DRAFTING DISCLOSURE STATEMENTS AND CHAPTER 11 PLANS

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I. An overview of the plan process

A. The construction of a plan of reorganization is more of an art than a science. Because there are relatively few absolute rules with respect to what a plan of reorganization must include, there is an opportunity for creativity and ingenuity in crafting a plan that will appeal to creditors while at the same time maximizing the reorganized debtor's ability to survive and prosper.

· A recent example of the effect of a well-drafted plan can be found in the Eleventh Circuit's decision in *IRT Partners, L.P. v. Winn-Dixie Stores, Inc.*, 639 F.3d 1053 (11th Cir. 2011), where a plan providing for distributions to creditors on account of their claims was found to prohibit, under principles of res judicata, the post-confirmation amendment of a proof of claim.

B. There are two fundamentally different types of plan

· a reorganization of the debtor as a going concern, and

· a liquidation of the debtor, often through a going concern sale

C. The Going Concern Reorganization - identifying the problems:

· Which claims (or, more accurately, which classes of claims) should or must be restructured?

· Is the debtor "solvent" on a going concern basis? On a liquidation basis? If the debtor is solvent under both tests, it is likely (if creditors are paying attention) that all creditors will have to be given an option to be paid in full.

· Are the debtor's secured creditors over-secured or undersecured?

· What cash will be available to fund payments to creditors under the plan.

D. The "solvency" and "available cash" analysis will determine the size of the "pie" to be divided among creditors and will also establish the time period to be covered by the plan.

· The division of this pie depends upon the nature and character of creditors' claims.

· For this reason, the debtor must identify claims that must be separately classified.

· Because secured creditors have different (and generally greater) rights than do holders of unsecured claims or holders of equity interests, and because each secured creditor has different collateral and rights than other secured creditors, it is customary, and may be required, to separately classify each secured claim.

- In contrast, because similarly situated unsecured creditors must be treated equally, general unsecured creditors are generally classified together or in a relatively small number of classes, each of which will probably contain more than one creditor.

- In addition to identifying secured claims, the debtor should identify and quantify the claims of creditors entitled to priority in payment.

E. Because each secured claim is normally separately classified, a debtor with many secured claims will inevitably have a plan containing a number of classes each of which contains only one secured creditor. Among the options of dealing with secured creditors are the following:

- If the pre-bankruptcy terms (interest, maturity, amortization, etc.) are favorable, the best approach may be to leave those terms in place by simply curing defaults (if any) and reinstating the loan, utilizing the non-impairment provisions of 11 U.S.C.A. §1124;

- If the collateral held by the secured creditor is not productive or useful to the debtor, the debtor can sell the property (if there is equity) under 11 U.S.C.A. §363(m) or abandon it (if there is no equity) under 11 U.S.C.A. §554(a);

- The debtor can keep the collateral and restructure the payment terms, modifying the timing and amount of payments of principal or interest and, if the creditor is undersecured, reducing the amount of the secured debt and treating the shortfall (deficiency) as a general unsecured claim.

F. Treatment of unsecured claims offers a virtually infinite variety of plan provisions. Among the more customary provisions are those that would reduce the amount of the claims (historically referred to as a "composition") or that would extend the maturity on claims (an "extension").

- Frequently, these two concepts are combined, and it is not unusual to see plans offering a percentage of the claim payable over an extended period of time (for example, 50% of the amount of the claim, payable over five years in equal annual installments).

G. Because a consensual plan requires that all impaired classes accept the plan, and because both (a) one-half in number of creditors voting in each class and (b) two-thirds in the amount of claims voting vote to accept the plan, the debtor may give creditors in the same class an option to select one of two (or presumably more) treatments.

- A plan might offer either to pay creditors who so elect 50 cents on the dollar in cash or, alternatively, to pay 100 cents on the dollar over a five-year term.

- Under this option-type plan, creditors who are willing to discount for cash and

creditors who are willing to run the risk of future defaults if the reward is payment in full may both accept the plan.

- Another alternative, particularly in larger cases with publicly traded securities, would be to transfer some or all of the common stock in the debtor to unsecured creditors, or to create preferred stock or warrants which could be so transferred.

- In cases with no market for equity securities, the same concept of permitting creditors to participate in future profits can be achieved by combining some minimum return with contingent "earn-out" payments which would depend on future operating results of the debtor.

- Yet another alternative is the "pot plan." Under this plan, the debtor places a fixed amount (either in cash or in payments over time) in an escrow account for the benefit of all creditors in one class. The amount which each creditor will receive under the plan will depend upon the total amount of allowed claims in the class. This alternative is particularly attractive where the total amount of claims cannot be determined prior to confirmation and where there are large disputed contingent or unliquidated claims that would dramatically affect the feasibility of a composition or extension plan.

- A variation on these themes is the creation of a post-confirmation trust that is vested with causes of action (such as preference claims) that can be pursued for the benefit of creditors to supplement any cash or notes.

H. With these general alternatives in mind, the debtor should calculate the total amount that will be available to pay creditors. It should then deduct from the total available funds the amount necessary to pay secured creditors the allowed amount of their secured claims.[1]

- If this process results in a negative number, leaving nothing to pay priority and general unsecured claims, then the plan would not appear to be capable of confirmation because it would not be feasible under §1129(a)(9).

- This is both good news and bad news for the debtor. The good news is that the creditor expectations should be low, enabling the debtor to negotiate substantial discounts. The bad news is that, absent some event, the business will close.

- There are several things that a debtor can do in this event, including approaching the secured creditors to accept a discount, trying to determine whether abandonment of certain items of collateral to the secured creditors would put this equation back into balance, or approaching existing owners or new equity investors to infuse money to fund distributions to priority and unsecured creditors.

- If there is money left over after allocations for allowed secured claims, priority

[1] The allowed amount of a secured creditor's claim will be the lesser of the total amount owed on the claim or the value of the collateral. 11 U.S.C., §506(b).

creditors are entitled to be paid in full before unsecured creditors receive anything.

· All priority creditors are permitted to voluntarily modify their claims and to accept less than they would otherwise be entitled to. As a general rule, however, absent waiver, administrative claims are entitled to be paid in full and in cash. Tax claims are entitled to be paid in full, but may be stretched out over a period of time if interest is paid. Other priority claims are entitled to be paid in cash unless the class consisting of such claims accepts a different treatment.

· After making allowance for priority claims, the balance that is left is available for general unsecured creditors and equity holders.

· The size of this remaining distributable amount will determine the debtor's proposal to unsecured creditors. In any circumstances, the payments to unsecured creditors must be something more than those creditors would receive in a liquidation. 11 U.S.C. §1129(a)(7).

· Ideally, the debtor should leave some cushion for contingencies after it makes the payments to unsecured creditors, even if the debtor utilizes conservative cash flow projections. The debtor's proposal should result in a post-confirmation balance sheet reflecting that the value of its assets, under proper accounting principles, is more than the amount of debt to be repaid under the plan. A debtor emerging from Chapter 11 with a highly leveraged balance sheet reflecting near insolvency, and with cash flow projections that leave no margin for error, will have difficulty surviving.

· At the same time, if the cushion is too large, or if there is too much equity on the debtor's projected balance sheet, unsecured creditors are likely to want some share of that "upside." It is against this backdrop that the plan of reorganization is proposed and negotiated with creditors.

I. In addition to determining the size of the pie and how it is to be distributed between the three basic creditor groups (secured, priority, and unsecured creditors), the debtor must make numerous other decisions at the time it proposes a plan.

· What executory contracts and unexpired leases does it desire to assume or reject?

· Are there disputed claims (either against the debtor or owned by the debtor) that must be (or prudently should be) resolved prior to confirmation?

· What assets should be abandoned?

· What protection, in the form of releases or indemnities, should be afforded to third parties?

· In the case of an individual Chapter 11 debtor, are there non-dischargeable debts?

J. There is then the question of whether the plan can be a “stand alone” plan. Under this type of plan, also sometimes referred to as a “boot strap” plan or an “internally-funded” plan, the debtor's assets and future revenues form the basis for payment of amounts to creditors. This type of plan is probably the most common type of plan, particularly in the case of smaller debtors. Funding can also be provided by a new equity contribution, which may be necessary to provide “new value” for cramdown purposes in the event the plan is not accepted by all classes of unsecured creditors. Finally, there is the possibility of a liquidating plan, under which the plan is to be executed by a sale of the debtor's going concern, or even as the result of an orderly liquidation of its assets.

II. Mandatory plan provisions

A. Section 1123(a)of the Bankruptcy Code sets forth the provisions that a plan of reorganization must contain. Most of these mandatory provisions relate to classification of claims. The provisions relating to classification of claims require that, notwithstanding any otherwise applicable non-bankruptcy law, a plan must:

(i) designate classes of claims and interests, other than claims of a kind specified in §§507(a)(1), (2), or (8) of the Bankruptcy Code;

(ii) specify any class of claims or interests that is not impaired under the plan;

(iii) specify the treatment of any class of claims or interests that is impaired under the plan; and

(iv) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.

B. In addition to the foregoing, a plan must “provide adequate means” for the plan's implementation. Non-exclusive examples of such “adequate means” include:

(i) retention by the debtor of all or any part of the property of the estate;

(ii) transfer of all or any part of the property of the estate to one or more other entities, including entities to be organized after confirmation of the plan;

(iii) merger or consolidation of the debtor with one or more other persons;

(iv) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of property of the estate to creditors in kind;

(v) satisfaction or modification of any lien;

(vi) cancellation or modification of any indenture or similar instrument;

(vii) curing or waiving of any default;

(viii) extension of a maturity date or a change in an interest rate or other term of any outstanding security;

(ix) amendment of a corporate debtor's charter; and

(x) issuance of securities of the debtor in exchange for the claims of creditors, the interests of equity holders, cash, property, or any other appropriate consideration.

C. It is clear that this list of potential means of execution is extremely broad, and these provisions are designed to give the debtor flexibility in structuring a plan of reorganization that fits the facts and circumstances of the case. All that the statute requires is that the plan must have an appropriate process for its implementation and execution. The specific manner in which this is accomplished, however, is not mandatory and is left to the debtor, other parties in interest, and the Bankruptcy Court to achieve.

D. The other mandatory provisions are of relatively little significance. In the case of a corporate debtor, the charter must be amended to prohibit the issuance of non-voting equity securities. In addition, the plan cannot provide for the selection of any officer, director, or trustee called for under the plan unless such election is consistent with the interests of creditors and equity security holders and with public policy.

III. Definitional provisions

A. Plans of reorganization are frequently drafted with a series of defined terms, often segregated in one part of the plan. Complex plans in large cases may have dozens of such definitional terms. Some of the key definitional terms that a debtor may want to consider inserting in the plan are discussed below.

B. The Effective Date. Section 1129(a) of the Bankruptcy Code often uses the phrase the "effective date of the plan" to signify the date of certain events. Consequently, the plan should contain a provision establishing an effective date.

1. Determining an effective date involves several considerations. The first involves the legal issue whether or not the plan can become effective if the order confirming the plan is challenged on appeal. That issue will be discussed below.

2. The second issue is whether there are post-confirmation conditions to the effectiveness of the plan. Although conditions precedent and subsequent are discussed below, it is important to note that there is the possibility of a "Catch-22" with respect to a plan. The plan may depend upon a new equity investor infusing cash into the plan to pay the claims of creditors. The new investor may be unwilling to do so until the confirmation order has become final and until other conditions have been complied with. These conditions may be the performance of ministerial acts (that is, the delivery of new stock certificates) or substantive acts (that is, government regulatory approval, completion of a due diligence investigation, or the proposed

investors obtaining its own source of funds). The more numerous and substantive that these conditions are, the more difficult it will be to obtain confirmation of the plan due to feasibility concerns. At the same time, however, parties must recognize that occasionally things go wrong under even the most "iron clad" contract, and there is the possibility that the transaction may fail to close.

3. One way to solve this problem is to place an effective date that follows both the entry of the confirmation order and the expected closing date of the new equity infusion. Provided that the effective date is not too far from the date of the confirmation order, most courts would have little difficulty in approving such a term. Even in the absence of such a contingency, the debtor should choose an effective date that gives the debtor ample time to do anything necessary to assure that the plan may be consummated.

C. Final or Non-Final Order. If confirmation of a plan of reorganization is contested by third parties who may appeal from the order confirming the plan, it is important to consider the potential effect of such an appeal. In making this decision, the debtor should recognize that there is a significant body of case law regarding dismissal of appeals from Bankruptcy Court orders confirming a plan of reorganization if the plan of reorganization has been implemented, as constitutionally or equitably moot.[2] If the plan is drafted, however, to require that a final and nonappealable order be in existence before a plan can become effective, the debtor may in essence be providing third parties with a stay pending appeal by agreeing that it will not implement the plan until the appeal is resolved. Since many appeals last years, this type of provision can be extremely dangerous. Furthermore, this type of provision may "sneak into" the plan definition simply because many lawyers are used to defining orders in that way.

1. For purposes of the reorganization plan, the debtor should not automatically make the plan contingent upon entry of a final and non-appealable confirmation order. If the plan is contingent upon entry of an order that has not been stayed within a certain time period (the standard time seems to be ten days) after entry of the order, the debtor may simply want to implement the plan and then argue that any appeal is moot. Under those circumstances, any party appealing from an unstayed confirmation order will run the risk that the appeal will be futile.[3]

2. There are circumstances in which the debtor may not be willing to proceed to confirmation in the face of an appeal of the confirmation order. In those circumstances, the debtor should, in addition to requiring the confirmation order to be a final order, insert a

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[2] *In re Wooley v. Faulkner (In re SI Restructuring), Inc.,*, 542 F.3d 131 (5th Cir. 2008); *In re Manges*, 29 F.3d 1034, 1040 (5th Cir. 1994) (dismissing appeal of confirmation order as moot); *In re UNR Industries, Inc.*, 20 F.3d 766 (7th Cir. 1994); *In re Club Associates*, 956 F.2d 1065, 1071 (11th Cir. 1992) (dismissing appeal from order confirming debtor's plan of reorganization); *In re Holywell Corp.*, 901 F.2d 931 (11th Cir. 1990) (confirmation of plan mooted a dispute over amount of secured claim); *Miami Center Ltd. Partnership v. Bank of New York*, 838 F.2d 1547, 1553 (11th Cir. 1988).

[3] Courts have held that a "party who appeals without seeking to avail himself of that protection (from a stay pending appeal) does so at his own risk." *In re Chateaugay Corp.*, 988 F.2d (2d Cir. 1993).

provision in the plan that permits it to waive the requirement of a final order.

D. Allowed, Disputed and Contingent Claims and Proofs of Claim are deemed allowed unless and until an objection to the claim is filed. With the filing of the objection, however, the claim becomes a disputed claim and is no longer automatically deemed to be allowed. In that framework, for example, the holder of the disputed claim is not entitled to vote on the plan of reorganization unless permitted to do so by the court on motion and after a hearing.[4] Notwithstanding the filing of an objection, however, it seems clear that the claim of the disputed creditor is entitled to some degree of protection until the court has resolved the objection. For example, available assets should not be distributed to holders of allowed claims without making sure that holders of disputed claims will be paid the same share if their claims are ultimately allowed by the Bankruptcy Court.

1. This situation changes, however, if the Bankruptcy Court sustains the objection and disallows the claim. At that point, the disputed "creditor" has been judicially determined to be no creditor at all. Accordingly, it has no vested interest in the case and would be entitled to no distributions. What happens, however, if the creditor appeals from the Bankruptcy Court order sustaining the objection and disallowing the claim? It is submitted that the appealing creditor has the same burden to seek and obtain a stay pending appeal as would any other party challenging a court order. If this were not the case, absent an extremely solvent debtor, one creditor asserting a contingent and unliquidated claim for massive amounts could halt the entire distribution process of the case even though its claim had been disallowed.[5]

2. It is not unusual in plan drafting for language to appear that refers to claims which have been "allowed or disallowed by final court order." The debtor, particularly in the case where there are disputed claims, should carefully consider whether this provision is in its best interests and the best interests of the rest of its creditors.

IV. Classification of claims

A. As set forth above, the classification of claims is mandatory.

B. Section 1123 of the Bankruptcy Code excepts the following priority claims from classification:

(i) claims entitled to administrative priority under §507(a)(1) of the Bankruptcy Code;

(ii) "gap" claims which were incurred by the debtor after the filing of an involuntary petition; and

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[4] Bankr. R. 3018.

[5] *In re Bicoastal Corp*., 146 B.R. 492, 494-495, (Bankr. M.D. Fla. 1992). In that case, the court refused to require the debtor to escrow or set aside funds for disputed claimants whose claims had been disallowed by Bankruptcy Court order.

(iii) priority tax claims.

The reason behind this exception for classification of these claims is to make it clear that each creditor holding a claim within that group is entitled to the treatment provided under the Bankruptcy Code unless that individual holder elects otherwise.

C. Administrative and gap creditors are entitled to be paid in full and in cash on the effective date of the plan.[6] Similarly, priority tax claimants are entitled to be paid in full, although the claim may be paid over an extended period of time together with interest.[7] Each holder of an administrative, gap, or priority tax claim is entitled to that treatment, regardless of what other holders of similarly situated claims may elect to do unless it itself elects to accept alternative treatment. In other words, a dissenting administrative creditor cannot be bound to accept less than its full payment simply because a majority of other administrative creditors are willing to do so. Consequently, the plan should contain a general provision dealing with the payment of these non-classified claims, but it should not create classes for holders of administrative, gap, or tax claims.

D. Except for the creditors described above, all claims must be placed in classes. These classes may consist of priority claims, secured claims, or general unsecured claims. In addition, equity interests may be classified. As noted above, each secured claim is generally separately classified.[8] With respect to general unsecured claims and equity interests, those claims and interests must be classified with other claims and interests that are substantially similar to them. The Bankruptcy Code itself recognizes that small unsecured claims may be separately classified to promote administrative convenience.[9] An example of an administrative convenience class might be the holders of claims for less than $100 under a plan calling for a distribution of 10 percent per year for five years. Under this scenario, small creditors would be receiving five annual checks of 2, which is probably a fraction of the cost to the debtor to calculate, record, supervise, and mail the payments. Accordingly, the debtor is authorized by Congress to treat such small creditors differently, although it needs to be able to demonstrate that such treatment is "reasonable and necessary" for administrative convenience.

E. Except for the administrative convenience class, there is no statutory recognition of any other appropriate separate classification of general unsecured creditors. The case law on what classification is appropriate becomes somewhat murky, and it is difficult to determine in

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[6] 11 U.S.C., §1129(a)(9)(A).

[7] 11 U.S.C., §1129(a)(9)(C). The fact that the tax claim is secured will not affect this payment requirement. Taxing entities must be treated not less favorably than the most favored general unsecured claim.

[8] *FGH Realty Credit Corp. v. Newark Airport/Hotel Ltd. Partnership*, 155 B.R. 93, 99 (D.N.J. 1993) ("Holding that 'each secured claim is generally not substantially similar to other secured claims'").

[9] 11 U.S.C., §1122(b).

advance what classification may meet court approval.[10] In separately classifying unsecured claims, debtors have frequently looked at the following types of claims as being dissimilar from other unsecured claims and thus subject to separate classification:

(a) the claims of prepetition trade creditors;[11]

(b) the claims of prepetition trade creditors who have also granted trade credit to the debtor since the Chapter 11 case was filed;

(c) trade creditors who make commitments to advance trade credit post-confirmation;

(d) deficiency claims of secured creditors;

(e) insider claims;[12]

(f) claims of entities holding a third party guaranty;

(g) claims held by labor unions pursuant to collective bargaining agreements;[13]

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[10] *See, generally*, Blair, "Classification of Unsecured Claims in Chapter 11 Reorganizations," 58 Am. Bankr. L.J. 197 (1984). The uncertain status of the law has been further confused by the separate classification of the deficiency claim of a secured creditor in single-asset real estate cases. See Krause, "The Bias of the Courts Against Single-Asset Real Estate Cases is Creating Bad Law in the Area of Classification," 22 Calif. Bankr. J. 47 (1994). In *In re Barakat*, 99 F.3rd 1520 (9th Cir. 1996), the court held that a secured creditor's deficiency claim could not be placed in a separate class from other unsecured creditors, that a tenant's claim for a security deposit could be separately classified, and that future trade creditors could not be separately classified when other parties would readily extend post-confirmation credit. The first ruling in *Barakat* was distinguished by the court in *In re Indian Nat. Finals Rodeo, Inc*, 453 B.R. 387 (Bankr. D Montana 2011), where the court found that contributions by a class of unsecured creditors justified separate classification of those claims from the secured creditor's deficiency claim.

[11] *Brinkley v. Chase Manhattan Mortgage & Realty Trust (In re LeBlanc),* 622 F.2d 872 (5th Cir.1980) (decided under the Bankruptcy Act) (separately classifying trade creditor claims from insider debt).

[12] *In re Foxridge L.P.,* 238 B.R. 810 (Bankr.W.D.Mo.1999) (permitting classification of two limited partners separately from other limited partners where the two separately classified partners had been engaged in a battle for control of the debtor). *See also Brinkley v. Chase Manhattan Mortgage & Realty Trust (In re LeBlanc),* 622 F.2d 872 (5th Cir.1980).

[13] *In re U.S. Truck Co., Inc.*, 800 F.2d 581 (6th Cir. 1986); *FGH Realty Credit Corp. v. Newark Airport/Hotel Ltd.,* 155 B.R. 93 (D.N.J.1993) (permitting separate classification of rejection claims of union employees where union had a non-creditor interest arising from its members' employment).

(h) holders of disputed claims;

(i) claims of parties, such as tenants, holding security deposits;[14]

(j) claims covered by insurance;

(k) claims of a competitor;[15] and

(l) claims of taxing authorities with liens on the debtors property;[16]

(m) specific types of tort claims or all tort claims generally.

There may be arguably some justification for separately classifying each group of creditors described above. For example, if the compromise of a dispute is to be accomplished by separately treating the disputed claimant and incorporating the terms of the compromise in the plan, it makes enormous sense to separately classify that disputed creditor. If, on the other hand, the dispute is simply over the amount of the claim, and the creditor will receive the same treatment as other creditors once its claim is allowed in the compromised amount, there is probably no need for separate classification.[17]

As a practical matter, the debtor must remember that every additional class that is created without the support of all creditor classes increases the likelihood that the plan will be non-consensual in nature and will require a "cramdown" proceeding. Because each and every class of

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[14] *In re Lafayette Hotel P'ship,* 227 B.R. 445 (S.D.N.Y.1998), aff'd 198 F.3d 234 (2nd Cir.1999) (permitting separate classification of tenant's unsecured claim where tenant had non-creditor interest in keeping its lease).

[15] *In re Premiere Network Svcs., Inc.,* 333 B.R. 130 (Bankr.N.D.Tex.2005) (permitting separate classification of unsecured claim of direct competitor of the debtor who would benefit if the reorganization failed).

[16] *In re New Midland Plaza Assoc.,* 247 B.R. 877 (Bankr.S.D.Fla.2000) (permitting separate classification where city, as a taxing authority, had a direct interest in the profitability of the debtor and an interest in preserving the property for the benefit of citizens). *See also In re HRC Joint Venture,* 187 B.R. 202 (Bankr. S.D.Ohio 1995) (permitting separate classification of city's claim where city had an interest in maintaining the debtor's hotel property for the benefit of its citizens); *In re Way Apts., D.T.,* 201 B.R. 444 (N.D.Tex.1996) (permitting separate classification where Department of Housing and Urban Development had a public interest under the National Housing Act).

[17] The Fifth Circuit has stated that substantially similar claims or those sharing common rights against the estate must be placed in the same class. *In re Greystone III Joint Venture,* 995 F.2d 1274, 1278 (5th Cir.1991), *cert. denied* 506 U.S. 821, 113 S.Ct. 72, 121 L.Ed.2d 37 (1992). Such claims may not be classified separately solely to gerrymander a favorable vote on a plan of reorganization. *Id.* at 1279. However, separate classification is permitted if there are "good business reasons." *In re Briscoe Enters., Ltd. II,* 994 F.2d 1160, 1167 (5th Cir.1993).

creditors must accept the plan for that plan to be entirely consensual,[18] the debtor runs the real risk that it will end up with most of its friendly creditors in various accepting classes, while isolating its unfriendly creditors in other classes. Under the "absolute priority" rule, this means that the plan must pay all creditors in full or provide that equity interests retain nothing. Although the debtor may, by utilizing the "new value" exception described hereafter, nonetheless confirm the plan, it is asking for expensive and prolonged litigation by creating too many classes. Consequently, it is frequently much better to create one large creditor class with the expectation that the friendly creditors will outvote any unfriendly creditors. Furthermore, in addition to other cramdown issues, the separate classification of unsecured claims will give rise to litigation over whether the plan "unfairly discriminates" between various classes of unsecured creditors.

In summary, the classification of claims will depend upon a careful analysis of the facts and circumstances of each case. What is clear is that "more" is not necessarily "better" when it comes to the number of classes of claims.[19]

V. Treatment of claims

A. Non-Impaired Claims.

1. Section 1124 of the Bankruptcy Code permits the debtor to treat claims as unimpaired, while curing any defaults. The non-impairment provisions are most frequently used with respect to secured claims. In the case of an oversecured creditor holding a claim that is not matured, the treatment of the claim as not impaired may be the easiest and safest way to avoid paying default interest to the oversecured creditor.[20]

2. In addition, it is possible that the prepetition interest rate and amortization terms negotiated by the debtor are superior to the interest rate that could be forced upon the creditor under §1129(b).

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[18] 11 U.S.C., §1129(a)(8).

[19] The one possible exception, from the debtor's standpoint, is that a large number of separate classes increases the likelihood that at least one class will accept the plan, since the debtor cannot propose a cramdown unless at least one impaired class has accepted the plan. 11 U.S.C. §1129(a)(10). Consequently, debtors with no readily apparent accepting class have been accused of "gerrymandering" the classification to obtain one accepting creditor. See, e.g., *In re Holywell Corp*., 913 F.2d 873, 880 (11th Cir. 1990) ("If the plan unfairly creates too many or too few classes, if the classifications are designed to manipulate class voting, or if the classification scheme violates basic priority rights, the plan cannot be confirmed"). This problem, however, is generally confined to single-asset cases where the secured creditor's deficiency claim dwarfs all of the other unsecured claims, creating no prospect for a cram down plan. In the normal commercial case, there will be so many different secured creditors that obtaining acceptance of one impaired class should not be difficult.

[20] *Great Western Bank & Trust v. Entz-White Lumber & Supply, Inc.* (*In re Entz-White Lumber and Supply, Inc.),* 850 F.2d 1338 (9th Cir. 1988). Oversecured creditors may be entitled to interest at the contract rate, including default interest, under §506(b). *But see In re Sweet*, 369 B.R. 644 (Bankr. D.Col. 2007).

3. In the case of smaller secured claims, such as an automobile loan payment which has remained current during the Chapter 11 case, it may simply be easier to leave the claim unimpaired.

4. It is unusual to treat unsecured creditors as not impaired, at least unless there is the prospect for payment in full of all creditors' claims. Creditors holding claims arising under executory contracts will instead be treated under §365 of the Bankruptcy Code.

B. Impaired Secured Claims.

1. The first step to treating the claim of a secured creditor is to determine the amount of the secured creditor's claim. Section 506(b) of the Bankruptcy Code gives the secured creditor an allowed secured claim in the lesser of (a) the amount owed to it or (b) the value of its collateral. In other words, if the creditor is owed more than the value of its collateral, its claim will be bifurcated into a secured component and an unsecured component. Consequently, such a creditor will have claims in two separate classes. The value of the collateral is to be determined (a) in light of the purpose of the valuation and of the proposed disposition or use thereof and (b) in conjunction with any hearing on such disposition or use or on a plan affecting the secured claim. If there is a dispute with a secured creditor over the value of its collateral, that dispute should be resolved, if possible, prior to the confirmation hearing.

2. Once the value of its claim has been determined, the secured creditor, as well as the debtor, operates under the knowledge that the secured creditor must receive money or property having a present value equal to the amount of such allowed secured claim (unless, of course, the secured creditor consents to lesser different treatment). At the same time, the secured creditor is not entitled to receive money or property having a present value in excess of the allowed amount of its claim, since that would prejudice junior classes. If walking this tightrope were not difficult enough, §1111(b) of the Bankruptcy Code permits an undersecured creditor to elect to be treated as a fully secured creditor in the Chapter 11 case.[21] In general terms, §1111(b) was designed to prevent the debtor from obtaining an artificially low valuation of a non-recourse creditor's collateral, reducing the amount of that secured creditor's claim, and then "flipping" the property and realizing this equity for itself. The electing creditor, however, loses its deficiency claim and is required to accept below-market interest rates, thus protecting junior creditors from any overpayment of the secured creditor. Implicit in this philosophy is the assumption that the debt would have to be paid off if the property is sold by the reorganized debtor. Otherwise, the debtor could simply "sell" the below-market financing to which it is entitled to a prospective buyer which would assume the debt. It is probably better practice to draft the plan without reference to the potential §1111(b) election by a secured creditor and to then amend the plan if

[21] It is fairly rare for a secured creditor to make an election under §1111(b)(2), and there is not an abundance of case law with respect to such an election. *See, generally*, *Pusateri, Swartz and Shaiken,* "Section 1111(b) of the Bankruptcy Code: How Much Does the Debtor Have to Pay and When Should the Creditor Elect," 58 Am. Bankr. L.J. 129 (1984).

the creditor actually makes the election. Creditors must make the §1111(b)(2) election prior to the conclusion of the disclosure statement hearing, unless the court fixes a different time.[22]

3. Assuming no election under §1111(b)(2), the debtor may modify both the amount and frequency of the payments due to secured creditors and the non-monetary provisions of the loan. The debtor, for example, can provide for the cure of defaults, for the modification of interest rates, for an extension of the maturity date, for modified periodic payments (indeed, even providing for negative amortization), and for relief from covenants and other provisions in the loan documents. In addition, the debtor can propose to surrender the property to the secured creditor or to sell the property either alone or in conjunction with other property of the debtor.

4. If there is litigation with a secured creditor with respect to confirmation of a plan, that litigation will probably extend far beyond the issues, the most significant of which is the appropriate interest rate, related to cramdown alone. Normally, a secured creditor challenging confirmation will litigate over feasibility and other issues equally available to unsecured creditors. In addition, a large secured creditor is the entity most likely to attempt to file a competing plan.

C. Priority Claims.

1. The method of payment of administrative claims, gap claims, and priority tax claims is established by statute. As previously noted, administrative and gap claims are entitled to be paid in full. Holders of priority tax claims are also entitled to be paid in full. If the debtor elects to pay the priority amounts over time, the debtor must pay post-confirmation interest.

2. Of significance to principals of a corporate debtor which is liable for payroll taxes to the Internal Revenue Service, several cases have permitted the debtor to allocate the payments made to the Internal Revenue Service under a plan of reorganization to the trust fund portion of the unpaid taxes.[23] This may be true even when the plan is a liquidating plan.[24] It is the position of the IRS, outside of Chapter 11, that it has the right to allocate these payments as it chooses.

D. Impaired Unsecured Claims.

1. The section of the plan which specifies the treatment of unsecured claims may be short and straightforward in many cases. All that is absolutely required is that the payment terms be described in sufficient detail to create an enforceable contract if approved by the court.

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[22] Fed. R. Bankr. P. 3014.

[23] *U.S. v. Energy Resources Co., Inc.*, 495 U.S. 545, 110 S. Ct. 2139, 109 L. Ed. 2d 580 (1990). *In re Poydras Manor, Inc.,* 242 B.R. 603, 608 (Bankr.E.D.La.2000).

[24] *In re Deer Park, Inc.*, 10 F.3d 1478 (9th Cir. 1993).

2. If the funding of the distribution to creditors is to be provided by a sale or liquidation of the debtor's assets,[25] the plan will probably provide for the proceeds of sale to be paid first to secured and priority creditors, with the balance to be distributed pro rata to unsecured creditors.[26] The primary provisions in such a plan, discussed in more detail below, will relate to the appropriate procedures to collect the funds, calculate the amounts to be distributed, and handle the funds.

E. The two key questions facing the debtor in drafting a plan for unsecured creditors are:

1. Can the plan, if it is accepted by the requisite majority of each class of unsecured claims, be confirmed over the objection of any dissenting creditor?

2. Can the plan be confirmed ("crammed down") notwithstanding the non-acceptance of the plan by one or more classes of unsecured creditors?

The first question requires close attention to the provisions of §1129(a) of the Bankruptcy Code, and particularly §1129(a)(7)(A), the so-called "best interests of creditors" provision, and §1129(a)(11), the "feasibility" provision. The second question requires close attention to the cramdown provisions of 11 U.S.C.A. §1129(b)(2)(B).

The "best interest" test applies unless each impaired unsecured creditor (not each class of such creditors) has accepted the plan. In the absence of such unanimous acceptance, which is rare, §1129(a)(7)(A) requires that each unsecured creditor "receive or retain under the plan ... not less than the amount that such holder would so receive or retain if the debtor were liquidated under Chapter 7." Consequently, the liquidation value (not, however, the going concern value) of the debtor's assets normally sets the floor to what must be proposed to be distributed to creditors.

The feasibility requirement prevents the confirmation of "visionary schemes."[27] By inserting this provision in the Bankruptcy Code, Congress intended to prevent the debtor from offering more than it could deliver to creditors in order to induce them to accept the plan of reorganization. Consequently, in the same way that the "best interest" sets the floor on what must be paid to creditors, the feasibility test limits the debtor's payments to those that are reasonably achievable and thus operates to establish a ceiling on the payments. Although it is easy to promise to pay claims in full, it is much more difficult to generate the revenues to do so. The

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[25] As discussed hereafter, some courts have held that a sale of substantially all the assets of the debtor can be approved only in the context of a plan of reorganization. Although cases decided under Chapter XI of the Bankruptcy Act of 1898 held that a liquidation plan was not favored, *In re Pure Penn Petroleum Co.,* 188 F.2d 851 (2d Cir. 1951), there is no question that such a sale or liquidation can now be accomplished through a plan of reorganization. 11 U.S.C. §1123(a)(5)(D).

[26] An allowed secured claim must be paid from the proceeds of collateral securing the claim before there is any payment to unsecured creditors. E.g., *In re Darnell*, 834 F.2d 1263, 1265 (6th Cir. 1987).

[27] *Matter of Pizza of Hawaii, Inc.*, 761 F.2d 1374 (9th Cir. 1985).

cramdown provisions of §1129(b)(2)(B) permits the Bankruptcy Court to confirm a plan if it provides either (a) that each holder of an unsecured claim receive or retain property having a value equal to the allowed amount of the claim or (b) that no junior class will receive or retain any property on account of such junior claim or interest. This provision places a premium, of course, on obtaining consent from the requisite majority of claims voting in classes of unsecured creditors. If the class does not accept the plan, the debtor must either pay creditors in full, give up control of the company by transferring equity to the creditors, or contribute new value in the form of money or property to the debtor. New value in the form of "sweat equity" was rejected by the United States Supreme Court.[28]

These general provisions establish the parameters for the debtor's treatment of unsecured creditors. Some of the specific types of plans for unsecured creditors are further discussed below.

F. The Extension.

1. The simple extension plan is one which pays the claims of unsecured creditors in full over a period of time. This type of plan recognizes that, if the debtor is significantly solvent, it may be difficult to obtain acceptance of any composition plan which reduces the amount of claims. Furthermore, even if such a plan were to be accepted by creditors, any dissenting creditor might be able to challenge confirmation under the "best interest" test described above. The extension plan does impair creditors to the extent that their claims would otherwise be payable in full. If a liquidation in Chapter 7 would pay all creditors in full and in cash, then the payments to creditors under an extension plan would have to include a component for interest on the deferred payments. Such a provision would also be necessary to achieve cramdown should the unsecured creditors not accept the extension plan under §1129(b)(2)(B)(i).

G. The Composition.

1. The simple composition plan is one which satisfies the claims of unsecured creditors for a cash discount which is calculable at the time of confirmation. An example of a composition plan is one that would pay, on the effective date of the plan, 20 percent of the allowed amount of each unsecured claim.

The composition plan must yield more to unsecured creditors than they would receive in a Chapter 7 liquidation. Because a true composition plan involves the payment of cash to unsecured creditors, the source of the cash must be readily apparent at the time of confirmation, and the Bankruptcy Court may require that the debtor deposit the cash payment to such creditors.[29]

Because the unsecured creditors are not paid in full under a composition plan, the plan is not capable of being "crammed down" if any junior classes (generally equity interests) retain anything on account of their claims or interests. Consequently, the only hope for the debtor faced

[28] *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).
[29] Bankr. R. 3020. This Rule requires any money deposited to be kept in a special account established for the exclusive purpose of making the distribution.

with a dissenting class of creditors on a composition plan is to rely upon the "new value" exception, which will require the junior interests to make a new value contribution to the reorganized debtor in order to retain an interest in it.

H. The "Pot Plan."

1. The "pot plan" has been previously discussed in some detail. This is the type of plan generally involved in a sale or liquidation of all the debtor's assets. In this instance the debtor's assets are transformed into a "pot of cash" for distribution to creditors.[30] It may also be the functional equivalent of a composition plan, with the distinction that unsecured creditors would not receive the right to a specified percentage of their claims, but would rather receive a pro rata share of the funds deposited into the pot. Thus, the amount to be received by each creditor might not be calculable until all claims have been resolved.

Typical plan provisions in the case of a "pot plan" include the establishment of a trust for the sole and exclusive benefit of the creditors sharing in those funds. The plan should specify that only those creditors are beneficiaries of the trust and that neither the debtor nor any of its other creditors are able to attach any funds in the trust. In drafting such a plan, the debtor should consider:

a. who should serve as trustee;

b. where the trust assets should be invested;

c. what type of investment should be permitted of the funds held in trust;

d. when and how distributions of funds should be made; and

e. how should the trust be terminated.

The debtor will be faced with the same issues in confirming the pot plan as it will in confirming a composition. The amount distributed into the trust fund must be greater than the amount that creditors would realize in a Chapter 7 liquidation. If the pot plan is the result of the sale of all assets, and if the sale itself is feasible, then the pot plan will itself be feasible. If, however, the amounts to be contributed into the trust fund depend upon the debtor's future operations, then the same feasibility standards will apply. Finally, if junior interests retain anything, the pot plan will not be subject to cramdown unless the "new value" exception applies.

I. The Equity for Debt Plan.

1. In most Chapter 11 cases, the equity holders' goal in seeking to reorganize under Chapter 11 is to retain control of the company. In these circumstances, a plan which wipes out existing equity and issues new equity to creditors will be regarded as an unacceptable result.

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[30] *See, e.g.*, *In re White Motor Credit Corp.*, 14 B.R. 584, 587 (Bankr. N.D. Ohio 1981) (discussing this type of plan).

Nevertheless, the equity for debtor plan does have certain advantages. First, it provides maximum benefit to the debtor's balance sheet because it eliminates from the liability side all of the debtor's prepetition debt. Second, because it includes no promise to pay unsecured creditors, the plan is per se feasible as to these creditors. Third, assuming that the debtor is worth more as a going concern than in a Chapter 7 liquidation, the plan will also provide to creditors all of the residual value which would be capable of distribution to them in a Chapter 7 case. Such a plan will, therefore, generally meet the best interests of creditors test. Finally, because no junior class retains anything, this plan is subject to cramdown under §1129(b)(2)(B)(ii). There is a safe harbor for registration of the securities issued to creditors under §1145.

J. Compromises of Disputes.

1. Compromises may be effected separately during the reorganization proceedings or in the body of the reorganization plan itself.[31] In order to be confirmed by the court, the compromise must be "fair and equitable."[32]

Although compromises are routinely submitted to and approved by the court during the course of most Chapter 11 cases, some compromises are so significant to the case that the debtor, the settling party, and/or the creditor constituencies will not support the settlement until each of those groups knows what it will receive (or retain) under the terms of the plan. In those cases, the compromise should be placed in the plan. Depending on the terms of the compromise, the debtor may create a separate class to contain the settling party as a single-creditor class, or it may place the terms of the settlement elsewhere in the plan. In either situation, the court's confirmation of the plan will also effect the settlement.

VI. Treatment of executory contracts and unexpired leases

A. The treatment of executory contracts and unexpired leases can be a trap for the unwary in the drafting of a confirmation plan. As previously noted, executory contracts and unexpired leases are governed by §365 of the Bankruptcy Code.

There is no time limit for the assumption or rejection of such contracts and leases with two exceptions. First, leases of non-residential real property must be assumed or rejected within one hundred twenty days of the order for relief, unless that time has been extended by the Bankruptcy Court for up to an additional ninety days, or the date of the confirmation order, §365(d)(4).

If the contract or lease is in default when it is assumed, §365(b)(1) requires that the debtor in possession "promptly" cure such default, compensate the non-debtor party for any actual pecuniary loss to that party resulting from the default, and provide adequate assurance of future performance of the contract. Because the "adequate assurance of future performance" requirement of §365(b) is similar to the "feasibility" requirement with respect to plan payments to creditors under §1129(a)(11), many courts will permit (or indeed require) the debtor to deal

[31] *Matter of AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984).

[32] *In re Cajun Elec. Power Coop., Inc.,* 119 F.3d 349, 355 (5th Cir.1997).

with assumption of executory contracts at the same time as the plan confirmation. This is particularly true since a pre-confirmation assumption of an executory contract or unexpired lease creates the risk that the subsequent breach of that contract will result in an administrative priority claim against the estate which is payable in full.

The debtor's right to assume beneficial contracts and to reject burdensome contracts is often of great importance to its ability to reorganize. Congress authorized the debtor in possession to pick and choose (subject, of course, to court approval) which of those contracts it wants to perform and which it does not. Nevertheless, the law is not absolutely clear on what constitutes an executory contract. The courts have variously adopted the "Countryman test"[33] or the "functional test."[34] Neither of these tests, however, may be easy to apply when dealing with specific contracts, and litigation abounds over whether particular contracts are in fact executory. Consequently, a debtor in possession may not be able to accurately determine, without the benefit of a court ruling, which contracts are executory and which are not.

In most cases, a relatively small number of executory contracts will have been either assumed or rejected prior to the confirmation hearing. In the case of contracts and leases which have already been assumed or rejected, the debtor's rights will have been established and can be dealt with as a *fait accompli* in the plan process.

What of those contracts and leases, however, that have been neither assumed nor rejected before confirmation? What about those contracts that may or may not be executory? If executory contracts are neither assumed nor rejected, do they "ride through" the Chapter 11 case, becoming binding upon the reorganized debtor whether burdensome or beneficial? Or are they deemed rejected in the absence of a court-approved assumption by the debtor in possession?

These are obviously important issues for the debtor. Executory contracts include franchise agreements, employment agreements, option contracts, purchase and sale contracts, and insurance contracts. The cumulative impact of these contracts on the reorganized debtor may be enormous. For example, one court authorized a debtor to reject in a plan of reorganization some 35,000 to 40,000 warranty service agreements.[35] The impact upon the reorganized debtor of continued liability under those contracts would have been obviously of great significance.

The general rule seems to be that executory contracts that are not dealt with during the reorganization case or in the plan do in fact "ride through" the Chapter 11 case and are enforceable by the reorganized debtor and the other parties following confirmation.[36] The debtor,

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[33] Under this test, which is named after Professor Vern Countryman, a contract is executory if both parties have obligations, the breach of which would constitute a material breach excusing the other party's performance. *See, e.g., Matter of Murexco Petroleum, Inc.,* 15 F.3d 60 (5th Cir. 1994).

[34] *See, e.g., In re Martin Bros. Toolmakers, Inc.,* 796 F.2d 1435, 1439 (11th Cir. 1986).

[35] *In re Auto Dealer Services, Inc.*, 65 B.R. 681 (Bankr. M.D. Fla. 1986).

[36] *Matter of Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977).

therefore, is faced with an extremely difficult choice in drafting plan language to deal with these contracts. It can choose to deal only with known executory contracts and hope that there are no executory contracts that are burdensome which "ride through" the process. It can deal with known executory contracts and provide for a blanket rejection of all contracts not assumed. The problem with this approach, of course, is that if there are unknown contracts that are beneficial, they may be deemed rejected by this provision.

There is no easy answer to this dilemma. Obviously, the debtor needs to study all of its contractual arrangements and discuss those with its counsel. Every contract that is a known executory contract can, at least, be dealt with. The debtor should then elect a fallback position to deal with executory contracts not otherwise assumed or rejected. One alternative is to attempt to defer this decision, asking the Bankruptcy Court to retain jurisdiction until the time that the case is closed to deal with contracts not assumed or rejected.[37] A sample provision electing the first option might read something like the following:

> All executory contracts or unexpired leases of the debtor that have not been rejected by order of the Bankruptcy Court or are not the subject of a motion to reject pending on the effective date shall be deemed assumed [or rejected] by the reorganized debtor as of the effective date. All payments to cure defaults that may be required by Bankruptcy Code §365(b)(1), which have not been made prior to the effective date, shall be made by the reorganized debtor within thirty days of the date of an order determining the existence and amount of such default. Any claim for damages arising by reason of the rejection of any executory contract or unexpired lease must be filed with the Bankruptcy Court and served upon the reorganized debtor within thirty days from and after the date of entry of an order of the Bankruptcy Court approving such rejection or shall be forever barred.

VII. Means of execution

A. The plan must provide adequate means for it to be executed.

1. Among the items that the debtor should discuss in a reorganization plan dealing with the means of execution are:

(a) Any asset sale that is required to implement the plan;

(b) Any liquidation process that is anticipated;

(c) Description of any consolidation or merger of the debtor with any other entity;

(d) Any procedure whereby assets to be surrendered to a secured creditor in satisfaction of an allowed secured claim is to be accomplished;

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[37] The extent to which the Bankruptcy Court can retain jurisdiction following confirmation to permit assumption or rejection of contracts is uncertain. See, e.g., *In re J.M. Fields, Inc.,* 26 B.R. 852, 855-57 (Bankr. S.D. N.Y. 1983).

(e) The mechanism for the filing of objections to and for the allowance and payment of claims;

(f) Amendments to the corporate debtor's charter; and

(g) If not separately discussed when describing the treatment of each class, any requirements for the satisfaction or modification of any lien, the curing or waiving of any default, and/or the cancellation or modification of indentures or other debt instruments.

At this point, it should be noted that some courts have restricted a debtor's ability to dispose of all or substantially all of its assets by a motion filed under §363(b) of the Bankruptcy Code. These courts have concluded that such sales may require the disclosures and other protective procedures associated with a plan of reorganization rather than a simple motion.

The leading circuit court case on this issue was *In re Braniff Airways, Inc*.[38] In *Braniff*, the debtor obtained approval of a sale of "cash, airplanes and equipment, terminal and landing slots" to another airline in exchange for "travel scrip, unsecured notes and a profit participation" in the purchaser's proposed airline operation.[39] Obviously, this consideration was much more difficult for a creditor to evaluate than an all-cash purchase price and would seem to require far more disclosure than a simple motion. To compound the problem, the distribution of this consideration was also established by the contract. For example, the travel scrip was largely allocated to employees of *Braniff* rather than to other creditors. For all of these reasons, the court properly determined that the sale in question required the protective features of a plan of reorganization.

Other courts have recognized that the *Braniff* case should not be held to preclude a sale of substantially all assets pursuant to a §363 motion as a matter of law. Two tests seem to have been adopted by various courts. The most lenient test simply requires that the debtor have an "articulated business justification, other than appeasement of major creditors" to accomplish such a sale.[40] Other courts have indicated that something akin to an emergency situation which requires a speedy liquidation is required before such a sale will be approved.[41]

As a practical matter, a debtor faced with the necessity of a quick sale should proceed by all available means. A motion under §363(b) should immediately be filed. If time permits, a plan and disclosure statement seeking similar relief should also be filed. In the event that only a motion is filed, the debtor should give as much disclosure as possible to creditors.

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[38] *In re Braniff Airways, Inc.*, 700 F.2d 935, 939 (5th Cir. 1983).

[39] *Id.*

[40] *In re Chateaugay Corp*., 973 F.2d 141 (2d Cir. 1992); *Stephens Industries, Inc. v. McClung*, 789 F.2d 386 (6th Cir. 1986).

[41] *In re White Motor Credit Corp*., 14 B.R. 584 (Bankr. N.D. Ohio 1981).

Another method of implementing a plan may be a merger between a corporate debtor and a non-debtor corporation or between two corporate debtors. This process is akin to the concept of "substantive consolidation."[42] It is expressly authorized as one of permissive methods of implementing a plan under §1123(a)(5)(C).

Substantive consolidation must be distinguished from procedural, or administrative, consolidation. The former involves the treatment of two debtors as one, essentially collapsing one debtor into another. The latter simply involves the joint administration of two or more related cases. The latter, therefore, is routine, while the former is anything but routine, since it often involves the elimination of intercorporate guaranties and debts and the equal treatment of creditors of two different entities with different assets and liabilities. Nevertheless, management of a parent corporation which has subsidiary corporations may want to consider the business, legal, and tax ramifications of such mergers or consolidations.

VIII. Post-confirmation management

A. In order to achieve confirmation of its proposed plan, the debtor must disclose the identity and affiliations of any individual who is to serve as an officer, director, or voting trustee of the debtor.[43] The court must find that the appointment to such individual is consistent with the interests of creditors and equity holders and with public policy.[44] If these persons are insiders, their compensation must also be disclosed.[45] These disclosures may be made in the plan itself, in the §1125 disclosure statement, or presumably in some other filing.

1. There is occasionally bargaining between the debtor and creditors over restrictions on the post-confirmation compensation of management pending completion of plan payments to creditors. These restrictions may involve caps on salaries and bonuses. In addition, creditors will sometimes bargain to place one or more of their representatives on the board of directors.

2. There is no express statutory provision authorizing a committee appointed under §1102(a)(1) to continue to serve as such after confirmation of a plan. Generally, the debtor will prefer the committee be dissolved to avoid further costs and expanses. In the case of a "pot plan," however, the debtor may prefer to let the committee continue in existence to handle objections to general unsecured claims and the distributions to those creditors, since the debtor has no pecuniary interest in those matters. Similarly, if the proceeds of litigation go straight to creditors, the debtor may want to let a committee or other representative pursue that litigation.[46]

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[42] Although the usual consolidation takes place between two corporations, there are examples of consolidation of other entities such as a partnership and its general partners. *F.D.I.C. v. Colonial Realty Co.*, 966 F.2d 57 (2d Cir. 1992).

[43] 11 U.S.C., §1129(a)(5)(A)(i).

[44] 11 U.S.C. §1129(a)(5)(A)(ii); 11 U.S.C., §1123(a)(7).

[45] 11 U.S.C., §1129(a)(5)(B).

[46] The general rule is that the debtor's statutory causes of action to pursue preferential transfers and

Finally, the debtor may agree, as part of plan negotiations, to provide for continuation of the committee until certain distributions have been made. In some of these circumstances, the debtor may want to bargain to have the committee fees paid out of distributions to creditors, rather than from its property and future earnings.

IX. Conditions precedent

A. Any conditions that must be satisfied in order for the plan to become effective should be specified in the plan. Such conditions should be avoided if at all possible, since the existence of any condition imposes a risk that the debtor will find itself in a "never-never" land after the court's confirmation of a plan and before the effective date. Nevertheless, if the debtor cannot, for example, close on a funding commitment until thirty days after entry of a confirmation order as a result of the funder's requirements, it makes no sense for the Bankruptcy Court to insist upon the impossible condition that the transaction be closed before the confirmation order is entered. Because most "conditions" will not affect the treatment of creditors, but will rather affect only feasibility, it is important to make any such condition waivable by the debtor if it can otherwise make the payments under the plan.

What happens if a confirmation order is entered and the plan never becomes effective? As a legal matter, the confirmation order effectively terminates the court's involvement and is probably final for purposes of appeal and res judicata. As a practical matter, however, the plan (and perhaps the order) should probably contain a "blow up" clause which provides that the confirmation order will be vacated if the plan does not become effective by a certain date.[47]

X. Retention of jurisdiction

A. Although Bankruptcy Courts vary widely in their willingness (or at least desire) to exercise jurisdiction over matters involving a debtor after confirmation of the plan, it is fairly

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fraudulent conveyances may not be assigned to a single creditor or to a separate creditor group. *In re Texas General Petroleum Corp.*, 58 B.R. 357 (Bankr. S.D. Tex. 1986). The committee, however, may constitute a "representative of the estate" which is authorized to pursue such actions for the benefit of all creditors having an interest in those actions. E.g., *In re Southern Commodity Corp.*, 78 B.R. 626 (Bankr. S.D. Fla. 1987). See also *In re Chase & Sanborn Corp*., 813 F.2d 1177, 1180 (11th Cir. 1987).

[47] The underlying legal issue of what happens to a conditional plan that never becomes effective is not without its complexities. Normally, a confirmation order can only be set aside if it was procured by fraud. 11 U.S.C., §1144. The penalty for failing to consummate a plan is normally dismissal or conversion of the case, although this remedy is permissive, not mandatory. 11 U.S.C. §1112(b)(7), (8), (9). Theoretically, the "conditional" confirmed plan (and disclosure statement) could be modified by replacing it with an entirely new plan under 11 U.S.C., §1127(b), (c). In such a case, however, only the plan proponent is permitted to "modify" the plan, resulting in a de facto extension of exclusivity notwithstanding the complete failure of the confirmed plan. The best result is to treat the plan as terminated, as suggested by §1112(b)(9), provide in the confirmation order itself that the order will be vacated if the condition does not occur, and go back to the drawing board with respect to a new plan. The court can, of course, consider such a new plan, dismiss or convert the case, terminate exclusivity, or take such other action as the facts warrant.

well-established that the courts do in fact retain considerable jurisdiction after confirmation.[48]

1. The plan should spell out the areas in which the court retains jurisdiction, which may include:

(a) Any action necessary to implement the plan;

(b) Any action necessary to enforce the plan and vindicate the debtor's discharge;

(c) Resolution (by litigation or compromise) of all objections to claims;

(d) Resolution of all pending adversary proceedings, contested matters, and administrative matters;

(e) Resolution of actions to be brought in the future to collect funds;

(f) Interpretation and enforcement of any prior orders entered by the court;

(g) Approval of, and resolution of disputes related to, distributions to creditors;

(h) Modification of the plan;

(i) Resolution of disputes involving assumed executory contracts;

(j) All actions necessary to close the case; and

(k) Enforcement of any injunction in favor of the debtor or third parties.

XI. Miscellaneous provisions

A. Amendments.

1. Although §1127 of the Bankruptcy Code provides procedures for the modification of a plan before and after confirmation, it is generally wise to describe these procedures in the plan. Thus, the debtor should advise creditors in the plan that: (a) the plan may

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[48] Under 28 U.S.C. §1334(a), the Bankruptcy Court has exclusive jurisdiction of the bankruptcy case itself until it is closed. See *In re Terracor*, 86 B.R. 671, 675-76 (D. Utah 1988). An example of the extent of this jurisdiction can be found in *In re Ames Dept. Stores, Inc.*, 190 B.R. 157 (S.D. N.Y. 1995). In that case, the court held that the Bankruptcy Court's retained jurisdiction under a plan of reorganization included a post-confirmation suit between two non-debtors brought in a non-bankruptcy forum.

be modified at any time prior to entry of the confirmation order;[49] (b) that any such modification may be approved without further notice to creditors if the court finds that such modification does not adversely change treatment of other creditors;[50] (c) that modifications may be proposed orally or in writing at the time of the confirmation hearing;[51] and (d) that the confirmation hearing may be rescheduled in open court from time to time without further written notice. The procedure for modification will be discussed hereafter.

B. Unclaimed Distributions.

1. The plan should provide a procedure for handling unclaimed distribution. In default of such a procedure, the debtor (or other distributing agent) will have to hold funds for a five-year period.[52] After that time, absent a plan provision to the contrary, the unclaimed funds revert to the debtor or to any entity acquiring the debtor's assets.[53] Five years is generally too long for the debtor to wait for creditors to cash their checks or correct their address on the court's records. The plan, therefore, should establish an appropriate shorter time period and other mechanics of distributing those unclaimed funds.

C. No Admissions.

1. The plan of reorganization is itself a settlement offer from the plan proponent to creditors and equity holders.[54] Section 1141(a) of the Bankruptcy Code makes it clear that only the provisions of a confirmed plan are binding on the parties. Normally, settlement negotiations are not admissible into evidence under the Federal Rules of Evidence,[55] and the only difference between the ordinary settlement offer and an unconfirmed plan is that the latter is a matter of public record. Consequently, the plan should contain a statement that it is a compromise proposal and that nothing therein should be regarded as an admission against interest.

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[49] 11 U.S.C., §1127(a).

[50] Bankr. R. 3019.

[51] Not every court may accept an ore tenus motion for modification. Nevertheless, the giving of notice to creditors that this might happen may alleviate some of the court's concerns.

[52] 11 U.S.C., §1143.

[53] 11 U.S.C., §347(b).

[54] See H.R. Rep. No. 595, 95th Cong., 2d Sess. 220 (1978) (“The parties are left to their own to negotiate a fair settlement. ... [N]egotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders.”)

[55] FRE 408.

D. Injunctions and Releases.

1. The Bankruptcy Code provides statutory injunctive relief to a debtor with respect to discharged debts. In addition, under §1123(b)(5) of the Bankruptcy Code, the Chapter 11 plan may "include any other appropriate provision not inconsistent with the applicable provisions" of the Bankruptcy Code.

2. The debtor should include within the plan of reorganization a provision that restates and supplements the statutory injunction. The first purpose in doing this is to make it clear that the plan does not waive any of the statutory injunctive relief to which it is entitled (as is permissible). The second purpose may be to supplement the injunctive relief to protect the debtor's future operations and to enhance its ability to implement and perform the plan.

3. Apart from the protection of the debtor itself, the debtor may frequently wish to provide some measure of protection to third parties who are either jointly liable with the debtor on various obligations or who may have independent exposure to the debtor pursuant to tort, statutory, or contract causes of action.

4. With regard to causes of action that the debtor itself has (such as claims against its officers and directors for breach of their duties of loyalty and due care), there is no doubt that these causes of action are property of the bankruptcy estate pursuant to §541 of the Bankruptcy Code. As such, those assets can be disposed of in the plan of reorganization. Thus, a plan of reorganization which releases the debtor's own claims is within the subject matter jurisdiction of the Bankruptcy Court and may be approved if otherwise appropriate. If such a release is approved, it will bind not only the debtor but all parties claiming through the debtor. Accordingly, the Bankruptcy Court can enjoin the prosecution of derivative actions by third parties on account of such released claims.[56]

5. The issue becomes more difficult when creditors have direct (not derivative) causes of action against entities which are liable with the debtor. There are numerous examples where non-debtor third parties may be co-liable with the debtor to various creditors. Some examples of such third parties are:

(a) Entities which have provided guaranties of certain of the debtor's obligations;

(b) Entities which have agreed to become a surety for the debtor with respect to various obligations;

(c) Entities which have insured or agreed to indemnify the debtor against certain obligations;

[56] E.g., *In re Texaco Inc.*, 84 B.R. 893 (Bankr. S.D. N.Y. 1988).

(d) Individuals who are responsible for payment of trust fund taxes under §6672 of the Internal Revenue Code;

(e) General partners of the debtor;

(f) Entities that are the debtor's “alter-ego;” and

(g) Entities made co-liable with the debtor as responsible persons pursuant to various statutes, such as various securities, environmental, and pension laws.

Prior to confirmation, courts have occasionally enjoined suits against such co-debtors on a number of theories. Among the arguments that debtors have made to obtain such injunctions are that suits against the debtor's officers and directors would interfere with the debtor's reorganization efforts because the actions would divert their attention, or because those individuals are expected to fund a plan of reorganization. In those circumstances, debtors have maintained that injunctive relief was necessary to protect its interests (not, however, just the interests of the third parties). General partners of the debtor partnership have, in addition to the arguments articulated above, pointed out that their assets would be subject to administration in a Chapter 7 case of the partnership, in which event all partnership creditors would receive a pro rata distribution of the general partners' assets. They have argued that allowing certain partnership creditors to pursue assets that would be available for all partnership creditors would unduly prefer those creditors. A similar argument has been made by insurers, particularly where the insurance coverage is less than the amount of anticipated claims against the coverage. Courts have been receptive to such arguments on a number of occasions, in some cases issuing stays during the pendency of the Chapter 11 case.[57]

The more difficult issue is whether or not the debtor can provide in a plan of reorganization that non-debtor third parties (that is, creditors) are prohibited from pursuing other non-debtor third parties, such as guarantors, insurers, sureties, and partners. Several rules seem to have evolved. First, it is clear that the debtor's discharge does not itself discharge claims against third parties. This is the clear import of §524(e) of the Bankruptcy Code.[58]

Second, the plan can provide that third parties release claims against third parties on a voluntary basis, particularly if additional consideration for the release is given. Thus, parties who accept a plan providing for third party releases will be bound by those releases.[59]

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[57] Examples of cases in which courts have granted pre-confirmation injunctive relief to protect non-debtor third parties include HIST:0016 *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994 (4th Cir. 1986) (rejected by, Algemene Bank Nederland, N.V. v. Hallwood Industries, Inc., 133 B.R. 176 (W.D. Pa. 1991)); *Mitchell Excavators, Inc.* by Mitchell v. Mitchell, 734 F.2d 129 (2d Cir. 1984); *Matter of Provincetown Boston Airline, Inc.*, 52 B.R. 620 (Bankr. M.D. Fla. 1985); *In re Otero Mills, Inc.,* 21 B.R. 777 (Bankr. D. N.M. 1982).

[58] See also *In re A.J. Mackay Co*., 50 B.R. 756 (D. Utah 1985).

[59] See *In re AOV Industries, Inc.*, 792 F.2d 1140, 1150 - 54 (D.C. Cir. 1986).

Third, a plan that provides for voluntary third party releases is within the jurisdiction of the Bankruptcy Court. If the plan is confirmed, it is binding on all parties. Under basic principles of res judicata, third parties could not subsequently challenge those provisions in the plan.[60]

Fourth, if the third party is obligated by contract directly to the debtor pursuant to a contract that is property of the bankruptcy estate, such as an insurance policy, the Bankruptcy Court may prevent third parties from pursuing those persons.

Fifth, if the claims against the non-debtor parties are claims that all large groups of creditors or equity holders would have as opposed to claims that only specific creditors would have by virtue of contractual undertakings, the courts have been more liberal in permitting releases. An example of this would be instances in which all equity holders would have claims against officers and directors for securities violations. In this instance, the fact that the officers and directors might have indemnity claims back against the debtor may be an additional reason to uphold releases.

E. Transfer Tax Exemption.

1. Section 1146(a) of the Bankruptcy Code provides that the "issuance, transfer or exchange of a security, or the making or delivery of an instrument of transfer" under a confirmed plan may not be taxed under any law imposing a stamp tax or similar tax.

2. This exemption from taxation may be of significant monetary benefit to the debtor and the estate, and debtors have argued that transactions consummated pre-confirmation as part of the plan process, as well as transactions consummated a significant period of time after confirmation, fall within the scope of this exemption. These arguments were rejected by the Supreme Court in the *Picadilly* case in 2008.[61]

3. It is unclear whether "second generation" transfers can be immunized from stamp taxes - such as where real property is surrendered to a secured creditor who will then market the property as part of its REO portfolio. Can the second transfer, which is contemplated under the plan, be protected? Our firm has included such provisions in confirmed plans with the caveat to the secured creditor that we are not sure that this works - but so far, there have been no cases testing the principle.

4. If appropriate notice is sent to the state taxing authority, these provisions may acquire binding effect.

XII. The Disclosure Statement

A. Section 1125(b) of the Bankruptcy Code provides that the acceptance or rejection of a plan may not be solicited unless, at the time of or before such solicitation, there is

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60 *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987).

61 *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.,* 54 U.S. 33, 128 S. Ct. 2326 (2008).

transmitted to the creditor or equity holder a written disclosure statement approved by the Bankruptcy Court as containing "adequate information."

B. Section 1125(a)(1) of the Bankruptcy Code provides that "adequate information" is "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgement about the plan."

1. The determination of what constitutes adequate information will depend upon the facts and circumstances of each case. A dispute over what information to include in the disclosure statement is submitted to the sound discretion of the Bankruptcy Court. As a general rule, disclosure statements must include a discussion of the following topics:

(a) a brief description of events that have occurred after the Chapter 11 filing, including key court rulings;

(b) a description of the debtor's business and assets;

(c) a description of the terms of the plan, including the means of execution;

(d) a liquidation analysis, which is designed to provide information to creditors as to the alternative of liquidation in Chapter 7 and is also designed to serve as the basis for the debtor's proof of compliance with §1129(a)(7) dealing with the "best interest of creditors" test;

(e) a projection of future operations, including a statement of any assumptions made in those projections and a discussion of the risks related to those operations;

(f) a description of any pending or expected litigation;

(g) a discussion of transactions with insiders;

(h) a disclaimer of the potential tax consequences of the plan, or a description of the tax consequences if the debtor has conducted such an examination; and

(i) a discussion of alternatives to the plan and the reasons for creditors to accept the plan.

From a cursory review of the factors set forth above, it is evident that some of the sections can be drafted well in advance of any deadline for the filing of a plan and disclosure statement. A description of the history of the debtor's business and various historical financial information can be assembled immediately. Other sections will depend upon ongoing analysis and may be ignored until the last minute when the debtor has the maximum amount of time to consider the results of post-petition operations. For example, the projections of future operating

results and the liquidation analysis will require thought and analysis, and the debtor is well-advised to begin to work on those sections early in the Chapter 11 case. If nothing else, those items will be essential for the debtor itself to consider in formulating a plan.