LJN LAW JOURNAL NEWSLETTERS

The Bankruptcy Strategist®

An ALM Publication

Volume 35, Number 7 • May 2018

Ninth Circuit Ruling Eases Plan Acceptance Requirement In Multi-Debtor Plans of Reorganization

By Adam H. Friedman, Jonathan T. Koevary and Lauren B. Irby

In a case of first impression at the circuit level, the United States Court of Appeals for the Ninth Circuit held that section 1129(a)(10) of the Bankruptcy Code — which requires a favorable vote of at least one impaired class of creditors in order to confirm a Chapter 11 plan — applies on a "per-plan" basis, rather than a "per-debtor" basis. *See*, *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props. Inc., et al.* (*In re Transwest Resort Props. Inc.*), No. 16-16221, 2018 WL 615431 (9th Cir. Jan. 25, 2018) (http://bit.ly/2J3XX9f).

Bankruptcy Code section 1129(a) sets forth the legal requirements that must be met before a court may confirm a Chapter 11 plan of reorganization. Among them are the creditor acceptance requirements necessary for plan confirmation. A Chapter 11 plan must divide creditors into classes of similarly situated creditors — generally according to the priority level of their claims. 11 U.S.C. §1122. Impaired creditors vote on a Chapter 11 plan together with other members of their class. A class of creditors is deemed to accept when at least two thirds by number of creditors and over one half by dollar amount votes in favor of the plan. 11 U.S.C. §1126. Bankruptcy Code section 1129(a)(8) suggests that all creditor classes must vote to accept in order to confirm a Chapter 11 plan. However, if certain additional statutory requirements are met, a "cramdown" plan may be confirmed under section 1129(a)(10), provided that at least one class of impaired creditors has voted to accept the plan.

It is commonplace for a single Chapter 11 plan to cover multiple affiliated debtor entities. Section 1129(a), however, is silent as to this practice and as to whether its requirements apply on a per-debtor or per-plan basis. For example, if a plan has two debtors — a parent and a subsidiary — each with three voting classes, have the voting requirements been met *as to the parent debtor* where only one (or even all) of the *subsidiary's classes* voted to accept the plan and none of the parents' creditors did? Under the Ninth Circuit's ruling, the answer is "yes." As discussed herein, the Ninth Circuit's holding runs counter to commonly understood practice within other circuits, invites gerrymandering and raises corporate separateness and substantive consolidation concerns.

Transwest Facts and Ninth Circuit Analysis

The *Transwest* case began in 2010 when five related entities (the Debtors) filed for Chapter 11 bankruptcy. Prior to filing, the Debtors had acquired various resort properties, financed by: 1) a $209 million mortgage loan (the Operating Loan) to the three operating debtors (the Operating Debtors) from JPMCC 2007-C1 Grasslawn Lodging, LLC (the Lender); and 2) a $21.5 million loan (the Mezzanine Loan) from Ashford Hospitality Finance, LP (the Mezzanine Lender), secured by the interests of the two subsidiary debtors (the Mezzanine Debtors) in the Operating Debtors. The Lender filed a claim for $298 million, based on the Operating Loan, and the Mezzanine Lender filed a $39 million claim based on the Mezzanine Loan. Subsequently, the Lender then acquired the Mez-

Adam H. Friedman is a member of this newsletter's Board of Editors and a partner in the Bankruptcy & Financial Restructuring Practice Group of Olshan Frome Wolosky LLP in New York. **Jonathan T. Koevary** is Counsel at the firm and **Lauren B. Irby** is an associate. They may be reached at AFriedman@olshanlaw.com, jkoevary@olshanlaw.com and lirby@olshanlaw.com, respectively.

zanine Lender's claim.

The bankruptcy court confirmed a Chapter 11 plan, whereby a third-party investor would acquire the Operating Debtors and erase the Mezzanine Debtors' interests. The plan provided no recovery to the Mezzanine Loan claims if they rejected the plan, and holders of all such claims voted to reject the plan. The Lender, having acquired the Mezzanine Lender's claim, objected to the Debtors' Chapter 11 plan, arguing that no creditor class of the Mezzanine Debtors voted to accept the plan. Classes 2-6, consisting of both secured and unsecured claims against certain of the Operating Debtors, voted in favor of the plan. Overruling the objection, the court confirmed the plan as to all Debtors.

On appeal, the district court affirmed the bankruptcy court's determination that Bankruptcy Code section1129(a)(10) applies on a per-plan, not a per-debtor, basis. The Ninth Circuit affirmed, pointing to the plain language of section 1129(a)(10), which states that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan …. " The statute does not, the court reasoned, make a distinction concerning creditors of different debtors under the plan, and had Congress intended to require approval from an impaired class for each debtor, it would have explicitly stated so.

Before *Transwest* and Other Precedent

Bankruptcy courts in various districts have grappled with the lack of clarity surrounding the appropriate interpretation of section 1129(a)(10). The leading case adopting the per-debtor approach is *In re Tribune*, 464 B.R. 126 (Bankr. D. Del. 2011). In that case, two competing plans sought to reorganize over 100 jointly administered debtors without substantive consolidation. Absent substantive consolidation, the *Tribune* court concluded that the joint plan "actually consists of a separate plan for each Debtor," and each such plan must separately satisfy the confirmation requirements of section 1129(a). 464 B.R. at 182. Other cases also adopted the per-plan approach. *See*, *e.g.*, *In re SGPA Inc.*, No. 1-01-02609, 2001 Bankr. LEXIS 2291 (Bankr. M.D. Pa. Sept. 28, 2001); *In re Enron Corp.*, No. 01-16034, 2004 Bankr. LEXIS 2549 (Bankr. S.D.N.Y. July 15, 2004); *JPMorgan Chase Bank v. Charter Commc'ns* (*In re Charter Commc'ns*), 419 B.R. 221 (Bankr. S.D.N.Y. 2009).

The Ninth Circuit declined to follow. Instead it relied upon Bankruptcy Code section 102(7), a rule of statutory construction, which provides that "the singular includes the plural." The per-debtor courts have interpreted section 102(7) to mean that "the fact that §1129(a)(10) refers to "plan" in the singular is not a basis, alone, upon which to conclude that … only one debtor … must satisfy this standard." *In re Tribune Co.*, 464 B.R. 126, 182 (Bankr. D. Del.), on reconsideration, 464 B.R. 208 (Bankr. D. Del. 2011). However, the Ninth Circuit instead maintained that "[s]ection 102(7) effectively amends section 1129(a)(10) to read: 'at least one class of claims that is impaired under the plans has accepted the plans.'" The Ninth Circuit concluded that the per-plan approach is still consistent with such a reading.

Analysis and Concerns

A Procedural Rule of Convenience Encroaches Upon on a Statutory Right

Any affiliated debtor seeking bankruptcy relief must file its own bankruptcy petition. At the outset of a case involving multiple affiliated debtors, pursuant to Federal Rule of Bankruptcy Procedure 1015, courts will typically allow "joint administration" of affiliated cases for procedural purposes. It is under the joint administration regime that parties file plans concerning multiple debtors.

Joint administration is a rule of procedural convenience and efficiency that does not purport to remove any of the corporate formalities of the underlying entities. Rule 1015(c) provides that once a joint administration order has been entered, the court "while protecting the rights of the parties under the [Bankruptcy] Code, may enter orders as may tend to avoid unnecessary costs and delay." The Advisory Committee Notes to Rule 1015 offer several passages as to why joint administration is *not* consolidation of the debtors, and also note that section (c) is an adaptation of Rule 42(a) of the Federal Rules of Civil Procedure, which allows for consolidation of actions or matters at issue where actions involve a common question of law or fact.

That consolidation does not alter substantive rights is bolstered by the March 2018 U.S. Supreme Court decision concerning Rule 42(a) in *Hall v. Hall*, 584 U.S. ___ (2018) (holding that the right to appeal arises when a final decision is reached in an individual case, notwithstanding its consolidation with others under Rule 42(a), even where the other cases are not fully adjudicated). As stated by the Court: "[f]rom the outset, we under-

stood consolidation not as completely merging the constituent cases into one, but instead as enabling more efficient case management while preserving the distinct identities of the cases and the rights of the separate parties in them." (Slip Op. at 7).

Not discussed by the Ninth Circuit is that the Bankruptcy Code itself does not contemplate joint administration. The Bankruptcy Rules (which are inferior to the statutes of the Bankruptcy Code) allow for joint administration subject to "*protecting the rights of the parties under the Code*." Fed. R. Bankr. P. 1015(c). The Ninth Circuit's statutory construction concerning the "single means the plural" construct *does not take into account that the Bankruptcy Code did not contemplate plan confirmation of multiple debtors in the first instance and that joint administration is a judicial creature of convenience*. In other words, Congress granted creditors of *each debtor* a statutory right: no plan would be confirmed unless at least one impaired consenting class accepted. Under the per-plan approach, the administrative convenience of joint administration has in fact pierced creditors' rights "under the Code."

Permitted Plan Engineering: Gerrymandering on Steroids

Gerrymandering of classes to ensure an impaired accepting class is a frequent concern in Chapter 11 cases. While the general rule is that creditors with similar types of claims are grouped together, objecting parties often accuse plan proponents of separating similar claims or grouping dissimilar ones for the sole purpose of generating an impaired accepting class. Likewise, plan proponents who may have the resources to leave a class of creditors unimpaired are often accused of artificially impairing that class to create the impaired accepting class necessary for confirmation.

The per-plan approach exponentially increases the opportunity for gerrymandering. For example, a debtor who anticipates difficulty in obtaining the votes to confirm its plan might cause its affiliate to file for bankruptcy — even where there is no need for its bankruptcy protection — because it is confident that its affiliate would provide an impaired accepting class and therefore file a joint plan and satisfy the per-plan standard. More creativity could certainly be imagined.

Substantive Consolidation under The "Per-Plan" Approach

A related concern is that *Transwest* opens the door for substantive consolidation of separate entities — or at least a removal of corporate separateness. Lenders and trade creditors provide credit to entities based on separateness, understanding of the capital structure and who may have leverage within that structure. They do so in reliance on legal opinions concerning separateness and where a company has a single affiliate or hundreds of them. Indeed, commercial real estate lending (both securitized and non-securitized lending) requires the use of special purpose entities. The entire structure of such lending is premised on the assumed recognition of corporate separateness and, assuming such separateness, no substantive consolidation. Law firms are routinely asked to provide "non-consolidation" legal opinions in support of such financings.

By allowing a creditor of one affiliate to vote on the future of another affiliate, the per-plan approach undermines the corporate separateness upon which lenders — and legal opinion writers — rely. The *Transwest* plan itself essentially substantively consolidated the different debtors by combining the assets. However, the Ninth Circuit left open the door for that issue to be argued another day.

Implications for Bankruptcy and Transactional Attorneys

Transwest raises new concerns for attorney caution. The Lender in *Transwest* apparently failed to raise (in the bankruptcy court) the objection that the Plan was, in effect, a substantive consolidation, and instead focused on the per-plan vs. per-debtor argument. Accordingly, the Ninth Circuit declined to address this issue on appeal.

Thus, lawyers in similar cases are well advised to challenge multi-debtor plans seeking cram down on a "per plan" basis using alternative theories, including de-facto substantive consolidation objections. Lawyers giving non-consolidation opinions may also need to consider taking *Transwest* into account.

Finally, *Transwest* demonstrates the importance of preserving objections at the lower court level, as the case may have come out quite differently if the Ninth Circuit found itself obligated to address the substantive consolidation questions raised on appeal.

—❖—