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Confirming a Plan

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Editors' Note: *The ultimate objective of a chapter 11 case is confirmation of a plan. The plan is the document that sets forth the terms of the reorganization. It is the "contract" that rewrites the relationship between the debtor and its creditors and shareholders (and often other parties). The plan process can be very complicated. Here, we try to simplify it somewhat by providing a short outline of what you need to do to get a plan confirmed.*

Chapter 11 plans come in all shapes and sizes:

- There are pre-packaged plans, pre-arranged plans and "regular" plans;
- There are plans of reorganization and plans of liquidation;
- There are consensual plans and non-consensual plans;
- There are plans that effect a particular transaction, like a sale or a merger; and
- There are plans proposed by a debtor, a committee or another party.

When drafting a plan, it makes sense to start with one or more precedent plans (why re-invent the wheel?). Ideally, the precedent you use will have some things in common with your plan. It is also very helpful to have an outline or term sheet of some sort that delineates the key business points to be included in the plan. Without this, trying to draft a plan is akin to trying to hit a shadow: A plan merely memorializes the deal. The client (with our input) needs to decide how it wishes to group creditors and equity owners and how much (and how) it wants to pay them. Our job is to try to effectuate the client's goals and to advise the client if any of its goals are unlikely to be achievable. Here is a short lesson on how to confirm a plan under chapter 11.

First, look at Bankruptcy Code §1121 to see whether your client can propose a plan. Part of this will depend on whether the "exclusive period" has expired. Debtors have the exclusive right to propose a plan for the first 120 days of the case (or longer, if extended—and the period often is extended). After exclusivity expires, the door is open to other parties who may want to propose a plan.

Then turn to Code §1122. This deals with classification of claims and interests. It says you can only classify claims together if they are "substantially similar." It doesn't say what "substantially similar" means, and it doesn't say whether you can classify claims that are "substantially similar" in separate classes—which is often helpful in trying to achieve the required votes—so that's all left to the case law (of which there's a lot). Section 1122 also permits what are referred to as "convenience classes"—something like "all unsecured creditors whose claims are less than $5,000, or who agree to reduce their claims to $5,000, get paid in full."

The next section, 1123, deals with what can go in a plan. The first part, subsection (a), outlines what a plan must contain. Always use this section as a checklist to make sure you have done everything you are required to do. Subsection (b) lists provisions that a plan *may* contain.

Code §1124 defines what constitutes "impairment" of a class of claims or interests. This is important because "impaired" classes get to vote on the plan. A basic oversimplification is this: If the plan alters the rights you would otherwise have, you are impaired.

Code §1125 deals with requirements for a disclosure statement. The Code provides that we cannot solicit acceptances of our plan until we have provided the creditor with a "disclosure statement" sufficient to enable him to cast a rational vote. Think "securities prospectus." No, try *not* to think "securities prospectus." The drafters pretty clearly intended that the disclosure statement be something more informal than a full-fledged S-1. Indeed, §1125(e) provides a "safe harbor" from the registration and solicitation provisions of the securities laws, as well as the anti-fraud provisions, for the proponents of plans providing for the issuance, purchase or sale of securities if the proponents complied with the requirements of the Code, including §1125, and solicited acceptances of the plan in good faith. In order to get to the confirmation hearing, you need to have your disclosure statement approved by the court. Parties are permitted to object to the disclosure statement, and the court will conduct a hearing on its adequacy. Often the objections do not really go to disclosure, but are instead disguised (sometimes very thinly disguised) objections to the plan itself. The practical result is that the hearing on the disclosure statement can become kind of a preview of the plan confirmation battle.

Code §1126 deals with who has accepted and who has rejected a plan. More about that below.

Code §1127 deals with modification of a plan. The important rules here are (1) you can't modify a plan so that it fails to comply with the requirements for a confirmable plan and (2) if you modify a plan in a material way after creditors have voted, then you are likely to have to re-solicit—that is, tell the creditors about the change and give them a chance to change their vote, if they want to do so.

Code §1128 says the court will hold a hearing to consider confirmation of the plan, and that parties can object to confirmation if they want to do so. That takes us to the heart of the matter—§1129—the Code section that sets the criteria for confirmation.

Start with the "general" requirements of §1129—those that apply to the plan itself, as opposed to the acceptance of the plan by, and treatment of, particular classes of creditors. Those general requirements are found in subsections 1129(a)(1) through (a)(6), and

(a)(11) through (a)(13). Some of these are specific requirements, such as the requirement that the plan proponent disclose the identity of and compensation to be paid to any insider who will be retained by the reorganized debtor. Some are more general, such as the requirement that the plan be proposed "in good faith"—a judgment call for the court.

One of these requirements that deserves special note is the "feasibility" test of §1129(a)(11). The proponent must show that the plan is not likely to be followed by a liquidation or further reorganization of the reorganized debtor.

Then turn to the sections that deal with the treatment of classes of creditors. With respect to each class of creditors and interest-holders, the proponent should ask: Can I meet the confirmation requirements? If the answer is "no," go back to the drawing board. If your answer is "yes" with respect to all classes, then you are pretty much done. With respect to any particular class, how do you get to "yes?" There are three ways.

- *Leave the class "unimpaired."* If the class is unimpaired, it is deemed to accept the plan, and for most purposes, you don't have to worry about them any more.
- *Get their votes.* If you get the right number of votes, you can confirm with respect to a class. More important, you can impose the plan on dissenters within a class. Indeed, this rule is the linchpin of chapter 11—something vital that you can do under the Code that you cannot do outside bankruptcy. There is only one important catch; we'll explain it later.
- *Cram them down.* Finally, even if the class is impaired, and even though you don't have the votes, you may still be able to confirm—to impose the plan on the dissenting class over its objection. You do it under the "fair and equitable" rule of §1129(b), more commonly (if less elegantly) known as the "cramdown." We consider each of these in turn.

Leaving the Class Unimpaired

Code §1129(a)(8)(B) provides that we need not obtain the acceptance of an unimpaired class (and §1126 instructs us that we need not even solicit the votes of creditors in an unimpaired class, as such creditors are conclusively presumed to accept the plan).

Getting the Votes

If the claims (or interests) in a class are impaired, then the debtor needs to rely on §1129(a)(8)(A) and solicit votes of the class members. You can confirm with respect to a voting class if you get the votes of:

- a majority in number and
- two-thirds in amount.

Note that these numbers are *of those voting* (not "of all creditors").

So, if there are 200 creditors in a class and only 10 cast ballots, you have a majority in number if you have six votes. Also, if claims total $1 million and only claims aggregating $100,000 return ballots, then you have two-thirds in amount if you get the votes of claims aggregating $67,000. *See* Code §1126.

Once you have the votes, you can impose the plan on dissenters in the class. There is only one important exception to this important rule: A dissenting creditor (even one in a consenting class) may defeat confirmation if he can show that he would receive less under the plan than in a chapter 7 liquidation. This is the "Best Interest" test of Code §1129(a)(7), sometimes also known as the "liquidation test." Most courts will insist that you provide a "liquidation analysis" in the disclosure statement, accompanying your plan, to show whether the plan passes the liquidation test.

For example, suppose we have a class of claims aggregating $100,000 that would get $20,000 in a liquidation. We propose to pay them $10,000 next year and $10,000 more the following year. Can we confirm with respect to this class? Probably not. Money now is worth more than money later. If the relevant interest rate is anything greater than zero, then two (deferred) payments of $10,000 do not have a (present) value of $20,000, and the creditor class is getting less than it would get in a chapter 7.

Cramming Down

Even if a class is impaired, and even if you don't have the votes, you still may be able to cram down under §1129(b). Suppose the debtor owes $1 million to the creditor under a contract providing for payment in annual installments over 10 years, with interest at 10 percent (the payment pencils out at about $162,000 a year). The debt is secured by Blackacre, which, luckily, is worth $1 million—exactly the same amount as the debt.

The creditor has made it clear that he favors no resolution except payment in full immediately. Your client certainly can't do that; indeed, he can't even meet the installments.

But he could pay a lower installment. You fire up the spreadsheet and determine that if you strung the loan out from 10 to 20 years at the same rate of interest, then the payment would fall to around $127,000. Your client figures he could pay $127,000.

Can you impose this deal under the cramdown rule? Let's say it's a close call. The rule provides that we can impose the plan if the creditor gets a payment stream with a present value equal to the amount of its secured claim. Indeed, we are proposing to give him a payment stream with a value equal to his claim—*if* 10 percent is the right interest rate.

The creditor will say that a 20-year loan is riskier than a 10-year loan and so he has a right to a higher interest rate. But if the interest rate is higher than 10 percent, a stream of 20 payments of $127,000 has a present value that is less than $1 million. So we may be heading for a fight over the question of what the right interest rate is.

In *Till v. SCS Credit Corp.,* 124 S. Ct. 1951 (2004), the Supreme Court very recently adopted the "formula approach" for determining the appropriate interest rate to be used to determine the present value of a stream of payments. Under this approach, the national prime rate is used as a starting point and is increased based on the risk of default in the particular case. The Court rejected the "coerced loan," "presumptive contract rate" and "cost of funds" approaches for determining an interest rate.

While *Till v. SCS Credit Corp.* involved payments to a secured creditor under a chapter 13 plan, the Court suggests that the same approach should be used in chapter 11 wherever the Code requires a plan to provide a secured, priority or unsecured creditor with payments having "a value, as of the effective date of the plan, equal to" the allowed amount of its claim (or, for purposes of satisfying the best-interests test, the amount the creditor would have received under chapter 7).

If we change the hypothetical, and the collateral value is *less* than the amount of the debt, then the plan will treat the claim as two claims—one secured and one unsecured. For example, if the creditor has a debt of $50 million secured by collateral with a value of $35 million, then, pursuant to §506(a), it has a $35 million secured claim and a $15 million unsecured deficiency claim. Its claim is "bifurcated" into those two parts. Let's say the $50 million debt carried a 13 percent interest rate and was scheduled to mature six months after the bankruptcy petition was filed. The plan can cram down the secured claim by giving the creditor a stream of payments with a present value of $35 million, just as the creditor in the prior hypothetical was entitled to a stream of payments with a present value of $1 million. As a result, this secured creditor may find himself with a new note that has a smaller principal balance than his original note,

an extended maturity and perhaps a lower interest rate, as well.

If the plan proponent seeks to cram down a class of unsecured creditors (or a secured lender with a deficiency claim—as in the example above—since the deficiency claim is treated as an unsecured claims), then no junior class can receive *anything* on account of its pre-bankruptcy claim unless the plan provides that each holder in the class "receive or retain an account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim." Again, this implicates *Till v. SCS*.

This last limit is important: It means that the equity class will ordinarily not support a cramdown plan unless the plan pays the whole of the cramdown debt; if it fails to do so, equity (a junior class) cannot receive anything.

There is yet one more limit on the cramdown plan: If we propose to impose the plan on a dissenting class of claims, then we must show that at least one impaired class of claims has voted to accept the plan. *See* Code §1129(a)(10). Think of this as the "somebody-has-to-like-it" rule. ■

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