to Abel for any part of the attorneys' fees. Abel filed suit against PSO in state court to recover what remains of the fees left unsatisfied under the retainer agreement. However, the bankruptcy court granted an injunction that enjoined Abel from further prosecution, including post-confirmation, of his state action against PSO in order to prevent Abel from getting a second bite at the apple on his fees. On appeal, the Tenth Circuit rejected the validity of the bankruptcy court's injunction, finding that, while a temporary injunction in order to facilitate the confirmation of LDP's plan may have been warranted, a permanent injunction was inappropriate. In permanently enjoining Abel's action against PSO, "the bankruptcy court, in essence, discharged PSO's liability to Abel under state lien law just as it discharged LDP's contractual debt to Abel under federal bankruptcy law." *Id.* at 600. The Tenth Circuit reasoned that the existence of section 524(e) means that Congress did not intend to extend the same benefits of discharge to third parties as it did to debtors.

Western Real Estate has not been meaningfully challenged in the Tenth Circuit Court of Appeals and continues to represent the general proposition that the Tenth Circuit prohibits non-debtor releases of any type. However, at least one district court case distinguished this case on the basis that *Western Real Estate* is limited in scope to those cases where confirmation of a plan would serve to bar litigation against non-debtors for the remainder of the discharged debt. *See In re Midway Gold US, Inc.*, 575 B.R. 475, 505 (Bankr. D. Colo. 2017).

The *Midway Gold* court read the word "such" in section 524(e) to mean that section 524(e) is only intended to govern the debt of the debtor being discharged (and any remaining portions of "such" debt should the third party not receive the full amount from the debtor). Therefore, section 524(e) does not refer to independent obligations of other entities not subject to the discharge. The court stated that, under section 524(e), "even if a debt is discharged as to the debtor in a Chapter 11 plan, a creditor can still seek to collect that debt from a non-filing co-debtor, guarantor or obligor." *Id.* In other words, "*Western Real Estate* is limited to cases where a Chapter 11 plan provides, contrary to § 524(e), for the release of or injunction on claims against a non-debtor, such as a co-debtor or a guarantor, with respect to an obligation jointly owed with the debtor where the non-debtor has not submitted itself to the bankruptcy process." *Id*.

Midway Gold declined to adopt a specific test or set of factors to use in approving third-party releases, but stated that there is not an absolute ban on third-party releases. Rather, "due consideration should be given" to the factors that other circuits use, including non-exclusive guiding principles: (1) whether a release is appropriate and permissible should be determined "on a case-by-case basis"; (2) the court "must parse out exactly who is releasing whom for what" and distinguish between the debtors' release of non-debtors and third parties' release of non-debtors; (3) the court must find the release to be "necessary for the reorganization and appropriately tailored to apply only to claims arising out of or in connection with the reorganization itself; and (4) should not provide non-debtors with "blanket immunity for all times, transgressions and omissions and may not include immunity from gross negligence or willful misconduct." *Id.* at 506. However, the third-party releases in question did not ultimately pass muster because the court found them so broad that it lacked subject matter jurisdiction — a subject discussed in more detail below. *See id.* at 516-21.

B. Permissive Circuits

The Permissive Circuits do not find section 524(e) to be an absolute bar to third-party releases. Rather, these circuit courts, in holding the majority view, tend to read section 524(e) as "a saving clause; it limits the operation of other parts of the bankruptcy code and preserves rights that might otherwise be construed as lost after the reorganization." *In re Airadigm Comms., Inc.*, 19 F.3d 640, 656 (7th Cir. 2008). Courts subscribing to this majority view also cite the "broad authority" granted to bankruptcy courts under section 105(a) to "reorder creditor-debtor relations needed to achieve a successful reorganization." *In re Dow Corning Corp.*, 280 F.3d 648, 656 (6th Cir. 2002).

Within the Permissive Circuits, certain factors must be present for third-party releases to be approved. Such factors vary among the circuits, and the general consensus is that third-party releases must be granted sparingly and with prudence. *See In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015) (holding that releases are permitted but "ought not to be issued lightly, and should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable under all the facts and circumstances"); *Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 347-50 (4th Cir. 2014); *Behrmann v. Nat'l Heritage Found.*, 663 F.3d 704, 712 (4th Cir. 2011) (holding that involuntary releases should be imposed "cautiously and infrequently"); *Dow Corning*, 280 F.3d at 658 ("Because such an injunction is a dramatic measure to be used cautiously, we follow those circuits that have held that enjoining a non-consenting creditor's claim is only appropriate in "unusual circumstances"); *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 143 (2d Cir. 2005) (holding that a "nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the plan").

i. Courts in the First and Eighth Circuits: Master Mortgage Factors

Bankruptcy courts within the First and Eighth Circuit consider five, non-exclusive and non-conjunctive factors from *In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994). These *Master Mortgage* factors are:

- There is an identity of interest between debtor and third party (usually an indemnity relationship) such that a suit against the third party is a suit against the debtor.
- The non-debtor has contributed substantial assets to the reorganization.
- The release (or "injunction," as it may be termed) is essential to the reorganization's success. Without it, there is little likelihood of success.
- A substantial majority of creditors agree to such release, and specifically, the impacted class(es) have voted "overwhelmingly" to accept the proposed plan treatment.
- The plan provides a mechanism for payment of all or substantially all, of the claims of the class(es) affected by the release.

Master Mortg., 168 B.R. at 935 (finding "[n]o court has set out a rigid 'factor test'" to be applied in every case, and the five factors are neither exclusive nor conjunctive); *see also In re Mahoney Hawkes, LLP*, 289 B.R. 285, 299–303 (Bankr. D. Mass. 2002) (adopting the *Master Mortgage* multi-factor test to determine necessity for non-debtor third-party injunctions, but finding plan provisions did not satisfy factors warranting issuance of permanent injunction); *In re U.S. Fidelis, Inc.*, 481 B.R. 503, 519 (Bankr. E.D. Mo. 2012) (finding *Master Mortgage* requirements fulfilled).

ii. Third Circuit: Hallmarks from Continental Airlines + Master Mortgage Factors

While the Third Circuit has not adopted a specific test for when such releases are appropriate, the Third Circuit nevertheless looks for the "hallmarks of permissible non-consensual releases — fairness, necessity to the reorganization, and specific factual findings to support these conclusions." *In re Continental Airlines*, 203 F.3d 203 (3rd Cir. 2000).

In determining the fairness and necessity of releases, courts within the Third Circuit have used the *Master Mortgage* factors as "guideposts" that may be instructive to the court. *In re Millennium Lab Holdings II, LLC*, 591 B.R. 559 (D. Del. 2018) (noting that the *Master Mortgage* factors, while helpful guideposts, are not controlling); *see also In re Washington Mutual*, 442 B.R. 314 (Bankr. D.

Del. 2011) (considering *Master Mortgage* factors); *In re Zenith Elecs. Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999) (same).

Most recently, in *In re Takata Corp.*, the court found that proposed third-party releases satisfied the five factors of Master Mortgages, emphasizing that the case presents "extraordinary circumstances" involving the "largest consumer recall in history" (for defective airbags). Case No. 17-11375, Hearing Transcript at 173-74 (Dkt. No. 2109-3) (Bankr. D. Del. Feb. 16, 2018).

iii. Fourth, Sixth and Eleventh Circuits: Dow Corning Factors (i.e., Master Mortgages Plus)

The Sixth Circuit has followed Second Circuit logic in finding that third-party releases should be appropriate only in "unusual circumstances. *Dow Corning Corp.*, 280 F.3d at 658 (citing *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 293 (2nd Cir.1992); *In re A.H. Robins Co.*, 880 F.2d 694, 702 (4th Cir. 1989); *MacArthur v. Johns–Manville, Corp.*, 837 F.2d 89, 93–94 (2nd Cir.1988)).

To determine whether such "unusual circumstances" are present, the Sixth Circuit has adopted a seven-factor test that is more stringent than what is applied in the First, Third and Eighth Circuits. *See id.* These are also referred to as the *Dow Corning* factors, and incorporate the five *Master Mortgage* factors (plus two others). *Id.*

Accordingly, when the following seven *Dow Corning* factors are present, the bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor:

(1) There is an identity of interests between the debtor and the third-party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;

(2) The non-debtor has contributed substantial assets to the reorganization;

(3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;

(4) The impacted class, or classes, has overwhelmingly voted to accept the plan;

(5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;

(6) The plan provides an opportunity for those claimants who choose not to settle to recover in full; and

(7) The bankruptcy court made a record of specific factual findings that support its conclusions.

See id.

The Fourth and Eleventh Circuits follow the *Dow Corning* factors as well, but apply them more flexibly and in a more case-specific way than the Sixth Circuit.

The Fourth Circuit has held that a debtor does not have to demonstrate that every *Dow Corning* factor weighs in its favor. *See Highbourne Foundation*, 760 F.3d at 352. Furthermore, third-party releases should only be approved "cautiously and infrequently." *Id.* (denying a third party release provision after an analysis of each of the *Dow Corning* factors).

In the Eleventh Circuit, the *Dow Corning* factors should be considered a "nonexclusive list of considerations" and "should be applied flexibly," with bankruptcy courts retaining discretion to determine which of the factors will be relevant in each case. *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d at 1079. Echoing the Fourth Circuit, the Eleventh Circuit also stressed that such releases should be used "cautiously and infrequently, and only where essential, fair, and equitable." *Id.* (quoting *In re Munford*, 97 F.3d 449, 455 (11th Cir. 1996)).

iv. Second and Seventh Circuits: Facts-Intensive Inquiry

Courts in the Second and Seventh Circuits do not adhere to specific tests or factors, but recognize that unique circumstances must be in place for third-party releases to be approved and that the court must approve such releases only after a fact-intensive inquiry. *See Metromedia,* 416 F.3d at 142-146; *Airadigm*, 519 F.3d at 657.

The Second Circuit has held: "A nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the plan" and where the scope of the release is necessary to the plan. *Metromedia*, 416 F.3d at 143. *Metromedia* cautioned that a third-party release is a "device that lends itself to abuse" because a non-debtor can shield itself from liability to third parties through the release and "in effect, it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code." *See id.* at 142.

The *Metromedia* opinion continued by listing five types of instances where third-party releases have been approved and which could act as guidance for courts when considering approving a third-party release:

- Where the estate received substantial consideration.
- Where the enjoined claims were "channeled" to a settlement fund.
- Where the enjoined claims would indirectly impact debtor's reorganization "by way of indemnity or contribution."
- Where the plan otherwise provided for the full payment of the enjoined claims.
- Where the affected creditors consent.

Id. (internal citations omitted). In the latest case in the Second Circuit to discuss *Metromedia* in depth, the Bankruptcy Court for the Southern District of New York emphasized the extraordinary nature imposing involuntary releases on third parties and explained that "the teaching of *Metromedia* is that releases should be given only when they are an important part of a reorganization." *In re Aegean Marine Petroleum Network Inc.*, 599 B.R. 717, 727 (Bankr. S.D.N.Y. 2019) (J. Wiles).

Likewise, the Seventh Circuit has held that a "natural reading of [§ 524(e)] does not foreclose a third-party release from a creditor's claims." *Airadigm*, 519 F.3d at 656 (citing *Specialty Equipment*, 3 F.3d 1043, 1046–47 (7th Cir. 1993) ("while section 524(e) has generally been interpreted to preclude the discharge of guarantors, the statute does not by its specific words preclude all releases that are accepted and confirmed as an integral part of a reorganization.")). Indeed, the "residual authority" permitted under § 105(a) permits bankruptcy courts to release third parties from liability to participating creditors if the release is "appropriate" and not inconsistent with any other provision of the Code. *Airadigm*, 519 F.3d at 657.

Thus, in the Seventh Circuit, whether a release is appropriate is a fact-intensive inquiry and dependent on the nature of the reorganization, and only where the release "was necessary for the reorganization and appropriately tailored" to claims, "arising out of or in connection with the reorganization itself, and does not include "willful misconduct." *Airadigm*, 519 F.3d at 657 (internal quotations omitted).

III. RECENT CASES SIGNAL DISAGREEMENT OVER WHETHER BANKRUPTCY COURTS HAVE SUBJECT MATTER JURISDICTION OVER THIRD-PARTY RELEASES

28 U.S.C. § 1334(b) provides: "[T]he district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." Accordingly, district courts have the authority to refer to bankruptcy courts any or all cases "arising under title 11 or arising in or related to a case under title 11." 28 U.S.C. § 157(a). Furthermore, "[b]ankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under [28 U.S.C. § 157(a)], and may enter appropriate orders and judgments." 28 U.S.C. § 157(b)(1).

Proceedings "arising under" the Code assert a cause of action created by the Code. Proceedings "arising in" a bankruptcy case are those that could not exist outside of a bankruptcy case, but that are not causes of action created by the Code. Proceedings are "related to" a bankruptcy case where the proceeding could have been commenced in federal or state court independently of the bankruptcy case, but the outcome of that proceeding could conceivably have an effect on the bankruptcy estate.

Accordingly, releases related to "arising under" claims are usually uncontroversial because they clearly relate to the bankruptcy. On the other hand, a few key decisions in the last few years have used "arising in" and "related to" subject matter jurisdiction to block certain third-party releases that were particularly broad in scope. *See In re Midway Gold US, Inc.*, 575 B.R. 475 (Bankr. D. Colo. 2017); *In re SunEdison, Inc.*, 576 B.R. 453 (Bankr. S.D.N.Y. 2017). Another 2017 opinion, *In re Millennium Lab Holdings*, complicated the issue by finding that third-party releases are indeed part of a bankruptcy courts" arising in" and "arising under" jurisdiction. 575 B.R. 252 (Bankr. D. Del. 2017).

A. *In re Midway Gold*

As described above, the *Midway Gold* court did not find a blanket statutory prohibition on third-party releases as long as they satisfy certain factors and are distinct from the particular type of third-party release carved out by *Western Real Estate*. However, the court ultimately barred the third-party releases on the basis of subject matter jurisdiction due to their particularly broad nature.

In *Midway Gold*, a mining company sought confirmation of a chapter 11 plan containing broad third-party releases that would have forever released, waived, and discharged the Released Parties, as defined in the plan, from "all causes of actions and claims, debts and obligations based in whole or in part upon any act or omission, transaction, or other occurrence or circumstances existing or taking place on or after the Petition Date but prior to or on the Effective Date in any way related to the Debtors, the Chapter 11 Cases or the Plan." *Midway Gold*, 575 B.R. at 516.

The court found that third-party claims are not cases "brought under" the Code because the third parties are not debtors in the bankruptcy case. *Id.* at 518. Such claims also do not strictly "arise under" the Code because the "[causes of action] being released . . . are not limited to causes of action under the Bankruptcy Code, such as avoidance actions." *Id.* The debtors argued that the releases arise in the bankruptcy case because they are limited to post-petition claims, but the court did not find this compelling because the actual language provides for the release of claims "*existing* or taking place *on* or after the Petition Date," which would include pre-petition claims in existence on the Petition Date. *Id.*

Moreover, the court found no "arising in" jurisdiction even though the court has subject matter jurisdiction over chapter 11 cases pursuant to 28 U.S.C. § 157(a) and even though the "confirmation of plans" are expressly determined to be "core proceedings," which the court may hear and determine on a final basis, pursuant to 28 U.S.C. § 157(b)(2)(L). Specifically, the court found "arising in" jurisdiction objectionable because the court "cannot permit third-party non-debtors to bootstrap their disputes into a bankruptcy case in this fashion." *Midway Gold*, 575 B.R. at 519. There must be an independent statutory basis or risk acquiring "infinite jurisdiction." *Id.* ("If proceedings over which the Court has no independent jurisdiction could be metamorphisized *[sic]* into proceedings within the Court's jurisdiction by simply including their release in a proposed plan [and using section 105(a) as authority for approving such a release], this Court could acquire infinite jurisdiction.") (internal quotation omitted).

Likewise, "related to" jurisdiction does not extend to "controversies between third-party creditors which do not involve the debtor or his property unless the court cannot complete administrative duties without resolving the controversy." *Id.* (quoting *In re Gardner*, 913 F.2d 1515, 1518 (10th Cir. 1990)). The court noted that a non-debtor released party's financial contribution to the proposed chapter 11 plan was "insufficient alone" for the court to "exercise "related to" jurisdiction even if the success of the plan depends on releases given in exchange for certain contributions and settlements. *Id.*

B. *In re SunEdison*

Following on the heels of *Midway Gold*, the Bankruptcy Court for the Southern District of New York also found that certain, particularly broad third-party releases in *SunEdison* lacked "related to" subject matter jurisdiction. 576 B.R. 453 (Bankr. S.D.N.Y. 2017)

In *SunEdison*, the third-party releases included past and future claims against an expansive list of third parties and also extended to a list of unidentified current and former affiliates, employees, and advisors of the identified released third parties. *Id.* at 456-57. None of the affected claimholders objected to the releases but the court questioned their validity *sua sponte* and reserved its decision on that issue while confirming the plan. *Id.* at 455. After supplemental briefing, the court found the third-party releases were non-consensual (discussed in more detail below) and that the bankruptcy court only had limited jurisdiction to grant broad third-party releases. *Id.* at 461-64. Specifically, the court lacked "related to" subject matter jurisdiction over third-party claims that would not give rise to contribution or indemnification against the debtor's estate. *Id.* at 462-63.

In its analysis, the court asserted that whether jurisdiction exists rests on whether the outcome of the non-debtor's claim has a "conceivable effect" on the estate for purposes of a bankruptcy court's "related to" jurisdiction. *Id.* There is such a "conceivable effect" where a third-party claim "may give rise to a potential indemnification or contribution claim against the estate. *Id.* However, the court found that the third-party release in the case went far beyond any indemnification obligation that the debtors contend support the release, as the release sought to extinguish claims that "relate in any way to the Debtors or their bankruptcy cases and that arose from the beginning of time to an unspecified date in the *future* when the Effective Date occurs." *Id.* at 463. The court also noted that the release would have been granted to parties far beyond those with potential indemnification claims against the debtor and included professionals retained by the debtors, the creditors' committee and its members as well as any underwriters, arrangers, or placement agents in respect of the second lien senior notes and many other unidentifiable Released Parties, such as a variety of advisors and other professionals, just to name a few. *Id.* Additionally, the court noted, as did *Midway Gold*, that financial contribution to the estate by the release, without more, is not sufficient to confer subject matter jurisdiction. *Id.* at 451.

However, the judges in the Bankruptcy Court for the Southern District of New York have not uniformly adopted such an approach — another judge within the Bankruptcy Court for the Southern District of New York (Judge Chapman) has explicitly declined to apply the reasoning on jurisdiction in *SunEdison* (Judge Bernstein), stating that "every case is different." *See* Transcript of Hearing at 26, *In re Cumulus Media Inc., et al.*, No. 17-13381 (Bankr. S.D.N.Y. Feb. 8, 2018) [D.I. 434].

C. *In re Millennium Lab Holdings*

In this case, a laboratory testing company filed a pre-packed chapter 11 plan with a broad third-party release that released common law fraud and RICO claims against the debtor's former equity holders (the releases were in exchange for a $325 million cash infusion to fund the reorganization). *In re Millennium Lab Holdings II, LLC*, 575 B.R. 252 (Bankr. D. Del. Oct. 3, 2017), *aff'd* 591 B.R. 559 (D. Del. Sept. 21, 2018). The releases were opposed by certain creditors, including Voya, which held 5.8% of Millennium's debt. Voya argued that the bankruptcy court did not have authority to grant the releases pursuant to the Supreme Court's 2011 ruling in *Stern v. Marshall,* 564 U.S. 462 (2011).

In *Stern*, the Supreme Court considered whether a bankruptcy court, as a non-Article III court, had the authority to enter final judgment on a state-law governed counterclaim brought by a debtor in bankruptcy court against a counterclaimant. This decision was unique because the counterclaim fell within one of the enumerated categories of "core proceedings" that a bankruptcy court traditionally had jurisdiction over, pursuant to 28 U.S.C. § 157(b)(2). To resolve this issue, the Supreme Court announced a test for whether a bankruptcy judge can enter a final order on a trustee's counterclaim. *Stern*, 564 U.S. at 499 ("Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case; the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process"). The claim-at-issue failed this test and therefore, the bankruptcy court did not have authority over the counterclaim.

Wielding *Stern*, Voya argued that granting the third-party releases would be tantamount to adjudicating a state-law claim. The court rejected Voya's argument, holding that:

- The bankruptcy court has jurisdiction to grant the release because "core proceedings" arise under or arise in title 11. *See* 28 U.S.C. § 157(b)(1). In turn, "confirmations of plans," including the confirmation of third-party releases *within* those plans, is an enumerated core proceeding. *See* 28 U.S.C. § 157(b)(2); *Millennium Lab II*, 575 B.R. at 271. Thus, the third-party releases must merely meet the federal standards used by the Third Circuit. *Id.* at 271-72 (examining the *Continental* hallmarks and *Master Mortgage* factors, discussed above). "An order confirming a plan with releases, therefore, does not rule on the merits of the state law claims being released." *Id.* at 272.
- Furthermore, the adjudication of third-party releases does not violate a bankruptcy court's constitutional authority under *Stern* because *Stern* is, at its broadest, limited to the proposition that "a bankruptcy judge cannot enter a final judgment on all state law claims, all common law causes of action or all causes of action under state law." *Id.* at 268-69. Furthermore, a bankruptcy judge's final order on a core issue that may merely have a preclusive effect on a third-party lawsuit does not violate *Stern*. *Id.* at 276.
- Additionally, the bankruptcy court noted that adopting the Voya interpretation would dramatically change the division of labor between the bankruptcy and district courts. *Id.* at 285-86 (listing several instances where a district court would be compelled to enter a final order approving a debtor's requested relief, including "any § 363 sale of assets in which a purchaser seeks to be free of successor liability—which is every § 363 sale of assets," and finding, as a result, that "there is ample room for gamesmanship by both debtors and creditors in the bankruptcy context" should Voya's argument succeed).

Cases since *Midway Gold*, *SunEdison*, and *Millennium Lab* show that courts remain very unsettled as to how such jurisdictional issues affect a bankruptcy court's ability to grant a third-party release. *Compare In re Kirwan Offices S.à.r.l.*, 592 B.R. 489, 503 (S.D.N.Y. 2018) (affirming the bankruptcy court's decision, and rejecting an objecting shareholder's argument that "an involuntary release of non-debtor, third-party claim always falls outside a bankruptcy court's core jurisdiction."); *Aegean Marine*, 599 B.R. at 723 (highlighting the extraordinary nature of granting third-party releases and, with respect to jurisdiction, noting that (i) statutory authority only gives bankruptcy courts subject matter jurisdiction over "civil proceedings" but when third-party releases are proposed, there is rarely any "proceeding" pending at all; and (ii) that a court also needs personal jurisdiction over relevant parties and formal service of process is required); Transcript of Bench Decision Regarding Confirmation Hearing at 13, *In re ARO Liquidation, Inc. (Aeropostale),* No. 16-11275 (Bankr. S.D.N.Y. Mar. 28, 2018) [D.I. 1752] (addressing objection on basis of subject matter jurisdiction by concluding that the intent of the plan was to limit released claims to those relating to debtors and directing the debtors to include "clarifying language" to avoid capturing unrelated claims).

In sum, objecting parties have tried various and different approaches to challenge a bankruptcy court's jurisdiction over third-party releases. *SunEdison* and *Midway Gold* both involved particularly broad releases, which made those plans vulnerable to challenged based on "arising in" and "related to" jurisdiction. On the other hand, *Millennium Lab* addressed whether granting the release would violate its constitutional authority under *Stern*. The divergent approaches of *Midway Gold* and *Millennium Lab* also illustrate two opposing concerns: The *Midway Gold* court worried that broad third-party releases could lead to the court acquiring "infinite jurisdiction," such that any party could "bootstrap" their claim into the bankruptcy case by placing a release in the proposed plan, *Midway Gold*, 575 B.R. at 519, while the *Millennium Lab* court emphasized that adopting Voya's interpretation of *Stern* would "dramatically change the division of labor between the bankruptcy and district courts," *Millennium Lab II*, 575 B.R. at 285-86.

IV. COURTS MAY REQUIRE ACTUAL OR DEEMED CONSENT TO APPROVE THIRD-PARTY RELEASES

Finally, one of the other issues courts opine on in adjudicating third-party releases is whether creditors can be seen to have provided actual or deemed consent to release the claim(s) at issue.

Courts have traditionally granted third-party releases only to those creditors who affirmatively consent by voting in favor of the plan and not opting out of the third-party releases. *See In re Washington Mutual, Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011) ("[T]he Court concludes that the opt out mechanism is not sufficient to support the third party releases anyway, particularly with respect to parties who do not return a ballot (or are not entitled to vote in the first place)"). . . . [f]ailing to return a ballot is not a sufficient manifestation of consent to a third party release."); *In re Chassix Holdings, Inc.*, 533 B.R. 64, 81 (Bankr. S.D.N.Y. 2015) (J. Wiles) (finding that creditors who vote in favor and those who rejected the Plan but still opted in, clearly consented; however, creditors who abstained or were deemed to reject cannot have consented because "charging all inactive creditors with full knowledge of the scope and implications of the proposed third party releases, and implying a 'consent' to the third party releases based on the creditors' inaction, is simply not realistic or fair, and would stretch the meaning of 'consent' beyond the breaking point."). In other words, courts traditionally did not find sufficient consent to a third-party release from unimpaired creditors who did not vote (i.e., do not return a ballot), voters who abstained, and voters who rejected a plan (*unless* they affirmatively opted in).

The Office of the U.S. Trustee routinely files objections to plans that do not include affirmative acts of consent for a class of creditors giving third-party releases, and generally prefers an opt-in mechanism. In certain cases, they have not opposed an opt-out option. However, courts — prominently, those in the Second and Third Circuits — have shown signs of shifting away from the traditional view and courts in recent years have allowed third-party releases that affect voters who do not show affirmative consent given that certain conditions are met. *See, e.g.*, *In re Orchard Acquisition Co., et al.*, No. 17-12914 (Bankr. D. Del. Jan. 23, 2018) (finding notice sent to unimpaired creditors about opting out was sufficient where there were no objections); *ARO Liquidation,* No. 16-11275 (Bankr. S.D.N.Y. Mar. 28, 2018) (finding notice and an opportunity to opt out would be sufficient to find consent for unimpaired creditors); *Indianapolis Downs*, 486 B.R. 286 (Bankr. D. Del. 2013) (finding detailed instructions on opportunity to opt out sufficient); *In re Spansion, Inc.*, 426 B.R. 114 (Bankr. D. Del. 2010) (noting no unimpaired creditor had objected to the plan); *In re DBSD N. Am., Inc.*, 419 B.R. 179 (Bankr. S.D.N.Y. 2009) (finding warning on disclosure statement or ballot that a failure to vote against the plan constituted consent was sufficient);

Judicial opinions on what constitutes consent continue to differ widely and, as shown below, can even differ between judges within the same courthouse. Opinions may vary generally or can vary based on the particulars of a case and the form of the notice or opt-in/opt-out mechanism on the ballot.

A. Unimpaired Creditors

Recent opinions generally allow third-party releases with respect to such unimpaired creditors if other factors are present, such as no objections from unimpaired creditors or if reasonable consideration was received. *See* Transcript of Hearing at 17-18, *In re Orchard Acquisition Co., et al.*, No. 17-12914 (Bankr. D. Del. Jan. 23, 2018) [D.I. 160] (where unimpaired creditors received a notice stating that they must file an objection in order to opt out of the third-party release and in the face of objections from the U.S. Trustee that the notice was insufficient, the court ruled that the release was consensual, emphasizing that there were no objections from any type of creditor and that this silence constituted consent, and expressing concern that if the release was denied, the entire plan might "unravel"); *Spansion*, 426 B.R. at 144 (Bankr. D. Del. 2010) (overruling the U.S. Trustee's objection that unimpaired classes needed an opportunity to take affirmative action, such as fill out a ballot and use an opt-out mechanism, noting that no unimpaired creditor had objected to the plan). Decisions have also found consent where unimpaired creditors were given the opportunity to opt out. *See* United States Trustee's Objection to Confirmation at 2, *In re Orchard Acquisition Co., et al.*, No. 17-12914 (Bankr. D. Del. Jan. 11, 2018) [D.I. 126]; Transcript of Bench Decision Regarding Confirmation Hearing at 30-31, *ARO Liquidation*, No. 16-11275 [D.I. 1752] (stating that unimpaired creditors who are deemed to accept should be provided with a notice of non-voting status and an opportunity to opt out of certain third-party releases).

Another judge in the Bankruptcy Court for the Southern District of New York has taken a less rule-based approach, finding that third-party releases affecting unimpaired creditors can be approved, but only to the extent that one of three limiting instances pertaining to any third-party release was satisfied: in cases where (i) any affected party consented or were deemed to have done so through its ability to "check the box" on the ballots (including parties who voted in favor and those who voted to reject but failed to opt out); (ii) claims would trigger indemnification or contribution claims against the debtors and impact reorganization; and (iii) parties provided substantial consideration or concessions to the reorganization. *See In re Genco Ship. & Trading Ltd.*, 513 B.R. 233, 271-72 (Bankr. S.D.N.Y. 2014) (J. Lane).

B. Deemed Rejected Creditors

Courts generally do not allow third-party releases to apply to those entities not receiving any distribution under a plan. *See Indianapolis Downs*, 486 B.R. at 304. However, judges in the Bankruptcy Court for the Southern District of New York have suggested that third-party releases of deemed rejected creditors may be allowed if they are given the opportunity for an affirmative act, such as through an opt-in mechanism. *See* Transcript of Bench Decision Regarding Confirmation Hearing at 31, *ARO Liquidation,* No. 16-11275 (Bankr. S.D.N.Y. Mar. 28, 2018) [D.I. 1752] (stating that certain holders of claims whose treatment changed from some recovery to no recovery should be provided with a notice of non-voting status and the option to opt in because those who don't receive recoveries under a plan often don't carefully analyze the solicitation materials); *Chassix*, 533 B.R. at 81 (finding that creditors who are deemed to reject the Plan generally found to be deemed to reject third-party releases in the absence of an affirmative act, such as an "opt in" mechanism); *In re Chemtura Corp.*, 439 B.R. 561, 609–613 (Bankr. S.D.N.Y. 2010).

C. Impaired Voters

Impaired voters include those who vote to accept the plan, vote to reject the plan, or who are entitled to vote but nevertheless abstain. In the case of third-party releases, such voters may often be given the chance to opt out of the releases on their ballots, and courts are often called to adjudicate consent over those impaired voters who did not opt out.

There currently is a shift from the more traditional approach towards allowing deemed acceptance of abstaining or rejecting voters who do not opt out if there is adequate notice on the ballot or disclosure statement. *See Indianapolis Downs*, 486 B.R. at 306 ("As for those impaired creditors who abstained from voting on the Plan, or who voted to reject the Plan and did not otherwise opt out of the releases, the record reflects these parties were provided detailed instructions on how to opt out, and had the opportunity to do so by marking their ballots. . . . [u]nder these circumstances, the Third Party Releases may be properly characterized as consensual and will be approved."); *DBSD N. Am.*, 419 B.R. at 218 (Bankr. S.D.N.Y. 2009) (finding consent when a disclosure statement or voting ballot warned that a failure to vote against the Plan would be deemed consent to the third-party releases); *In re Calpine Corp.*, 2007 WL 4565223, at *10 (Bankr. S.D.N.Y. Dec. 19,

2007) ("Ballots explicitly stated that a vote to accept the Plan or abstention from voting without opting out of the releases each constitutes an acceptance and assent to the releases set forth in the Plan . . . [D]ue and adequate notice [were given].").

However, a closer examination of just the decisions of the Bankruptcy Court for the Southern District of New York shows a difference of opinion among the judges themselves. Judge Chapman has even acknowledged that "there are judges in this building" that hold different views with respect to the propriety of third-party releases and their consent requirements. Transcript of Confirmation Hearing at 33-34, *In re Nine West Holdings Inc.*, No. 18-10947 (Bankr. S.D.N.Y. Feb. 26, 2019) [D.I. 1311] (approving broad third-party release over the U.S. Trustee's objections that the case did not meet the "only in rare cases" standard in *Metromedia* due to unique components of the case).

For instance, Judge Lane has found that opt-out and opt-in mechanisms may be tailored to the treatment of specific classes. *See* Transcript of Bench Decision Regarding Confirmation Hearing at 31, *ARO Liquidation*, No. 16-11275 [D.I. 1752] (finding that those unimpaired and deemed to accept should be provided with notice of non-voting status and opportunity to opt out; those deemed to reject due to amendments in the Plan should be given notice of non-voting status and opportunity to opt in; and those deemed to reject but who previously had notice, should be deemed to consent to the third-party releases unless they are able to and do exercise the opportunity to opt out). Still others like Judge Drain generally approve third-party releases if they satisfy the *Metromedia* standards, even if there is no opt-out or opt-in mechanism on the ballots nor a conspicuous notice. *See In re Delphi Corp.*, No. 05-44481, 2009 WL 2482146, at *19 (Bankr. S.D.N.Y. July 30, 2009).

V. CONCLUSION AND PRACTICE POINTS

Third-party releases must be drafted with particular care in any chapter 11 plan. Such releases can take numerous forms and permutations, and consent can be obtained through several mechanisms during the voting process. As this article demonstrates, the courts can adopt a wide range of standards in considering whether to approve third-party releases, how they view subject matter jurisdiction over third-party releases, and the type of consent from certain voters that would prove sufficient. Even as a number of cases in recent years exhibit a softening towards the permission of third-party releases, still other judges have warned against these tidings of leniency. *See, e.g.*, *Aegean Marine*, 599 B.R. 726-27 (J. Wiles) ("Third-party releases are not a merit badge that somebody gets in return for making a positive contribution to a restructuring. They are not a participation trophy, and they are not a gold star for doing a good job. . . . [Rather,] [n]onconsensual releases are not supposed to be granted unless barring a particular claim is important in order to accomplish a particular feature of the restructuring."); *see also* Memorandum Decision Supplementing Order Denying Motion to Approve the Debtors' Disclosure Statement at 25-26, *In re FirstEnergy Solutions Corp., et al.*, No. 18-50757 (Bankr. N.D. Oh. Aug. 29, 2019) [D.I. 3135] (refusing approval of broad third-party releases for not satisfying *Dow Corning* factors and stating that the court "shares the reservations expressed by [Judge Wiles in] *Aegean Marine*" regarding the "increasingly cavalier" attitude of debtors towards third-party releases, "as if they were a routine request, not an exceptional one").

Thus, in crafting third-party releases and in consideration of the three major issues described herein, practitioners should, first and foremost, always research the particular judge that will be considering confirmation of the plan, paying attention to how permissive they are towards third-party releases, what standards they apply, and their view, if any, on subject matter jurisdiction. With respect to consent, it is best practice to give conspicuous and clear notice to both non-voters and voters, and to consider the use of opt-in or opt-out provisions in appropriate circumstances. Generally, plan confirmation will be easier to facilitate if it can be shown that those receiving releases gave substantial consideration such that the consideration was necessary to the chapter 11 plan. Finally, practitioners must consider the relation of the releases and of the Released Parties to the bankruptcy case — a court may determine it does not have jurisdiction to approve broad releases that are not sufficiently related to the bankruptcy case and/or do not have an effect on the bankruptcy estate.

News at 11

By Mark McDermott and Cameron Fee[1]

Consensual Third-Party Releases Under § 1141

An Emerging Analytical Framework

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In recent years, there has been a noticeable increase in litigation over what constitutes "consent" to third-party releases contained in a chapter 11 plan. To demonstrate consent, plan proponents typically rely on an opt-out mechanism: Each stakeholder receives an opt-out form that enables it to be carved out of the proposed third-party release contained in the plan.

If notice was adequate and the third-party release was conspicuously disclosed, a majority of courts have concluded that a stakeholder who does not submit a completed opt-out form is deemed to have consented to the third-party release. However, a growing number of courts have recently held that this opt-out structure is not a sufficient manifestation of consent to bind parties that fail to return an opt-out form.

Recently, in *In re Emerge Energy Services LP*, a judge in the U.S. Bankruptcy Court for the District of Delaware joined this growing group of courts requiring a more affirmative expression of consent than a failure to return an opt-out form.[2] Relying on state law contract principles, the *Emerge* court reasoned that failure to submit an opt-out form did not constitute consent to the plan's third-party release because creditors and interest-holders had no duty to speak.[3] The upshot of this position is that silence cannot be construed as consent unless there is a duty to speak.

Just a few months later, on April 2, 2020, in *In re Melinta Therapeutics Inc.*, a different bankruptcy judge in the District of Delaware disagreed with *Emerge* and found the debtors' § 1141 argument "more compelling ... than the contractual argument" relied on in *Emerge*.[4] While *Melinta* adopted the majority position, it did so based on a unique rationale: The court concluded that it is improper to rely upon state contract law in answering the third-party consent question without considering § 1141[5] (a Bankruptcy Code section that *Emerge* did not discuss).

Section 1141(a) provides that the "provisions of a confirmed plan bind," among others, "any creditor, equity security holder, or general partner in the debtor ... whether or not" such claim or interest "is impaired under the plan" and "whether or not [such parties have] accepted the plan." This Code section provides the source of the duty to speak and imposes on all parties-in-interest the duty to object. Notably, this argument, which provides a cogent rebuttal to the minority position, is just "emerging [in the] case law."[6] This article discusses *Emerge* and the primary decision it relies upon, then briefly explains why the growing minority position on third-party release consent is unpersuasive because it does not consider § 1141 in its analysis.

The Minority Position: Ability to Opt Out Is Insufficient to Imply Consent

Emerge marks the most recent published decision holding that a stakeholder's failure to return an opt-out form is insufficient to imply consent to a plan's third-party release. Acknowledging that the court's position was in the "minority amongst the judges" in Delaware, the court determined that in order to imply consent from nonresponsive creditors and equityholders, a debtor must show under "basic contract principles that the Court may construe silence as acceptance."[7] To find that such a stakeholder consented to a third-party release, the court must find "with certainty that those failing to return a ballot or Opt-Out Form did so intentionally."[8] Even though the debtors clearly notified stakeholders of the implications of the failure to submit an opt-out form, the court determined that there could be other explanations for this failure unrelated to an intent to provide a release, such as "[c]arelessness, inattentiveness or [a] mistake."[9]

In reaching this conclusion, the court expressly relied on the reasoning of *In re SunEdison Inc.*[10] Relying on New York contract law, the *SunEdison* court determined that a non-voting releasor's silence did not constitute implied consent to the plan's third-party release.[11] An offeror cannot transform an "offeree's silence into acceptance when the offeree does not

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1 The views expressed herein are solely those of the authors and not necessarily the views of Skadden, Arps, Slate, Meagher & Flom LLP or its clients.
2 Case No. 19-11563 (KBO), 2019 WL 7634308 (Bankr. D. Del. Dec. 5. 2019).
3 *Id.* at *18.
4 Case No. 19-12748 (LSS) (Bankr. D. Del. 2019).
5 *See In re Melinta Therapeutics Inc.*, No. 19-12748 (LSS) (Bankr. D. Del. April 2, 2020), Confirmation Hr.'g Tr. 120:1-14 ("*Melinta* Confirmation Tr."). All section references herein are to title 11 of the U.S. Code.
6 *Melinta* Confirmation Tr. 120:6-7.
7 *In re Emerge Energy Servs. LP*, No. 19-11563 (KBO), 2019 WL 7634308, at *18 (Bankr. D. Del. Dec. 5, 2019) (citing *Restatement (Second) of Contracts* § 19 (Am. Law Inst. 1981)).
8 *Id.*
9 *Id.*
10 576 B.R. 453 (Bankr. S.D.N.Y. 2017).
11 *In re SunEdison*, 576 B.R. at 460.

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requires a finding of a "sound business purpose" for approval of transactions outside the ordinary course of business.[21] The vendor "must (1) be in a position to cease providing goods or services to the debtor because it is not a party to a contract with the debtor; and (2) refuse to provide goods and services unless its pre-petition claim remains unpaid."[22] Next, payments to critical vendors must leave creditors "at least as well off as they were before."[23] In considering the foregoing standard in the critical vendor context, Judge Hoffman observed:

> The Court concludes that requiring proof on a vendor-by-vendor basis is not required by the Bankruptcy Code and would be detrimental to the interests of the Debtors' estates and creditors, including the unsecured creditors. In fact, the [objectors'] approach likely would result in the Debtors' paying *more* to their critical vendors than they will pay if the Motion is approved. That is, requiring evidence on a vendor-by-vendor basis would drain value from the bankruptcy estate to the detriment of all creditors. This is true for several reasons. For one, in order to provide particular evidence that each critical vendor would fail to do business with the Debtors, what are the Debtors to do? Ask their creditors if they will cease doing business with them if they do not pay their pre-petition claims? If asked, most creditors will certainly say "yes," increasing the amount of critical-vendor payments [that] the Debtors would make. As the court stated in *Windstream*, "the reason [the debtors have] only paid 12 [creditors under the interim critical-vendors order] to date is because [the others] haven't asked. [The Debtors are] only going to deal with them if they do ask. You want them to pay a blank check for the full amount." *Windstream*, Tr. of Hrg. at 92; *see also id*. at 106-07 (noting that this approach would create a "run on the bank"). And if the Motion is not approved, are the Debtors to wait until the critical moment when the creditors inform the Debtors that they are soon to be cut off, filing motions on an emergency basis each time this happens? On top of all that, are the Debtors, by filing a list of "critical vendors" and providing evidence regarding why each vendor is critical, to deprive themselves of any leverage they have in negotiations with the vendors? Such an approach would not only increase the costs incurred by the Debtors' estates for professional fees, but also would increase the risk of harm to the Debtors' business.[24]

Similarly, the district court in *Windstream* agreed with Judge Drain that evidence of "a formal refusal" was "impractical."[25] In so noting, the district court observed that a creditor-by-creditor determination of a "formal refusal" would harm the bankruptcy estate because it would be unduly time- and resource-consuming and would adversely impact the estates' leverage in negotiations, which would ultimately do harm to the entire estate.[26]

As Judge Drain noted, requiring evidence of critical-vendor status on a creditor-by-creditor basis would create the "type of disruption" that critical-vendor motions are intended to prevent.[27] It would, in many cases, result in unnecessary costs, expenses and distractions, or worse: require multiple additional emergency motions that may, or may not, prove to be timely.[28]

Conclusion

In certain respects, the *Windstream* and *Murray* decisions are not noteworthy insofar as they reflect what has become routine practice in chapter 11 cases in New York and Delaware. Nevertheless, they are important to bankruptcy courts, practitioners and chapter 11 debtors, because they provide (1) persuasive support for the proposition that evidence on a creditor-by-creditor basis is not necessary for approval of a critical-vendor motion; and (2) precedent to justify established practices that can be used as a road map to consider, formulate and implement critical-vendor protocols and, if necessary, payments. abi

21 *Murray*, 613 B.R. at 450 (quoting *Stephens Indus. Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986)).
22 *Id.* at 451 (citing, *e.g., Kmart*, 359 F.3d at 872-73).
23 *Id.* at 452.
24 *Id.* at 453-54.
25 *See Windstream*, 614 B.R. at 452, 458, n.10.
26 *Id.* at 458, n.10.
27 *See* Hr'g Tr., *In re Windstream Holdings Inc.*, Case No. 19-22312 (RDD) (Bankr. S.D.N.Y. April 16, 2020), ECF No. 1457 at 104:11-116:17; 108:15-109:17.
28 *Murray*, 613 B.R. at 455.

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intend to accept the offer."[12] Thus, "the offeror cannot ordinarily force the other party into a contract by saying, 'If I do not hear from you by next Tuesday, I shall assume you accept.'"[13] The court emphasized that under New York law, "[a]bsent a duty to speak, silence does not constitute consent."[14]

Section 1141's Impact on the Question of Consent

Emerge and *SunEdison* improperly rely on state contract law without considering § 1141 and bankruptcy law's import on the question of consent. A chapter 11 plan is not simply an ordinary contract governed by state law contract principles. Indeed, chapter 11 plans differ from traditional contracts in important ways.

Only the proponents of the plan actually sign the plan; yet the plan, which is often referred to as a "super contract," can bind potentially thousands of non-signatories.[15] The ultimate terms of a plan are also not predicated on the foundational elements of a contract: offer and acceptance. A plan, in many ways, is not an "offer" in the contractual sense; if it was, it

12 *Id.* at 458 (citation omitted).
13 *Id.* (citation omitted).
14 *Id.* (citation omitted).
15 *See In re Montgomery Ward Holdings Corp.*, 306 B.R. 489, 495 (Bankr. D. Del. 2004) (observing that confirmed plan is "a legally binding agreement").

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would turn contract law on its head because a party remains bound by the plan even if it "rejects" the offer (*i.e.*, the plan) by (1) voting against the plan and (2) objecting to the plan.

Unlike ordinary contracts, the source of a plan's binding effect on parties-in-interest is not based on mutual assent, but rather is supplied by the Bankruptcy Code and from principles of claim preclusion. As succinctly highlighted in *In re Frontier Insurance Group Inc.*:

> *References to chapter 11 plans as contracts or agreements — while useful for purposes of interpreting plans ... — are only by analogy, however. The binding effect of a chapter 11 plan is in fact premised on statutory and common law claim preclusion.* That is, for the debtor, its creditors and holders of interests, the chapter 11 plan is the crucible by which the parties' claims and rights in property dealt with by the plan are transformed and governed post-confirmation — a "super-contract" — not because it is signed by all of the parties with claims against the debtor and holders of interests affected by the plan who participated in the case, but because of applicable provisions of the Bankruptcy Code and principles of *res judicata*.[16]

Thus, while consulting state law contract principles might provide some guidance on the interpretation of plan provisions, state law sheds little light on the binding nature of a confirmed plan upon all parties-in-interest under § 1141. Section 1141(a) binds holders of claims and interests to a plan's provisions, including a third-party release contained therein.

In particular, § 1141(a) provides that "the provisions of a confirmed plan bind" the debtor, any entity acquiring property under the plan, and any creditor of, or equity security holder in, the debtor.[17] This subsection is also binding whether or not such parties' claims are "impaired under the plan ... [or such parties have] accepted the plan."[18] Thus, "[t]he confirmation order binds the world to the extent [that] the plan touches the debtor, its rights, assets or obligations as of the confirmation date."[19] A chapter 11 plan binds a party — even if such party does not file a claim, receive a distribution or retain any interest in the debtor.[20]

A confirmation order also operates as a final judgment.[21] A confirmation order "is a judgment *in rem* — a determination of the debtor's status as a chapter 11 debtor — and is binding upon all parties-in-interest, whether or not they have appeared to contest entry of the order."[22] Consequently, the confirmation order serves as *res judicata* as to any issues that were or could have been raised at the confirmation hearing.[23] For these reasons, a party must file an objection if it disagrees with its treatment under a plan.

Relying on § 1141 and the foregoing bankruptcy principles, in *In re Tops Holding II Corp.* the court disagreed with the reasoning of *SunEdison*.[24] In bankruptcy, silence can be deemed consent because § 1141(a) provides the "source of the duty to speak."[25] Bankruptcy law does not require a party's affirmative consent or signature for a plan to be binding. As the court highlighted in *Tops*, a chapter 11 plan "is a super contract to which thousands of parties don't sign," yet it is still binding upon all those parties.[26] Ultimately, the *Tops* court determined that § 1141(a) provided "the source for the deemed consent" and held that the opt-out mechanism was more than sufficient to imply consent.[27]

Section 1141 Arrives in Delaware

In *Melinta*, the court was faced with an objection from the Office of the U.S. Trustee to the debtors' opt-out mechanism. Relying on *Emerge*, the U.S. Trustee argued that the opt-out was insufficient to imply consent to the plan's third-party release. The debtors contended that *Emerge*, and the minority position generally, fails to account for (1) the bankruptcy overlay to the consent analysis; (2) the fact that all parties-in-interest have a duty to speak under § 1141; and (3) the binding nature of a confirmed chapter 11 plan on all parties-in-interest. With lack of due process being the limited exception, no party would contend (given that it is hornbook bankruptcy law) that a debtor's stakeholders must affirmatively agree to be bound by a chapter 11 plan before it becomes binding. But that is what the U.S. Trustee and the minority position are effectively espousing: excusing stakeholders from being bound by a chapter 11 plan because they did not perform some overt act of consent.

Overruling the U.S. Trustee's objection, the court concluded that § 1141 requires creditors to "speak up and object to release provisions, like they need to [for] other provisions."[28] Acknowledging that analyzing consent under § 1141 was a newly emerging argument, the court remarked that it found the argument "more compelling than the contractual argument"[29] that is "found in *Emerge* ... and *SunEdison*."[30] Notably, the court further observed that "until [it] hear[s] a real response to the [§] 1141 argument, that is where [the court's] thinking is" with respect to consent in the third-party-release context.[31]

16 585 B.R. 685, 693 (Bankr. S.D.N.Y. 2018) (emphasis added), *aff'd*, 598 B.R. 87 (S.D.N.Y. 2019).
17 11 U.S.C. § 1141(a).
18 *Id.*
19 8 *Collier on Bankruptcy* ¶ 1141.02[4] (16th ed. 2019).
20 *See, e.g., In re Platinum Oil Props. LLC*, 465 B.R. 621, 638 (Bankr. D.N.M. 2011) ("A confirmed Chapter 11 plan is binding on all parties described in 11 U.S.C. § 1141(a) who received proper notice.... In fact, confirmation binds creditors and other parties-in-interest, even if those parties have not accepted the plan ... 'even if it had a different understanding of [the plan's terms] or did not realize their effect.'" (quoting *In re K.D. Co. Inc.*, 254 B.R. 480, 491 (B.A.P. 10th Cir. 2000)).
21 *See Silverman v. Tracar SA (In re Am. Preferred Prescription Inc.)*, 255 F.3d 87, 92 (2d Cir. 2001).
22 8 *Collier on Bankruptcy* ¶ 1141.02[4] (16th ed. 2019).
23 *See Iberiabank v. Geisen (In re FFS Data Inc.)*, 776 F.3d 1299, 1306 (11th Cir. 2015).
24 *See In re Tops Holding II Corp.*, No. 18-22279 (RDD) (Bankr. S.D.N.Y. Nov. 9, 2018), Confirmation Hr.'g. Tr. 73:8-13 (Court: "So I believe those two cases [*Chassix* and *SunEdison*] clearly do not stand for the general proposition, which would be inconsistent with substantial circuit level case law, including in the Second Circuit, as well as Section 1141, 1141(a)'s and (c)'s plain language, that a plan is binding, if one does not object, let alone if one does not opt-out.").
25 *Id.* at 36:10-17.
26 *Id.* at 48:4-6.
27 *Id.* at 39:18-19.
28 *Melinta* Confirmation Tr. 120:10-14.
29 *Id.* at 120:8-10.
30 *Id.* at 120:4-5.
31 *Id.* at 120:10-14. At the confirmation hearing in *Melinta*, the court raised an interesting question as to why, if the § 1141 reasoning is the correct manner of approaching the consent question, a debtor needs an opt-out mechanism. *Id.* at 63:8-15. Under § 1141, an opt-out mechanism is unnecessary to imply consent. The § 1141 rationale stands for the proposition that stakeholders must object to demonstrate their lack of consent. As a practical matter, however, the opt-out structure has been widely accepted by courts and is the customary mechanism relied upon by debtors. Counsel for debtors will therefore likely continue to use the opt-out structure until the § 1141 argument gains further traction.

Conclusion

Unlike under state contract law, in federal bankruptcy court a plan proponent *can* say, "If I do not hear from you by next Tuesday, I shall assume you accept."[32] Adding a bankruptcy gloss to the deemed-consent analysis is the correct manner in which the issue should be analyzed. When you add that bankruptcy gloss, § 1141 and bankruptcy law jurisprudence also teach that consent in chapter 11 should be determined by whether a duly noticed party-in-interest objects.[33] Indeed, this is precisely how consent is construed under § 363(f)(2) when a debtor is seeking to sell assets free and clear:[34] "Consent pursuant to section 363(f)(2) [might] be satisfied where an entity has not objected to a sale."[35]

If a party does not want to be bound by a plan's third-party release, such a party should be required to file an objection just like other stakeholders who disagree with their plan treatment.[36] By filing an objection, the third-party release becomes nonconsensual, and accordingly, the objecting party must be carved out of the release (which would be mandatory in those jurisdictions prohibiting nonconsensual third-party releases),[37] or the debtor must make a substantial evidentiary showing that the release is fair and necessary.[38] Absent an objection, however, the releasing stakeholder is deemed to have consented to the third-party release.[39] abi

32 *In re SunEdison*, 576 B.R. at 458 (citation omitted).

33 *See* Confirmation Hr.'g. Tr. 62:10-14, *In re Gibson Brands*, No. 18-11025 (CSS) (Bankr. D. Del. October 2018) ("I have ruled numerous times that 'check the box' isn't required for a creditor to be deemed — to have been deemed to consent to something, that it's sufficient to say, here's your notice, this is what's going to happen and if you don't object, you'll have been deemed to consent."); *In re VER Techs. Holdco LLC*, No. 18-10834 (KG) (Bankr. D. Del. July 26, 2018) (confirming plan with third-party releases that required parties-in-interest to file formal objections to plan to be excluded as releasing parties).

34 11 U.S.C. § 363(f)(2) ("The trustee may sell property ... free and clear of any interest in such property of an entity ... only if such entity consents."); *see FutureSource LLC v. Reuters Ltd.*, 312 F.3d 281, 285-86 (7th Cir. 2002) ("It is true that the Bankruptcy Code limits the conditions under which an interest can be extinguished by a bankruptcy sale, but one of those conditions is the consent of the interest-holder, and lack of objection (provided of course there is notice) counts as consent.").

35 *In re GSC Inc.*, 453 B.R. 132, 183 (Bankr. S.D.N.Y. 2011).

36 *See In re U.S. Fidelis Inc.*, 481 B.R. 503, 517 (Bankr. E.D. Mo. 2012) ("If a creditor wants to preserve his right to object to confirmation, on whatever ground[s], he must file an objection. If he does not file an objection, he generally cannot complain about the results of the confirmation proceeding — even if he voted to reject the plan.").

37 *See In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995); *In re W. Real Estate Fund Inc.*, 922 F.2d 592 (10th Cir. 1990).

38 *See In re Cont'l Airlines Inc.*, 203 F.3d 203, 214 (3d Cir. 2000); *see also In re Metromedia Fiber Network Inc.*, 416 F.3d 136, 142-43 (2d Cir. 2005).

39 *See* 8 *Collier on Bankruptcy* ¶ 1141.02[5][b] ("The failure to file an objection to confirmation of a plan with the bankruptcy court may be a sufficient manifestation of consent for purposes of a third-party release.").

Ground Tenant Lease Rejection and Survival of Subordinate Interests

from page 25

The Fifth Circuit addressed the specific issue of the effect of rejection of a ground lease on a ground lease mortgage in the *Matter of Austin Development Co*.[20] Hon. Edith Jones held that rejection of a ground lease does not cause a rescission of the lease nor cause the mortgageholder to lose whatever rights it had under the terms of the ground lease. Judge Jones said that despite the rejection, the subordinate interests were not extinguished; whatever *state law contractual rights* they had *vis-à-vis* the ground lessor remained intact.

The rights flowing to the mortgagee in *Austin* were *not* found in a separate nondisturbance agreement, but rather were embedded in the ground lease itself and provided rights that were "similar to those found in nondisturbance agreements." This made the mortgagee a third-party beneficiary of the ground lease.[21] Because of the lack of privity, Judge Jones had to decide whether the rejection extinguished those rights found in the lease itself.

Judge Jones examined the body of case law that had equated rejection with termination, and found it wanting. She rejected the argument that the obligation of a tenant to "surrender" the premises after a deemed rejection meant that the lease was terminated. The rejection as termination view would make rejection of a lease an "avoidance" power, not merely a breach of contract. She found no legislative or policy basis for such a view, which she saw as working a forfeiture on the rights of subordinate holders, among other issues.

She also held that the notion that the tenant's rejection of a lease could extinguish the rights of a secured party in that the lease was arguably "unconstitutional" — a point that should not be ignored.[22] Given that the mortgagee had agreed to a subordinate position, and that under state law a foreclosure by a senior encumbrance extinguishes a junior encumbrance, this constitutional concern seems unfounded.

Judge Jones held that whatever rights the mortgage lender had would have to be resolved in state court, and that her ruling meant only that such rights were preserved — whatever they may be.[23] This view is not accepted by all courts and seems to overlook the requirement to "surrender" the real property.[24]

Does *Mission Product* Control in the Context of Leasehold Rejection? If So, Don't the Parties Just Return to State Court?

The Supreme Court's decision in *Mission Product Holdings Inc. v. Tempnology LLC*[25] seems, at first, to be more in keeping with *Austin Development*. The Court confirmed that rejection is not an avoidance power, but simply a decision not to assume, simply a breach of contract that gives rise to a damage claim: "For the reasons stated above, we hold that under Section 365, a debtor's rejection of an executory contract in bankruptcy has the same effect as a breach outside bankruptcy. Such an act cannot rescind rights that the contract previously granted. Here, that construction of Section 365 means that the debtor/licensor's rejection cannot revoke the trademark license."[26]

20 19 F.3d 1077 (5th Cir. 1994), *cert denied*, 513 U.S. 874 (1994).

21 *Austin*, 19 F.3d 1080.

22 *Id.* at 1081.

23 *Id.* at 1084.

24 *In re Collins*, 2019 WL 103774 at *3 (Bankr. E.D.N.C. 2019) ("With the deemed rejection of the Lease, § 365(d)(4) requires that the Debtors immediately surrender the Property ... without the need for relief from the automatic stay and eviction proceedings under state law [because] pursuant to the Constitution's Bankruptcy Clause, the Bankruptcy's Code requirement for immediate turnover of nonresidential real property following rejection of lease pre-empts state law regarding landlord-tenant relations.").

25 139 S. Ct. 1652 (2019).

26 *Id.* at 1666.

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INSIGHTS

Reports of the Demise of Gifting Chapter 11 Plans Are an Exaggeration

DECEMBER 2018 | NEWSLETTERS

In *Hargreaves v. Nuverra Environmental Solutions Inc. (In re Nuverra Environmental Solutions Inc.)*, 590 B.R. 75 (D. Del. 2018), the U.S. District Court for the District of Delaware affirmed a bankruptcy court order confirming a nonconsensual chapter 11 plan that included "gifted" consideration from a senior secured creditor to fund unequal distributions to two separate classes of unsecured creditors. The court also ruled that, even though the appeal was equitably moot, the plan's separate classification and differing treatment of unsecured noteholders and trade creditors: (i) did not unfairly discriminate between, or improperly classify, the two unsecured classes because there was a rational basis for the classification scheme; and (ii) were "fair and equitable" because they did not constitute "vertical gifting" that violated applicable precedent and they promoted the debtor's reorganization.

In so ruling, the district court dispelled speculation that the U.S. Supreme Court's 2017 decision in *Czyzewski v. Jevic Holding Corp.* concerning "structured dismissals" might presage an end to all kinds of gifting chapter 11 plans. Because the district court's *Nuverra* ruling has been appealed, the U.S. Court of Appeals for the Third Circuit may soon have yet another opportunity to weigh in on gifting chapter 11 plans.

Classification of Claims and Interests Under a Chapter 11 Plan

Section 1122 of the Bankruptcy Code provides that, except with respect to a class of "administrative convenience" claims (i.e., relatively small unsecured claims, such as trade claims below a certain dollar amount), a plan may place a claim or interest in a particular class "only if such claim or interest is substantially similar to the claims or interests of such class." The statute, however, does not define "substantially similar."

This task was left to the courts. They have relied largely upon past practice under the former Bankruptcy Act and lawmakers' statements in connection with the enactment of the Bankruptcy Code that indicate that the term should be construed to mean similar in legal character or effect as a claim against the debtor's assets or as an interest in the debtor. *See* Collier on Bankruptcy ¶ 1122.03 (16th ed. 2018) (citing cases). Thus, for example, interests, such as stock, may not be classified together with claims, such as trade or bond debt, because the relationship between the debtor and its creditors, who assume credit risk but not enterprise risk, is fundamentally different from the relationship between the debtor and its stockholders, who undertake enterprise risk as investors. In addition, secured claims cannot be placed in the same class as unsecured claims, because a secured creditor has recourse to collateral to satisfy its debt in the event of nonpayment.

Cramdown Confirmation of a Chapter 11 Plan

Section 1129(a) of the Bankruptcy Code requires, among other things, that for a plan to be confirmable, each class of claims or interests must either accept the plan or not be "impaired." However, "cramdown" confirmation is possible in the absence of acceptance by impaired classes under section 1129(b) if all of the other plan requirements are satisfied and the plan: (i) "does not discriminate unfairly"; and (ii) is "fair and equitable" with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

Unfair Discrimination

The Bankruptcy Code provides no definition of "unfair discrimination." As noted by a leading commentator, "Courts have struggled to give the unfair discrimination test an objective standard." Collier on Bankruptcy ¶ 1129.03 (16th ed. 2018).

Nevertheless, most courts agree that the purpose underlying the requirement is to "ensure[ ] that a dissenting class will receive value equal to the value given to all other similarly situated classes." *In re Johns-Manville Corp.*, 68 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); *accord In re SunEdison, Inc.,* 575 B.R. 220 (Bankr. S.D.N.Y. 2017); *In re 20 Bayard Views, LLC*, 445 B.R. 83 (Bankr. E.D.N.Y. 2011).

Several courts have adopted some form of the unfair discrimination test (the "Markell test") articulated by Bruce A. Markell in his article *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L.J. 227, 249 (1998). *See, e.g.*, *Law Debenture Trust Co. of New York v. Tribune Media Co.* (*In re Tribune Media Co.),* 587 B.R. 606, 618 (D. Del. 2018); *In re Armstrong World Indus., Inc.*, 348 B.R. 111 (D. Del. 2006); *In re Quay Corp., Inc.*, 372 B.R. 378 (Bankr. N.D. Ill. 2007); *In re Exide Techs.*, 303 B.R. 48 (Bankr. D. Del. 2003). The Markell test was first applied by a bankruptcy court in *In re Dow Corning Corp.*, 244 B.R. 705 (Bankr. E.D. Mich. 1999), *aff'd in relevant part*, 255 B.R. 445 (E.D. Mich. 2000), *aff'd in part and remanded*, 280 F.3d 648 (6th Cir. 2002).

Under the Markell test, a rebuttable presumption that a plan unfairly discriminates will arise when the following elements exist:

> "
> **(1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.**
> "

Id. at 702. The burden then lies with the plan proponent to rebut the presumption by demonstrating that "outside of bankruptcy, the dissenting class would similarly receive less than the class receiving a greater recovery, or that the alleged preferred class had infused new value into the reorganization which offset its gain." *Id.*

Fair and Equitable

Section 1129(b)(2) of the Bankruptcy Code specifies what is necessary for a plan to be "fair and equitable" with respect to secured claims, unsecured claims, and interests. With respect to a class of unsecured creditors, the plan must provide that either: (i) holders of claims in the rejecting class will receive value, as of the effective date, equal to the allowed amount of their claims; or (ii) holders of claims or interests in a more junior class will not receive or retain any property under the plan on account of their claims or interests. The "fair and equitable" requirement as to unsecured creditors thus includes a form of the "absolute priority rule," which implicates the Bankruptcy Code's priority-of-distribution scheme.

The Bankruptcy Code's Distribution Scheme

The Bankruptcy Code recognizes a secured creditor's interest in estate property only to the extent that the value of the underlying collateral is equal to, or greater than, the face amount of the indebtedness. If this is not the case, the creditor will hold a secured claim in the amount of the collateral value and an unsecured claim for the deficiency. Applicable nonbankruptcy law and any agreements between the debtor and its secured creditors (or among such creditors) generally determine the relative priority of secured claims. However, if certain requirements are met, the Bankruptcy Code provides for the creation of priming liens superior to pre-existing liens in connection with financing extended to a debtor during a bankruptcy case.

The priority treatment of certain types of unsecured claims is specified in section 507(a) of the Bankruptcy Code. Priorities are afforded to a wide variety of unsecured claims, including specified categories and (in some cases) amounts of domestic support obligations, administrative expenses, employee wages, and taxes.

In a chapter 7 case, the order of distribution of unencumbered bankruptcy estate assets is determined by section 726 of the Bankruptcy Code. This order ranges from payments on claims in the order of priority specified in section 507(a), which have the highest ranking, to payment of any residual assets to the debtor, which has the lowest. Distributions are to be made pro rata to claimants of equal ranking within each of the six categories of claims specified in section 726. If claimants in a higher category of distribution receive less than full payment of their claims, lower-category claimants are to receive no distributions.

In a chapter 11 case, the plan determines the treatment of secured and unsecured claims (as well as equity interests) in accordance with the provisions of the Bankruptcy Code. As noted, if a creditor does not consent to impairment of its claim under a plan and votes to reject the plan, the bankruptcy court may confirm the plan only under certain specified conditions. Among these conditions are the following: (i) the creditor must receive at least as much under the plan as it would receive in a chapter 7 case (section 1129(a)(7)), a requirement that incorporates the priority and distribution schemes delineated in sections 507(a) and 726; and (ii) the plan must be "fair and equitable" (i.e., the plan satisfies the absolute priority rule).

Class "Gifting" Under Chapter 11 Plans

A matter of considerable debate concerning section 1129(b)'s "fair and equitable" mandate is whether the provision allows a class of senior creditors voluntarily to "gift" a portion of its recovery under a chapter 11 plan to a junior class of creditors or equity holders, while an intermediate class does not receive payment in full. This is sometimes referred to as "vertical gifting" or "class skipping."

In approving senior-class gifting, some courts rely on the First Circuit's ruling in *Official Unsecured Creditors' Comm. v. Stern (In re SPM Manufacturing Corp.)*, 984 F.2d 1305 (1st Cir. 1993). In *SPM*, the First Circuit upheld the validity of a "sharing agreement" under which a substantially undersecured first-priority secured creditor in an administratively insolvent, converted chapter 7 case agreed to gift a portion of the proceeds of the sale of its collateral to general unsecured creditors even though priority tax claims were not paid. Reasoning that the lender was otherwise entitled to the entire amount of any proceeds of the sale of the debtor's assets, the court wrote that "[w]hile the debtor and the trustee are not allowed to pay nonpriority creditors ahead of priority creditors . . . , creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors."

Even though *SPM* was a chapter 7 case, some courts have cited the ruling as authority for confirming a nonconsensual chapter 11 plan in which a senior secured creditor assigns a portion of its recovery to creditors (or shareholders) who would otherwise receive nothing by operation of section 1129(b) and the Bankruptcy Code's priority scheme. *See, e.g.*, *In re MCorp. Financial, Inc.*, 160 B.R. 941 (S.D. Tex. 1993); *In re Journal Register Co.*, 407 B.R. 520 (Bankr. S.D.N.Y. 2009); *In re World Health Alternatives, Inc.*, 344 B.R. 291 (Bankr. D. Del. 2006); *In re Union Fin. Servs. Grp.*, 303 B.R. 390 (Bankr. E.D. Mo. 2003); *In re Genesis Health Ventures, Inc.*, 266 B.R. 591 (Bankr. D. Del. 2001).

Other courts have rejected *SPM* and the gifting doctrine as being contrary to both the Bankruptcy Code and notions of fairness. *See, e.g.*, *DISH Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79 (2d Cir. 2011) (ruling that a class-skipping gift made by an undersecured creditor to old equity under a plan violated the absolute priority rule, but declining to determine whether the creditor, after receiving a distribution under the plan, could in turn distribute a portion of that recovery to old equity "outside the plan").

In *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir. 2005), the Third Circuit affirmed an order denying confirmation of a chapter 11 plan under which equity holders would receive warrants waived by one class of unsecured creditors even though another class of unsecured creditors received less than full payment. According to the Third Circuit, if the distribution scheme proposed in the debtor's plan were permitted, it "would encourage parties to impermissibly sidestep the carefully crafted strictures of the Bankruptcy Code, and would undermine Congress's intention to give unsecured creditors bargaining power in this context." However, the Third Circuit did not categorically reject the gifting doctrine. Rather, as noted by the court in *World Health Alternatives*, 344 B.R. at 299, "*Armstrong* distinguished, but did not disapprove of," the gifting doctrine because it left open the possibility that gifts by a senior class under a plan might pass muster under other circumstances.

Settlements, Structured Dismissals, and *Jevic*

Most rulings construing the "fair and equitable" requirement in section 1129(b) involve proposals under a chapter 11 plan providing for the distribution of value to junior creditors without paying more senior creditors in full. Even so, the dictates of the absolute priority rule must be considered in other related contexts as well. For example, in *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452 (2d Cir. 2007), the Second Circuit ruled that the most important consideration in determining whether the court should approve a pre-chapter 11 plan settlement of disputed claims as being "fair and equitable" is whether the terms of the settlement comply with the Bankruptcy Code's distribution scheme. In remanding a proposed "gifting" settlement to the bankruptcy court for further factual findings, the Second Circuit reserved the question of whether the gifting doctrine "could ever apply to Chapter 11 settlements." The Second Circuit, however, rejected a per se rule invalidating the practice, such as that adopted by the Fifth Circuit in *United States v. AWECO, Inc. (In re AWECO, Inc.)*, 725 F.2d 293 (5th Cir. 1984).

Because of the significant time and costs associated with confirming a liquidating chapter 11 plan or converting the case to chapter 7 following the sale of substantially all of a debtor's assets under section 363(b) of the Bankruptcy Code, "structured dismissals" of chapter 11 cases have become a popular mechanism for concluding liquidating chapter 11 cases. A structured dismissal is conditioned upon certain elements agreed to in advance by stakeholders and then approved by the court, as distinguished from an unconditional dismissal of the chapter 11 case ordered by the court under section 1112(b). One such structured dismissal reached the U.S. Supreme Court on appeal from the *Jevic* bankruptcy case.

In *In re Jevic Holding Corp.*, 787 F.3d 173 (3d Cir. 2015), the Third Circuit ruled that "absent a showing that a structured dismissal has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion processes, a bankruptcy court has discretion to order such a disposition." The court also held that "bankruptcy courts may approve settlements that deviate from the priority scheme of [the Bankruptcy Code]," but only if the court has "specific and credible grounds" to justify the deviation. The Third Circuit affirmed approval of a structured dismissal of a chapter 11 case that incorporated a settlement under which unsecured creditors would receive a distribution from secured creditors' collateral, but certain holders of priority wage claims would receive nothing. According to the court, "dire circumstances" justified the remedy—the debtor had no prospect of confirming a plan, and conversion of the case to chapter 7 would mean that only secured creditors would recover anything.

The U.S. Supreme Court reversed in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017). By a vote of 6-2, the Court held that, without the consent of affected creditors, bankruptcy courts may not approve "structured dismissals" providing for distributions that "deviate from the basic priority rules that apply under the primary mechanisms the [Bankruptcy] Code establishes for final distributions of estate value in business bankruptcies."

The Court distinguished cases where courts have approved *interim* settlements that distributed estate assets in violation of the priority rules, such as *Iridium*, from *Jevic*, which involved *final* distributions pursuant to a structured dismissal. The Court found that *Iridium* "does not state or suggest that the Code authorizes nonconsensual departures from ordinary priority rules in the context of a dismissal—which is the final distribution of estate value—and in the absence of any further unresolved bankruptcy issues." In this sense, the Court explained, the situation in *Iridium* is similar to certain "first-day" orders, where courts have allowed for, among other things, payments ahead of secured and priority creditors to employees for prepetition wages or to "critical vendors" on account of their prepetition invoices. However, the Court noted that "in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve." By contrast, the Court explained, the structured dismissal in *Jevic* served no such objectives—it did not benefit disfavored creditors by preserving the debtor as a going concern in order for the debtor to possibly emerge under a confirmable plan of reorganization.

Nevertheless, the Court wrote, "We express no view about the legality of structured dismissals in general."

At least one court has invoked *Jevic* in refusing to approve a settlement involving distributions in violation of the Bankruptcy Code's priority scheme. *See In re Fryar*, 570 B.R. 602 (Bankr. E.D. Tenn. 2017). Until *Nuverra*, however, no court had addressed whether a gifting chapter 11 plan is categorically prohibited by the Supreme Court's ruling in *Jevic*.

Nuverra

Nuverra Environmental Solutions, Inc., and certain affiliates (collectively, "NES") filed a prepackaged chapter 11 case on May 1, 2017, in the District of Delaware with $500 million in secured debt and a value of approximately $300 million. NES's chapter 11 plan proposed a secured debt-for-equity swap as well as distributions to unsecured creditors consisting of: (i) a combination of new stock and cash to unsecured noteholders amounting to a 4 to 6 percent recovery; and (ii) reinstatement and payment in full of trade and certain other business-related unsecured claims (collectively, "trade claims"). Senior secured creditors agreed to fund all payments to unsecured creditors, which otherwise would receive nothing under the plan.

The unsecured noteholder class voted to reject the plan. An unsecured noteholder ("Hargreaves") objected to confirmation, arguing that: (i) the plan's proposed treatment of the dissenting unsecured noteholder class was not "fair and equitable," because the plan distributed less value to that class than to the trade claim class; and (ii) the plan's classification scheme was improper.

The bankruptcy court overruled the objection and confirmed the plan. The court determined that separate classification of the noteholder claims and the trade claims was reasonable, because trade creditors were critical to the success of reorganized NES. In addition, the court ruled that, although the disparate treatment of the classes gave rise to a rebuttable presumption of unfair discrimination, that presumption had been rebutted because the noteholder class was "indisputably out of the money and not, otherwise, entitled to any distribution under the [B]ankruptcy [C]ode's priority scheme[,] and . . . the proposed classification and treatment of the unsecured creditors fosters a reorganization of these debtors." The court also held that the plan satisfied the absolute priority rule, because the secured creditors' "gift" was not from estate property.

Hargreaves appealed the confirmation order to the district court. The bankruptcy court denied his request to stay the confirmation order beyond the 10-day period specified in the order, finding that he was unlikely to succeed on the merits and would not suffer irreparable harm absent a stay.

The District Court's Ruling

The district court affirmed. As an initial matter, the court ruled that the appeal was equitably moot. The judge-fashioned remedy of "equitable mootness" bars adjudication of an appeal when a comprehensive change of circumstances has occurred such that it would be inequitable for a reviewing court to address the merits of the appeal. In bankruptcy cases, appellees often invoke equitable mootness as a basis for precluding appellate review of an order confirming a chapter 11 plan. *See, e.g.*, *In re LCI Holding Company, Inc.*, 802 F.3d 547, 554 (3d Cir. 2015) (stating that the doctrine "comes into play in bankruptcy (so far as we know, its only playground) after a plan of reorganization is approved" and ruling that equitable mootness would not cut off the authority to hear an appeal outside the plan context).

In *Nuverra*, the district court concluded that NES had "substantially consummated" its chapter 11 plan and that the relief sought by Hargreaves—equal distributions to noteholders and trade creditors—would "require undoing the [p]lan" and necessarily result in harm to third parties. Specifically, the court noted, "disgorgement would require the clawback, not only of cash payments made to hundreds of individual creditors, but also the clawback of stock that is trading on the national stock exchange, and may now be held by third parties who purchased these securities in the ordinary course."

In addition, the district court addressed the merits of the appeal. It ruled that NES's chapter 11 plan did not unfairly discriminate between the trade creditor and noteholder classes and that the plan's classification scheme was permissible.

Considering the Markell test for unfair discrimination, the court noted that: (i) the Third Circuit has not mandated that the test be applied in determining whether a plan discriminates unfairly; and (ii) the test does not address a situation in which the disparately treated classes are to receive distributions provided solely by means of a senior-class gift.

Even so, the district court concluded that the bankruptcy court did not err in applying the test. Specifically, the district court found no fault in the bankruptcy court's holdings that: (i) the presumption of unfair discrimination had been rebutted because the noteholder class was not otherwise entitled to any distribution under the Bankruptcy Code's priority scheme; and (ii) the plan's treatment of the trade creditor class fostered NES's reorganization. Because Hargreaves and his class were not entitled to any distribution in the first place, the court wrote, "providing a greater distribution to a different class of unsecured creditors does not alter the distribution" to which the noteholder class was entitled.

In so ruling, the district court distinguished between vertical and horizontal gifting. It explained that gifting in a manner that skips over an intermediate junior class of dissenting creditors—vertical gifting—violates the absolute priority rule. By contrast, horizontal gifting "concerns unequal gifts by a secured creditor to two classes of junior creditors." Only the former, the district court emphasized, is foreclosed by Third Circuit precedent, whereas horizontal gifting was expressly sanctioned by the bankruptcy courts in *General Health Ventures* and *World Health Alternatives* and is not foreclosed by the Third Circuit's ruling in *Armstrong*.

According to the court, nearly all of the cases cited by Hargreaves involved vertical gifting, and the only decision finding horizontal gifting invalid—*In re Sentry Operating Co. of Texas*, 264 B.R. 850 (Bankr. S.D. Tex. 2001)—was both nonbinding and distinguishable. In *Sentry*, the *Nuverra* district court explained, the court held that a plan under which a secured creditor gifted funds to pay trade creditor claims, but provided only a *de minimis* distribution to other unsecured creditors, unfairly discriminated because of conflicts of interest—the debtors' competitor controlled the secured creditor, and the secured creditor's corporate parent conducted substantial business with the trade creditors.

Finally, the district court ruled that separate classification of the trade and noteholder claims in NES's chapter 11 plan was permissible, because there was a rational basis for the classification. The court noted that numerous courts permit the practice "on the grounds that such claims have different legal attributes" (citing *In re Coram Healthcare Corp.*, 315 B.R. 321 (Bankr. D. Del. 2004)). According to the district court, the evidentiary record supported the bankruptcy court's conclusion that separate classification: (i) fostered NES's reorganization; (ii) was not arbitrary or fraudulent; and (iii) was necessary to preserve what little trade credit NES still had, because NES's businesses typically operated in smaller towns with limited vendors and because failing to pay any vendor accordingly would likely tarnish NES's reputation and harm relationships with other current or potential vendors.

Outlook

Senior-class gifting is an important tool for building consensus on the terms of a confirmable chapter 11 plan. *Nuverra* indicates that horizontal gifting is still alive and well, at least under the facts involved, because it offends neither Third Circuit precedent nor the Supreme Court's prohibition of final distributions that violate the Bankruptcy Code's priority scheme. The harder question—i.e., the validity of vertical gifting or other distributions (interim or final) that run afoul of the Bankruptcy Code's priority scheme but serve a valid reorganizational purpose or another "Code-related objective"—remains for another day. Hargreaves appealed the district court's ruling on September 19, 2018. Thus, the Third Circuit may have yet another opportunity to weigh in on gifting chapter 11 plans.

Another key takeaway from *Nuverra* is the principle that separate classification and treatment of different groups of general unsecured creditors, even where separate classification of such creditors creates an accepting impaired class needed for cramdown confirmation, violates neither section 1122 nor 1129(b)(2) so long as the plan proponent can articulate a rational basis for separate classification and show that it promotes reorganization.

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Gerrymandering votes in bankruptcy? The classification of an undersecured claim

FEBRUARY 25, 2020

Confirmation of a Chapter 11 plan generally requires the consent of each impaired class of creditors. A debtor can "cramdown" a plan over creditor dissent, however, as long as at least one class of impaired claims accepts the plan. This can be difficult when a dissenting secured creditor's unsecured deficiency claim is large enough to act as a "blocking position." To prevent a dissenting secured creditor from vetoing acceptance by the unsecured creditors class, and thus confirmation, debtors routinely attempt to classify the dissenting secured creditor's unsecured deficiency claim separately from the class of general unsecured creditors. In these cases, secured creditors routinely oppose confirmation and argue that the debtor gerrymandered the acceptance of the unsecured class by separately classifying the deficiency claim in a class of its own. Depending on the circumstances, such objections enjoy a varying degree of success. Rather than following this pattern, Tara Retail Group attempted something else—it simply did not bifurcate the secured creditor's claim into secured and undersecured portions—instead it kept the entire claim in its own class. Can this work?

Background

In *Tara Retail Group, LLC*, the Debtor owned and operated The Crossings Mall—a multi-tenant commercial property. Public access to the property was originally limited to a single bridge that spanned over a creek. In June 2016, significant rainfall caused debris and water to accumulate at the bridge and the creek overflowed its banks and flooded bordering properties before washing away the bridge. After the flood, the Debtor's tenants were unable to operate, and rents eventually stopped. When the Debtor was unable to service its debt, its principal creditor and mortgagee Comm2013 filed a civil action against the Debtor and sought to appoint a receiver. This lawsuit precipitated the Debtor's bankruptcy filing.

to reorganize its financial affairs while the Comm2013 plan sought to liquidate the Debtor's property. Both plans gained acceptance by the voting creditors, but Comm2013 objected to the Debtor's plan arguing that the plan improperly classified its entire (under)secured claim as one class and thus separated its deficiency claim from the general unsecured class. Comm2013 argued that the Debtor's plan was therefore unconfirmable as a matter of bankruptcy law because it gerrymandered classes of unsecured claims to obtain at least one consenting, impaired class.

Discussion

Bankruptcy Code Section 506(a) provides that an undersecured creditor's claim is bifurcated into a secured claim in an amount equal to the value of the collateral and an unsecured deficiency claim for the balance of the debt. The deficiency claim is typically placed in the general unsecured class. However, because acceptance of a plan requires the affirmative vote of the holders of two-thirds of the dollar amount of claims, a dissenting creditor with a large enough claim may have a veto power preventing the unsecured class from accepting the plan. Without an accepting impaired class, there can be no cramdown and a plan cannot be confirmed.

In *Tara*, had the Debtor bifurcated Comm2013's undersecured claim and classified the deficiency claim with the other unsecured claims, Comm2013's rejection of the plan would have prevented confirmation.

Rather than separately classifying Comm2013's deficiency claim, the Debtor put Comm2013's claim in its entirety, both the secured and unsecured portions, in one class. Thus, although Comm2013 voted to reject the plan, the acceptance by the unsecured class was used to cramdown the plan on Comm2013.

The court rejected Comm2013's gerrymandering objection to the Debtor's plan. Since the Debtor did not propose to bifurcate the claim, the court did not see any issue preventing confirmation. While the court agreed with Comm2013 that Section 506(a) involves the determination of a creditor's secured interest, it found that it has no bearing on proposed plan treatment, classification, or confirmation. The court further held that there is no requirement in the Bankruptcy Code that a plan proponent treat an undersecured creditor in a bifurcated fashion.

Conclusion

While the Bankruptcy Code provides a debtor with some flexibility in classifying claims, it requires that substantially similar claims be treated alike. Courts generally ask whether a separately classified unsecured claim is substantially similar to other unsecured claims. If it is, the claim cannot be separately

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to gerrymander votes to gain acceptance of a plan have been generally unsuccessful. The court's opinion in *Tara* raises the question, however, whether a debtor can skip bifurcation and confine a dissenting undersecured creditor's claim to one class, containing both the secured and deficiency portions of its claim, to reach the same result. Comm2013 appealed the bankruptcy opinion. Secured creditors should follow further developments with interest.

Read the opinion >>

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Plan Proponents Beware of "Death Trap" Traps in Chapter 11 Plans and Disclosure Statements

By Katharina Earle on December 22, 2016

A topic that receives relatively little attention is the practice of plan proponents to include "death trap" provisions in chapter 11 plans. A death trap provision can provide for a distribution, or a larger distribution, to an impaired class in exchange for a favorable vote on the plan. Although such a provision can be an extremely useful tool in achieving confirmation of a Chapter 11 plan, courts are reluctant to approve such provisions if they deviate from a certain standard, forcing the parties back to the drawing board and causing them to incur significant costs and delays in connection with the plan confirmation process.

Pursuant to 11 U.S.C § 1129 of the Bankruptcy Code, a court may only confirm a plan if, among other things, each class of claims or interests (a) accepts the plan or (b) is not impaired under the plan. § 1129(a)(8). If the requirements of § 1129(a)(8) are not met, the plan may be "crammed down" on an impaired class that does not accept the plan, but only under the condition that the plan does not "discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." § 1129(b).

Cramdown hearings can be costly and time-consuming. In order to prevent a cramdown fight, a plan proponent may include in the plan a "death trap" provision that will incentivize an impaired class to vote for the plan by providing a distribution, or a larger distribution than it otherwise would receive. Courts tend to approve disclosure statements and plans that contain such provisions if certain criteria are met.

For example, in *In re Zenith Elecs. Corp.*, Judge Walrath overruled the objection of the equity committee with respect to the treatment of certain bondholders under the plan. 241 B.R. 92, 105 (Bankr. D. Del. 1999). The plan contained a provision that provided for bondholders to receive nothing if they voted against the plan, but for a pro rata distribution of $50 million of new 8.19% Senior Debentures if they voted for the plan. *Id*. The equity committee asserted that such a treatment was unfair because, under the valuation conducted in that case, if correct, bondholders would not receive anything. *Id*. In addition, the equity committee argued that the plan was unfair because it did not provide for a similar treatment of shareholders. *Id*. Judge Walrath disagreed holding that “[t]here is no prohibition in the Code against a Plan proponent offering different treatment to a class depending on whether it votes to accept or reject the Plan.” *Id*. (citing *In re Drexel Burnham Lambert Group, Inc*., 140 B.R. 347, 350 (Bankr. S.D.N.Y. 1992). The Court continued explaining that such a disparate treatment can be justified in that it can save the plan proponent the “expense and uncertainty of a cramdown fight” which, in turn, furthers the Bankruptcy Code’s overall policy of “fostering consensual plans of reorganization . . . .” *Id*.; *see also In re MPM Silicones, LLC*, No. 14-22503-RDD, 2014 WL 4637175 (Bankr. S.D.N.Y. Sept. 17, 2014) (explaining that “[s]uch fish-or-cut-bait, death-trap, or toggle provisions have long been customary in Chapter 11 plans . . . [they] offer a choice to avoid the expense and, more importantly, the uncertainty of a contested cramdown hearing.”).

Courts, however, tend to disapprove death trap provisions if they deviate from the standard articulated by *Zenith* and other courts. For example, in *In re Mcorp Fin., Inc*., the court rejected a “death trap” provision that not only implicated the treatment of one class under the plan, but also the treatment of other classes. 137 B.R. 219, 236 (Bankr. S.D. Tex. 1992). In that case, the plan provided for a possible distribution to all equity classes (Classes 15, 16, and 17) in the event Class 15 voted for the plan. *Id*. However, Class 15 voted against the plan. *Id*. The Court held that the inclusion of the provision resulted in the plan not being confirmable because it was unfair, not equitable, and resulted in unfair discrimination, especially because “Classes 16 and 17 not only lost any possible distributions, but also the right to vote effectively, since they could not know until after [class 15] had cast its vote (due on the same date as that of all other claimants) . . . what their own status was.” *Id*.

More recently, the issue arose during the disclosure statement hearing in the Molycorp bankruptcy. Molycorp, the United States’ only rare earth miner, filed for bankruptcy protection in 2015 and sought approval of its disclosure statement. The disclosure statement and the proposed plan contained broad releases of current and former directors and officers of Molycorp and also a “death trap” provision that provided as follows:

> If the Entire Company Sale Trigger does not occur, the [Accepting GUC Distribution, will] be shared Pro Rata among the Holders of General Unsecured Claims in Class 5A who do not opt out of the Third Party Releases, if (a) Class 5A votes to accept the Plan **and** (b) none of (1) the Creditors’ Committee or any of its members, (ii) the Ad Hoc Group of 10% Noteholders or any of its members or (iii) the 10% Notes Indenture Trustee objects to the Plan.

Calling the inclusion of the provision “unprecedented and impermissible,” the Creditors’ Committee argued that this issue is “not only a confirmation issue, [but also] a voting issue [that] must be addressed at the disclosure statement hearing.” The Creditors’ Committee asserted that the provision deviates from the standard set forth by *Zenith* and other courts because the provisions that have passed muster in those cases “have been conditioned solely on a class voting to reject, not on whether a fiduciary or a creditor in a different class filed an objection to a plan.” In addition, the Creditors’ Committee asserted that the provision “attempts to shield the D&O Releases from any objections.” The United States Trustee argued that “this plan is patently non-confirmable because the collective effect of the deathtrap and the third-party release provisions is to muzzle the creditors and the fiduciaries from exercising their rights, and it should not be approved.” The United States Trustee noted that “[t]here is no democratic process involved” and that “[n]othing could be more fundamentally unfair or inequitable than provisions like this, that tell the creditors, you better vote for the plan or you get nothing.” At the disclosure statement hearing in January 2016, Judge Sontchi agreed ruling that the “deathtrap based on the objection is unacceptable.” Calling the proposal “ridiculous,” Judge Sontchi said to Oaktree’s attorney “I’d rather you not give them anything than you squash the rights of fiduciaries . . . [y]ou are trying to shut the committee — you’re trying to put the committee in an impossible situation, where they have — if they object to — on a legitimate basis, [where] everybody has voted yes, they are robbing their constituency of a recovery.” With respect to the releases, the Court noted that they are a “confirmation issue” and that “they’re fine for disclosure statement purposes.”

While a “death trap” provision can be, and often is, an important and useful tool in preventing time consuming and expensive cramdown fights, practitioners should be cautious in proposing provisions that deviate from the standards articulated by *Zenith* and other courts. In particular, courts have shown hostility to death trap provisions that (1) condition the recovery of multiple classes upon the vote of one class and (2) that limit the proper exercise of fiduciary duties.

Plan v. Code Impairment

Keystone Gas Gathering, L.L.C. v. Ad Hoc Comm (In re Ultra Petroleum), 943 F.3d 758, 763 (5th Cir. 2019)

Debtor oil companies became solvent due the sudden increase in oil prices after filing. As a result, debtors were able to treat certain creditors unimpaired. At issue were postpetition interest and a makewhole premium that the creditors demanded in order to be considered unimpaired.

The bankruptcy court held that since the creditors were entitled to all they would receive under state law, the creditors were impaired under the plan—even if the plan was merely incorporating the Code's disallowance of postpetition interest and makewholes. The Fifth Circuit overruled, holding that the plan must impair—i.e., a creditor is not impaired if the impairment is merely the result of the plan incorporating Code provisions that limit the claim of the creditor.

Consensual Third Party Releases

In re Avianca Holdings Sociedad Anónima, 632 B.R. 124, 129 (Bankr. S.D.N.Y. 2021)

The debtor proposed a disclosure statement that included in its definition of "Releasing Parties" (1) unimpaired creditors that do not opt out and (2) creditors entitled to vote who do not opt out regardless of whether they vote to reject or do not vote at all. The United States Trustee objected, arguing that consent to the releases "should be demonstrated through an unequivocal opt-in procedure."

The court overruled the objection, noting that this is consistent with Supreme Court authority in the context of class action releases, and quoting Judge Chapman in *In re Cumulus Media Inc.*, No. 17-13381 (Bankr. S.D.N.Y. Feb. 1, 2018): "Inaction is action under appropriate circumstances. When someone is clearly and squarely told if you fail to act your rights will be affected, that person is then given information that puts them on notice that they need to do something or else. That's not a trap."

The court also held that the opt-out procedure was binding on creditors who abstained: "If a creditor with a right to vote is sent a ballot that clearly explains that the ballot must be returned and the opt-out box checked if the creditor elects not to approve the third-party release, the release is effective as to that creditor."

Plan Confirmation Tactics

Gifting and Gerrymandering: *In re Mallinckrodt PLC*, No. 20-12522 (JTD) (Bankr. D. Del. Feb. 3, 2022)

The debtors faced gifting and gerrymandering challenges.

Gifting

A class of guaranteed unsecured noteholders made a horizontal gift to a class of trade claims while leaving unpaid a class of general unsecured claims that was divided into several sub-classes. Claimants in one of the sub-classes argued that they suffered unfair discrimination because the gift resulted in the trade creditors receiving a 100% recovery with the other unsecured sub-class receiving far less.

The court dismissed this argument, noting that both classes "are only receiving more than the de minimis recovery to which they are entitled because another creditor group is allocating its recoveries to fund the distributions. Without the gift . . . [the intermediate class] gets next to nothing. The fact that [the trade claims class] gets a greater gift than [the intermediate class] does no harm to [the intermediate class] claimants."

The court explained that distributions to trade claims have no impact on distributions to other unsecured claims because unsecured creditors are entitled to nothing under the Code's priority scheme, and if the trade creditors did not receive the increased recovery, the surplus would simply revert to the secured creditors, not the other unsecured creditors.

Gerrymandering

Three creditors brought classification challenges. The court sided with the debtors, finding that all three were done in furtherance of legitimate business reasons.

Trade Creditors

The court held that it was reasonable to separate trade creditors—"those with whom Debtors have a go-forward business relationship and provide goods and services necessary for Debtors' continued operations"—from non-trade creditors with whom debtors do not wish to continue their relationship.

Encouraging Settlement

The court held that the debtors reasonably separated unsecured claims because they "are different in nature (ranging from funded debt to contingent litigation claims, environmental claims, and non-supporting trade claims), sit at different Debtors, and the holders of such claims are separately represented;" thus making it more difficult to provide each class with its own bargained-for settlement had they been classified together.

Debt Structuring Rights

The court held that the debtor permissibly separated unsecured notes with equal rights and priority because they have different legal entitlements: (1) one class of notes is guaranteed by an additional 60 other debtor entities, and (2) they have different structuring rights, leading to different pre-bankruptcy entitlements.

Gerrymandering: *In re Platinum Corral*, No. 21-00833-JNC (Bankr. E.D.N.C. Jan. 13, 2022)

The debtor in this case had separated the general unsecured claims of an insider—the CEO—from the rest of the general unsecured claims, primarily consisting of unpaid trade debt and lease rejection claims; the former to be satisfied with 100% equity interest in the reorganized debtor, and the latter to receive quarterly pro rata distributions for 60 months.

The court noted that it evaluates separation of similar claims—whether through the lens of manipulative gerrymandering, fair and equitable treatment, or unfair discrimination—under the same four-pronged standard:

(1) whether there is a reasonable basis for the proposed discrimination;
(2) whether the plan can be confirmed without the discrimination;
(3) whether the discrimination is proposed in good faith; and
(4) whether the discriminatory treatment results in a material prejudicial result to the class discriminated against.

In its analysis, the court also noted that "[s]eparate classification 'is permissible if the debtor can offer any reason which will withstand scrutiny.'"

In holding that the separation was permissible, the court noted that it was made in good faith and that the following were "ample business plan reasons to divide non-insider trade debt and insider note debt:"

- The trade and lease claims were incurred in the ordinary course of the debtor's operations, whereas the insider's claim arose from a long term note
- The trade and lease claimants had different expectations when deciding to engage with the debtor as compared to the separately classified insider
- If classified together, the insider claims would receive two dollars for every one received by the other allowed unsecured creditors
- The trade and lease claimants are ineligible to exchange debt for equity because the franchisor made it clear it would veto them as new members
- There is no indication that any non-insider claimant is actually interested in becoming an equity holder
- The insider claimant is primarily concerned with protecting new equity

Death Traps: *In re Affordable Auto Repair, Inc.*, No. 6:19-bk-18367-MW (Bankr. C.D. Cal. Sep. 2, 2020)

The plan provided for the treatment of individual claimants in a class of general unsecured claims as follows:

1. If they vote to accept, they are paid 8 percent of their claims over 36 months at 4 percent per annum interest

2. If they vote to reject, they are paid 4 percent of their claims with no interest, the payment to be made in one lump sum in the 48th month

3. If they abstain, they are treated the same as those who vote to accept, provided that the class as a whole accepts

The court did not decide whether the death trap was permissible because the issue was not ripe. But the court acknowledged that numerous cases have held death traps to be permissible because “there is a valid and legitimate business purpose for the disparate treatment.” The court noted, however, that those plans generally reward an entire class with better treatment upon plan acceptance than the entire class would if it rejects, and the plan at issue treated accepting creditors more favorably than dissenting creditors, even if the entire class votes to reject.

The court also hinted that, although not ripe for decision, it may have the power to designate votes of the accepting creditors under such a plan if it is found that the debtor proposed the death trap provisions in bad faith: i.e., the debtor created “a structure intended and designed to facilitate vote-buying through impermissible coercion rising to the level of bad faith on the Debtor's part.”

Faculty

Kathryn A. Coleman is a partner in Hughes Hubbard & Reed LLP's New York office, co-chairs the firm's Corporate Reorganization & Bankruptcy practice and sits on the firm's Executive Committee. She has handled a wide range of chapter 11 representations and other high-stakes insolvency-related matters in her more than 30 years in practice, including dealing with "bet-the-company" litigation claims such as trade secret and RICO cases, nationwide DOJ investigations, chapter 11 restructurings for U.S. and non-U.S. companies, cross-border insolvency matters, out-of-court restructurings, acquisitions and investments. Her clients include chapter 11 debtors, special committees of boards of directors, DIP lenders, equity sponsors, traditional and nontraditional secured lenders, unsecured creditors (both official committees and significant creditors for their own account), and financial and strategic buyers. Ms. Coleman is experienced in advising management and boards of directors on corporate governance, fiduciary duty and D&O insurance matters. She has advised clients on, and litigated at the trial and appellate levels, the significant legal issues inherent in modern restructuring and financial practice, including contested plan confirmations, prepackaged plans, credit bidding, exclusivity, debtor-in-possession financings, valuation, adequate protection of security interests, the ability to collaterally attack orders of the bankruptcy court and cash collateral usage. She also has experience litigating venue, remand, removal and stay issues, and has represented recovery trustees dealing with myriad post-confirmation issues and litigation. Ms. Coleman is a Fellow of the American College of Bankruptcy, and she serves on ABI's Board of Directors and co-chairs its annual Complex Financial Restructuring Program. She frequently speaks on bankruptcy law and distressed investing, participating in programs sponsored by the Practising Law Institute, ABI, the Turnaround Management Association, the ARA, The M&A Advisor, the New York City Bar Association, the California Continuing Education of the Bar and the American Bar Association. She also serves on the Steering Committee of the NYC Bankruptcy Assistance Project and has twice been named to *Lawdragon*'s list of 500 Leading U.S. Bankruptcy & Restructuring Lawyers. Ms. Coleman was named a 2018 Bankruptcy MVP by *Law360* and one of the 100 Most Influential Women in Business by the *San Francisco Business Times*. She is ranked by *Chambers USA* as a leading restructuring lawyer and was designated a leading lawyer in bankruptcy in *The Best Lawyers in America*, and her expertise in cross-border insolvency was noted in the *IFLR 500* and in PLC's *Cross-Border Restructuring and Insolvency Handbook*. Ms. Coleman graduated *magna cum laude* from Pomona College and received her J.D. from Boalt Hall School of Law (U.C. Berkeley), subsequently clerking for Hon. C. Martin Pence, U.S. District Judge for the District of Hawaii.

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Hon. Christopher S. Sontchi is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, initially appointed in 2006, and he recently completed a term as the court's Chief Judge. He was recently appointed as an International Judge of the Singapore International Commercial Court, effective upon his upcoming retirement. Judge Sontchi is a frequent speaker in the U.S. and abroad on issues relating to corporate reorganizations, and he is a Lecturer in Law at The University of Chicago Law School. In addition, he has taught corporate bankruptcy to international judges through the auspices of the World Bank and INSOL International. Judge Sontchi is a member of the International Insolvency Institute, Judicial Insolvency Network, National Conference of Bankruptcy Judges, ABI and INSOL International. He was recently appointed to the International Advisory Council of the Singapore Global Restructuring Initiative and the Founders' Committee of The University of Chicago Law School's Center on Law and Finance. Judge Sontchi has testified before Congress on the safe harbors for financial contracts, and has published articles on creditors' committees, valuation, asset sales and safe harbors. Prior to his appointment, he was in private practice, representing a wide variety of nationally based enterprises with diverse interests in most of the larger chapter 11 reorganization proceedings filed in Delaware. Judge Sontchi served on the ABI Commission to Study the Reform of Chapter 11's Financial Contracts, Derivatives and Safe Harbors Committee and testified on safe harbors for financial contracts before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law of the House Committee on the Judiciary. Following law school, Judge Sontchi clerked for Hon. Joseph T. Walsh in the Delaware Supreme Court. He received his B.A. Phi Beta Kappa with distinction in political science from the University of North Carolina at Chapel Hill and his J.D. from the University of Chicago Law School.