PLANNING TO PLAN: STRATEGIC FORMULATION OF CHAPTER 11 PLANS

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I. INTRODUCTION

The formulation and acceptance of a reorganization plan is the ultimate goal in any chapter 11 case, as it allows a debtor to restructure its debts, obtain a discharge of its prepetition liabilities and emerge from bankruptcy with a "fresh start." In addition, the reorganization plan typically classifies creditors' claims against the debtor, specifies the treatment to be given to each class of claims and provides the financial and operational mechanisms for carrying out the plan. Based on the sheer importance of the reorganization plan to the debtor, its creditors, and other parties-in-interest in the bankruptcy case, it should come as no surprise that there are a number of strategic decisions that should be considered in formulating a plan. This discussion will focus on certain key issues in plan formulation that have garnered recent attention in the bankruptcy community, some due to seminal decisions issued by bankruptcy and federal courts in the past couple of years. Specifically, the topics of discussion will include:

- Use of Plan Support Agreements;
- Designation of Bad Faith Votes: Disqualification of Votes of Creditors who have "Loaned to Own," or who Otherwise have Purchased Claims in "Bad Faith";
- Gifting Restrictions;
- Separate Classification of Creditors with Equal Priority (Gerrymandering);
- Coercive Plan Provisions (Death Traps);
- Post-Confirmation Jurisdiction
    - Post-Confirmation Jurisdiction Retention Provisions; and
    - Preserving Causes of Action in Plans of Reorganization.

II. PLAN SUPPORT AGREEMENTS

Plan support agreements, also commonly referred to as "lock-up agreements," or "restructuring support agreements" (we will use "RSAs" as shorthand for these agreements) memorialize the material terms of a restructuring proposal (sometimes simply a term sheet) that has been agreed upon between a debtor or a soon-to-be debtor and one or more of its major stakeholder classes and provides that the parties will support the implementation of the restructuring proposal. The terms of these agreements can vary. They may include (1) an agreed timeline for achieving certain chapter 11 case milestones, (2) provisions requiring the debtor to file a plan containing certain specified terms, (3) a creditor's promise to vote in favor of the plan and (4) provisions requiring a debtor to pay certain fees and expenses to the consenting creditors. Although RSAs are often used as a prepetition tool in "prenegotiated" or "prearranged" chapter 11 cases, RSAs also have been utilized by debtors during the chapter 11 cases.

A. Applicable Statutory Provisions

Section 1125(b) of the Bankruptcy Code, which addresses postpetition solicitation, provides that "[a]n acceptance or rejection of a plan may not be solicited" until after the Court approves the dissemination of a disclosure statement."[1] Section 1125(g), which was added to the Bankruptcy Code in 2005 as part of the BAPCPA, provides that notwithstanding section 1125(b), an acceptance or rejection of a plan may be solicited if the solicitation "complies with applicable nonbankruptcy law and if such holder was solicited before the commencement of the case in a manner complying with applicable bankruptcy law."[2] Taken together, these provisions raise two interrelated issues: (1) Is entering into an RSA considered a solicitation under the Bankruptcy Code; and if so, (2) Can an RSA be entered into postpetition without violating section 1125(b)?

B. Prepetition RSAs

An RSA can be a critical tool in negotiating a prearranged chapter 11 case. In a prearranged chapter 11 case, a company reaches an agreement on all essential terms of a reorganization plan with its creditors, bondholders and essential vendors/suppliers (or some combination thereof) prior to filing for chapter 11. While all essential terms of the proposed reorganization plan take place prior to filing, formal solicitation of votes takes place after commencement of the chapter 11 case.[3] A prearranged chapter 11 case can be an attractive option for a distressed company because it provides certain advantages over "free-fall" or traditional chapter 11 cases. Such advantages include decreased costs, reduced time in chapter 11 and greater certainty of successful confirmation of a plan of reorganization. It is this last advantage in particular that a RSA helps secure.

A RSA contains a negotiated compromise of what the creditor parties will receive under the debtor's proposed plan of reorganization and may include certain other compromises such as forbearance agreements, where the creditor parties agree to forbear upon exercising rights that they may have under the relevant credit document while the debtor prepares to file for chapter 11. Once the compromise is reached, creditor parties agree to vote in favor of the plan when they are actually "solicited" by the debtor to vote upon the plan, subject to the following conditions: (1) the plan must be consistent with the term sheet; and (2) the creditor must receive a court-approved disclosure statement that is consistent with the information provided to the creditors in connection with their entering into the RSA.

Votes submitted on a debtor's plan postpetition pursuant to the terms of a prepetition RSA are unlikely to be the subject of a designation (disallowance) challenge as an improper solicitation under section 1125(b). Prior to the enactment of section 1125(g), however, there was some concern that if even a miniscule amount of activity, such as the actual signing of the RSA by any

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[1] 11 U.S.C. § 1125(b).

[2] 11 U.S.C. § 1125(g).

[3] A prearranged chapter 11 case is similar to a prepackaged case, except that in a prepackaged chapter 11 case, the company both negotiates an agreed-upon reorganization plan with its creditor constituents and solicits acceptances of its reorganization plan before filing for chapter 11.

party, occurred after the petition date, then the RSA could be considered a prohibited postpetition solicitation.[4] With the enactment of 1125(g), a debtor in the midst of finalizing a prearranged chapter 11 filing no longer has to risk forgoing the benefit of that process if it becomes necessary for the debtor to file for chapter 11 prior to obtaining all necessary RSA signatures. Still, a debtor seeking to effectuate a prepetition RSA as part of a prearranged bankruptcy must be cautious to make sure the RSA meets the standards of both applicable bankruptcy law and applicable non-bankruptcy law.[5] Additionally, while section 1125(g) obviates the need for a disclosure statement at the time of the RSA, the actual vote solicitation which is to be conducted postpetition may be subject to section 1125(b) and therefore would need to include a court-approved disclosure statement.

C. Postpetition RSAs

Although there is some debate, most courts find that postpetition negotiations that culminate in a RSA do not constitute an improper "solicitation," even where a disclosure statement has not yet been approved. The issue ultimately boils down to whether negotiating a RSA counts as a "solicitation" under section 1125(b) of the Bankruptcy Code. The Bankruptcy Code does not define "solicit" or "solicitation," but a number of courts have interpreted the terms narrowly in the context of section 1125. The seminal case taking the narrow approach is Century Glove, Inc. v. First Am. Bank of New York, in which the Third Circuit Court of Appeals ruled that "solicitation" refers only to "the specific request for an official vote."[6] A majority of courts have followed this line of reasoning.[7] Courts rejecting the notion that postpetition RSAs violate

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[4] See, e.g., Transcript of Motions, In re NII Holdings, Inc., No. 02-11505 (MFW) (Bankr. D. Del. Oct. 22, 2002) (designating the votes of parties to a RSA where all of the negotiations for the restructuring and the formation of the RSAs took place prepetition, but where certain agreements were dated and/or delivered a few days after the bankruptcy filing).

[5] A debtor must ensure that prepetition solicitation materials are clear and legally bind creditor parties to vote for its proposed plan in accordance with applicable non-bankruptcy law. See, e.g., In re Pioneer Finance Corp., 246 B.R. 626, 630 (Bankr. D. Del. 2000) (where a RSA asked bondholders to exchange old bonds for new bonds or, in the alternative, approve a plan of reorganization, the Court refused to count prepetition consents as votes and found that the debtor had not actually solicited the bondholders, but had sought their consent to some future plan).

[6] 860 F.2d 94, 101 (3d Cir. 1988).

[7] See, e.g., In re Owens Corning, Case No. 00-3837 (Bankr. D. Del. June 23, 2006) (Docket no. 18233 (transcript of bench ruling)) (overruling the U.S. Trustee's objection that a RSA that the debtor, the official committee for asbestos claimants, significant holders of the debtor's bonds, and others entered into six years after the bankruptcy filing was an impermissible violation of section 1125(b) and holding that "the Plan Support Agreement is not a solicitation."); In re Kellogg Sq. P'ship, 160 B.R. 336, 340 (Bankr. D. Minn. 1993) ("[T]here is no . . . reason not to apply Century Glove's rationale to the debtor in reorganization, so as to [describe] the concept of 'solicitation' as [equivalent to] the formal polling process."); In re Texaco, Inc., 81 B.R. 813 (Bankr. S.D.N.Y. 1988) (finding a pre-disclosure statement settlement agreement that included creditor covenant to use "best efforts to obtain confirmation of the Plan" not to be solicitation in violation of § 1125(b)); In re California Fidelity, Inc., 198 B.R. 567, 571-72 (B.A.P. 9th Cir. 1996) ("The term solicitation as used in § 1125(b) has been narrowly interpreted to mean nothing short of a 'specific request for an official vote.'" (quoting Century Glove, 860 F.2d at 101)).

section 1125(b) generally reason that an RSA is not an "official vote" on a plan but rather an agreement to cast an official vote in the future, subject to important conditions, including compliance with section 1125(b)'s requirement of a disclosure statement at the time of the official vote.[8] These courts have recognized that chapter 11 is, by its nature, a negotiated process and that a broad reading of section 1125 can seriously inhibit free creditor negotiations.

It should be noted, however, that two unpublished decisions by Judge Walrath of the Delaware bankruptcy court have called into question whether a debtor can ever enter into a postpetition RSA. In In re Stations Holding Co., a third-party seeking to acquire the debtor's assets emerged and requested that the debtor and major stakeholders sign a RSA to support a plan of reorganization under which the acquisition would be implemented.[9] The RSA was entered into prior to the disclosure statement having been approved. Although the court confirmed the plan, it designated the votes of the creditors that were party to the RSA because the court determined that the postpetition RSA constituted the solicitation of votes on a plan without a court-approved disclosure statement in violation of section 1125(b). The court was troubled by the fact that the RSA did not allow the creditor to change its vote after entering into the RSA if the circumstances changed or the information contained in the disclosure statement was materially different than that submitted to the creditor in connection with entry into the RSA. Shortly after the Stations Holding decision, the court issued its decision in In re NII Holdings, Inc., discussed *supra* in footnote 4. In NII Holdings, the court designated the RSA party creditors' votes because, even though the RSA was negotiated prepetition, it was signed, dated and released two days after the bankruptcy filing.

One way to mitigate the risk that a postpetition RSA will be found to violate section 1125(b) is to avoid an express obligation to vote for a plan. Rather, the creditor pledges to support confirmation or not to oppose confirmation. The creditor also pledges not to support any other plan.

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[8] See, e.g., Kellogg, 160 B.R. at 340 (finding postpetition RSA not to be a § 1125(b) solicitation because solicitation did not occur until court-approved disclosure statement was distributed for official votes); Owens Corning, Case No. 00-3837 at 12-14 ("There is nothing in the Plan Support Agreement that demands or solicits a vote unless the plan proposed meets with the satisfaction of the Plan Support Agreement parties. And those parties have put together in the Plan Support Agreement the information that tells the plan proponents what the parameters of the plan must be to achieve the favorable vote of the creditors who are parties."); see also In re Pioneer Finance Corp., 246 B.R. 626, 631-33, 43 (Bankr. D. Nev. 2000) (finding language of consent solicitation that is similar to lockup agreement language not to be an "acceptance" of a plan, but an "agree[ment] to agree on a plan"); Century Glove, 860 F.2d at 101-02 ("We find no principled, predictable difference between negotiations and solicitation of future acceptances. We therefore reject any definition of solicitation which might cause creditors to limit their negotiations.").

[9] Transcript of Omnibus Hearing, In re Stations Holding Co., Inc., No. 02-10882 (MFW) (Bankr. D. Del. Sept. 25, 2002).

III. DESIGNATION OF BAD FAITH VOTES

A. Background

Section 1126(e) of the Bankruptcy Code authorizes a bankruptcy court to designate (i.e. disregard or disallow) the vote(s) of an entity "whose acceptance or rejection of such plan was not in good faith."[10] The Bankruptcy Code does not define bad faith. The courts have, accordingly, established a framework of principles for determining whether bad faith exists. Application of these principles, however, is highly fact-specific and requires a detailed review of the facts in each case in order to determine whether they warrant a finding of bad faith.

In general, designation is a remedy employed sparingly by bankruptcy courts.[11] Courts will not find bad faith and designate a claimant's vote solely on the grounds that the claimant voted selfishly or in a manner that advances its self-interest in maximizing the value of its claim. On the other hand, courts may designate a vote where a claimant attempts to obtain a benefit that it would otherwise not be entitled to as a creditor. Claimants attempting to obtain such a benefit are considered to be acting with an "ulterior motive."[12]

Not every ulterior motive is considered an improper motive triggering designation of a vote. For example, trade creditors may choose to vote in favor of a plan in the hopes that the reorganized debtor will maintain the trade relationship post-confirmation. Similarly, secured bondholders holding bonds that pay interest at a rate lower than current interest rates may vote in favor of a plan of liquidation in order to receive cash that can be reinvested in securities paying a higher interest rate. Courts have found these motives to be legitimate.[13] Conversely, courts have found an illegitimate ulterior motive to exist where a creditor purchased a claim intending to obstruct a reorganization[14] or prevent confirmation.[15] In what the Second Circuit has characterized as "perhaps the most famous case,"[16] of a claimant acting in bad faith, a Pennsylvania bankruptcy court found bad faith where the party purchased its position after a plan had been proposed and then voted against the plan and proposed a competing plan.[17]

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[10] 11 U.S.C. § 1126(e).

[11] See, e.g., In re Adelphia Commc's Corp., 359 B.R. 54, 51 (Bankr. S.D.N.Y. 2006).

[12] Dish Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.), 634 F.3d 79, 102 (2d Cir. 2011) ("DBSD").

[13] See DBSD at 102 (citing John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs., 987 F.2d 154, 161-62 (3d Cir. 1993); In re Landing Assocs., Ltd., 157 B.R. 791, 807 (Bankr. W.D. Tex. 1993)).

[14] See, e.g., In re MacLeod Co., 63 B.R. 654 (Bankr. S.D. Ohio 1986) (designating votes of parties affiliated with debtor's competitors that were cast in furtherance of their own business interests).

[15] See, e.g., In re Applegate Prop., Ltd. 133 B.R. 827 (Bankr. W.D. Tex. 1991) (designating votes of debtor's affiliate that purchased claim to prevent confirmation of a competing plan).

[16] DBSD at 103.

[17] In re Allegheny Int'l, Inc., 118 B.R. 282, 289-90 (Bankr. W.D. Pa. 1990)

B. DBSD

In a recent and highly notable decision, the issue of bad faith was addressed by the Second Circuit. In DBSD, the debtors' business consisted of implementing a network of satellites that could deliver wireless communications to consumers. In order to deliver these services, the debtors obtained the rights to use certain frequencies on the wireless spectrum. DISH indirectly competed with the debtors through its satellite television service and was also a part owner of TerreStar Corp., a direct competitor of the debtors. After the debtors entered bankruptcy and filed a chapter 11 plan, DISH purchased all of the debtors' first lien debt and parts of the second lien debt that were not subject to a plan support agreement.[18] With its strategic purchase of claims in the debtors' bankruptcy complete, DISH proceeded to vote against the debtors' proposed reorganization plan and object to confirmation, arguing, among other things, that it did not receive the indubitable equivalent of its secured claim rendering the plan unconfirmable. The bankruptcy court designated DISH's vote, finding that the vote was not cast in good faith because DISH had purchased the claims to advance its strategy of acquiring the debtors' wireless spectrum rights and not to maximize the value of the claims.[19] Consequently, the bankruptcy court confirmed the debtor's plan[20] and the district court affirmed.[21] On appeal, the Second Circuit affirmed the bankruptcy court's decision designating DISH's vote.[22]

The Second Circuit focused on four factors in affirming the finding of bad faith: DISH was (i) an indirect competitor and part owner of a direct competitor, (ii) that purchased a blocking position in a class of claims, (iii) after the plan had been proposed, and (iv) with the intention of entering into a strategic transaction with the debtors. In light of these factors, the Second Circuit held that DISH was attempting to "bend the bankruptcy process" in a manner that would allow it to purchase the debtors' wireless spectrum rights and was not acting to maximize the value of the debt it had purchased.[23]

After the bankruptcy court's decision, some practitioners initially opined that the decision should be viewed in the context of the "particularly egregious facts."[24] This view has now been

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[18] In re DBSD N. Am., Inc., 419 B.R. 179, 192-93 (Bankr. S.D.N.Y. 2009) aff'd in part, rev'd in part Dish Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.), 634 F.3d 79 (2d Cir. 2011).

[19] In re DBSD N. Am., Inc. 421 B.R. 133, 137 (Bankr. S.D.N.Y. 2009).

[20] In re DBSD N. Am., Inc., 419 B.R. at 205, 221.

[21] See Sprint Nextel Corp. v. DBSD North Am., Inc. (In re DBSD North Am., Inc.), 2010 U.S. Dist. LEXIS 33253 (S.D.N.Y., Mar. 24, 2010).

[22] See DBSD at 104.

[23] Id.

[24] See Peter Friedman, Leslie W. Chervokas and Samuel S. Cavior, SDNY Bankruptcy Court Thwarts Takeover by Claims Purchaser, Restructuring Review (April 2010) available at http://www.cadwalader.com/assets/newsletter/RR_April_2010.pdf#page=1; See also Ken Ziman and Jason C. Putter, Ulterior Motive: Claim Purchaser's Vote Disqualified, (May 18, 2010) available at http://www.skadden.com/content/Publications/Publications2077_0.pdf (stating that distressed investors should not be "overly alarmed").

vindicated by the Second Circuit, which limited its holding to claimants who purchase claims with the specific intent to obtain a strategic asset. The court declined to rule on whether a preexisting creditor who votes with the same strategic intentions would be subject to designation and also emphasized that the decision did not impose a categorical prohibition on purchasing claims with "acquisitive or other intentions" and held that such a purchase could be appropriate under other facts.[25] Additionally, because courts have held that in order to designate a vote, the creditor's "sole or primary goal" must be to obtain an improper benefit,[26] most traditional loan-to-own strategies appear to remain viable.

Notwithstanding the seemingly narrow potential for DBSD's application to other fact patterns, debtors and other interested parties negotiating plans should investigate whether a class of claimants competes with the debtor and whether these claimants may have an improper motivation in voting against a proposed plan.[27]

IV. GIFTING RESTRICTIONS

A fundamental principle governing distributions to creditors in a chapter 11 case is the "absolute priority rule," which requires senior creditors to be paid in full before junior creditors or equity holders can recover from the bankruptcy estate. The rule is codified in §§ 1129(b)(1) and 1129(b)(2)(B)(ii) of the Bankruptcy Code. Section 1129(b)(1) provides that the plan must "not discriminate unfairly" and must be "fair and equitable, with respect to each class of claims or interests" that is impaired and does not accept the plan.[28] A plan is considered fair and equitable with respect to a class of unsecured claims if holders of claims or interests that are junior to that class do not receive or retain any consideration under the plan *on account of* the junior interest or claim.[29] Accordingly, in order to find that a plan is "fair and equitable," junior claimants cannot receive property under the plan on account of their claim while unsecured senior creditors are not paid in full.

In the past, senior creditors seeking to hasten a debtor's exit from bankruptcy so that they may recover expediently under the plan have offered to "gift" a portion of their projected recovery to junior claimants. As a result of the gift, the junior claimants end up with a small recovery even though the senior creditors do not get paid in full. There are two methods available to senior creditors who desire to make a gift to junior claimants. First, a plan of reorganization may include a distribution to a junior class even though classes with a higher priority are not paid in full. Second, the parties can enter into a settlement under which the senior creditor and the

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[25] DBSD at 105.

[26] See In re GSC, Inc., 453 B.R. 132, 161 (Bankr. S.D.N.Y 2011).

[27] One potential scenario involves a distressed investor that owns large amounts of a competitor's debt. If the debtor can demonstrate that the investor is voting to reject the plan in order to increase the value of the competitor's debt, such activity may be considered bad faith.

[28] 11 U.S.C. § 1129(b)(1)

[29] 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added).

debtor agree to gift property to the junior claimants. Such settlements require approval from the bankruptcy court pursuant to Federal Rule of Bankruptcy Procedure 9019.

The act of "gifting" can be perceived as a violation of the absolute priority rule. Typically, these gifts are challenged when a senior creditor gifts part of its anticipated recovery to a junior claimant while an intermediate class of creditor (i.e. senior to the beneficiary of the gift but junior to the donor) is not being paid in full. In these scenarios, intermediate creditors may object to the proposed plan and argue that the plan is not fair and equitable because a junior claimant – the beneficiary of the gift – receives property while classes senior to the beneficiary do not. In response, senior creditors argue that such gifts are beneficial to the reorganization process and should be permitted because the gifted property is property that the senior creditors would have been entitled to under the absolute priority rule. In order to understand the current state of the law on gifting, a brief review of the relevant caselaw is helpful.

A. SPM Manufacturing Corp. and its Progeny

Analysis of the gifting doctrine typically begins with In re SPM Manufacturing Corp.[30] In SPM, Citizens Savings Bank held a senior claim that was secured by a lien on substantially all of the debtor's assets. Citizens and the Unsecured Creditors' Committee entered into an agreement under which the parties agreed to share the proceeds of a reorganization or liquidation. After the debtor failed to reorganize, the bankruptcy court converted the case to a chapter 7 liquidation and the debtor's assets were sold for less than the amount of Citizens' claim. Citizens and the Committee filed a motion seeking a court order instructing the debtor to distribute $5 million in proceeds from the sale to Citizens who would then share the proceeds with the Committee in accordance with the agreement. The debtor objected, arguing that the agreement would violate the absolute priority rule because unsecured creditors would receive a payment while tax claimants with a higher priority under the Bankruptcy Code's priority provisions remained unpaid. The bankruptcy court rejected the motion and the district court affirmed.

The First Circuit reversed the lower courts, holding that chapter 7 distribution priorities do not apply until all valid liens are satisfied.[31] The court reasoned that because the debtor was required to turn over the entire proceeds to Citizens in order to satisfy Citizens' liens, there was no property left to distribute. Therefore, creditors junior to Citizens but senior to general unsecured creditors lost nothing under the agreement, because they were not entitled to a distribution. Furthermore, the court noted that once the proceeds were distributed to Citizens, those proceeds became Citizens' property and the bankruptcy court would have no control over how Citizens chose to disburse those proceeds.[32] As a result, the court concluded that the bankruptcy court could not prevent Citizens from turning over part of the proceeds to the unsecured creditors. Notably, because the case was already converted to a chapter 7, the court did not address the validity of a gift in the context of a chapter 11 plan.

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[30] 984 F.2d 1305 (1st Cir. 1993).

[31] Id. at 1312.

[32] Id. at 1313.

Following SPM, some lower courts approved gifts in the context of a chapter 11 plan,[33] while others prohibited gifts in this context.[34] The Third Circuit then weighed in on the gifting doctrine in In re Armstrong World Industries, Inc., where it affirmed a district court decision denying confirmation of a chapter 11 plan under which a class of unsecured creditors would waive its rights to a distribution of equity warrants in the reorganized entity if a class of tort claimants rejected the plan. The warrants would instead be issued to the existing shareholders.[35] The court held that the plain meaning of section 1129(b) prohibited a junior claimant from receiving gifted property under a plan of reorganization over the objection of a more senior class of claimants that was impaired under the plan.[36] Specifically, it found that SPM and other similar cases were inapplicable because those cases involved the gift by a secured creditor of the proceeds of its valid lien. Such proceeds were not subject to distribution under the Bankruptcy Code's priorities. On the other hand, the proposed plan in Armstrong would have automatically shifted estate property – the equity warrants – from the debtor to a junior class. As a result, the court held that the plan could not be confirmed. Based on the court's statements distinguishing gifts of estate property from gifts of non-estate property, some post-Armstrong courts in the Third Circuit have approved a gift if the source of the gift was not property of the bankruptcy estate.[37]

B. Recent Cases

In In re Iridium Operating LLC, the Second Circuit reversed the bankruptcy court's and district court's approval of a pre-plan settlement under which the unsecured creditors' committee agreed to recognize and not challenge the validity of certain senior secured creditors' liens in return for a small percentage of the senior secured creditors' recovery, which amounts would be used as seed funds to establish a litigation trust to pursue claims against the debtor's former parent.[38] The settlement explicitly provided that any recovery by the trust would be distributed according to the absolute priority rule. However, if after prosecuting the claims, any of the original seed funds for the trust remained unused, the funds would be distributed to the unsecured creditors, ostensibly in violation of the absolute priority rule.

The Second Circuit found that because the validity of the liens hinged on whether the settlement was approved, the seed money for the litigation trust was still estate property and accordingly, SPM did not apply.[39] The court set forth a standard for approving settlement agreements

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[33] See, e.g., In re Mcorp. Fin. Inc., 160 B.R. 941 (S.D. Tex 1993); In re Parke Imperial Canton, 1994 WL 842777 (Bankr. N.D. Ohio 1994).

[34] See, e.g., In re Snyder Drug Stores, Inc., 307 B.R. 889 (Bankr. N.D. Ohio 2004); In re Sentry Operating Company of Texas, Inc., 264 B.R. 850 (Bankr. S.D. Tex. 2001).

[35] 432 F.3d 507 (3d Cir. 2005).

[36] Id. at 513.

[37] See, e.g., In re TSIC, 393 B.R. 71 (Bankr. D. Del 2008); In re World Health Alternatives, 344 B.R. 291 (Bankr. D. Del 2006).

[38] 478 F.3d 452 (2d Cir. 2007).

[39] Id. at 460.

affecting a debtor's property that deviate from the absolute priority rule. The court held that the "most important factor" in determining whether a settlement should be approved is whether the proposed distribution complies with the Bankruptcy Code's priorities.[40] Deviations from the Bankruptcy Code's priority scheme would only be allowed if: (i) the remaining factors traditionally used by courts to evaluate settlements under Bankruptcy Rule 9019 weigh heavily in favor of approval; (ii) the proponents justify the deviation; and (iii) the court clearly articulates its reasons for approving the settlement.[41]

In DBSD, discussed above in the section on designation of bad faith votes, the Second Circuit also delivered a noteworthy and likely influential holding on the gifting doctrine. The Second Circuit reversed the bankruptcy court's and district court's decisions confirming a plan of reorganization under which the pre-bankruptcy equity holder received a gift of equity in the reorganized entity from the second lien lenders, even though a dissenting unsecured creditor class did not receive full satisfaction of its claims.

The Second Circuit analyzed the gift in the context of section 1129(b)(2)(B) and, citing language in the disclosure statement stating that the reorganized equity was issued "[i]n full and final satisfaction" of the pre-bankruptcy equity interest, held that the equity received by the pre-bankruptcy equity holders was property received under the plan "on account of" its prior equity interest.[42] The court rejected the existing shareholders' argument that they were entitled to the warrants because they were contributing new value to the reorganized debtor, finding that even if a gift recipient contributes new value, a plan could not be confirmed if the equity in the reorganized debtor was provided in part due to the purchaser's status as a junior claimant. Accordingly, the court held that the proposed plan was not fair and equitable and could not be confirmed.

The court also found that SPM was distinguishable because (i) SPM was converted to a chapter 7 and § 1129(b)(2)(B) was therefore not implicated; and (ii) the proceeds of the sale were no longer part of the bankruptcy estate in SPM because the bankruptcy court had already lifted the automatic stay to allow Citizens to foreclose on its collateral. Although the court acknowledged the policy arguments in favor of allowing gifting, including the ability to efficiently negotiate a quick bankruptcy exit, it ultimately found that Congress was aware of these policy considerations when it enacted § 1129(b)(2)(B) and chose not to include an exception for gifts.[43]

C. Going Forward

In the wake of Iridium and DBSD, it appears that in the Second Circuit, senior creditors may not "gift" estate property as part of a plan of reorganization in a manner inconsistent with the absolute priority rule unless the gift is not made on account of – even in part – the claimant's status. Additionally, such gifts may not be made under a pre-plan settlement unless it meets the

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[40] Id. at 464-65.

[41] Id. at 464-65.

[42] DBSD, 634 F.3d at 97.

[43] Id. at 100.

detailed requirements set forth in Iridium. It remains to be seen how the Second Circuit's decisions will affect courts in other jurisdictions.

V. SEPARATE CLASSIFICATION OF CREDITORS WITH EQUAL PRIORITY

Although a plan proponent has significant power and discretion in crafting its plan, such discretion is not unlimited. Under section 1123(a) of the Bankruptcy Code, a plan must designate classes of claims and interests. Section 1122(a) provides clarification to this general rule, stating that a plan, except as provided in subsection (b), "*may* place a claim or interest in a particular class *only if* such claim or interest is substantially similar to the other claims or interests of such class."[44] Section 1122(b) provides that a plan may assign a separate class of claims to be "established consisting of unsecured claims below or reduced to an amount that the court approves as reasonable and necessary *for administrative convenience*."[45] Thus, although substantially similar claims may be classified together, a debtor is not required to delegate all of its similar claims in the same class. These guidelines for a plan's classification scheme are significant because they affect the ability of a plan proponent to group claimants into classes in a strategic way that maximizes the possibility of having the requisite votes necessary to confirm the plan.[46]

A. The Problem of Gerrymandering

Because the Bankruptcy Code provides a plan proponent with significant discretion in classifying claims, it invites a plan proponent to strategize a scheme to round up enough support to ensure that its plan is confirmable. Put another way, it can incentivize a debtor or other plan proponent to creatively classify groups of claims solely to achieve the votes desired, rather than for a legitimate and reasonable purpose. A straightforward example is where a debtor proposes a plan where it jointly classifies general unsecured debt creditors with general unsecured trade creditors. If the debt creditors support the plan and outnumber the trade creditors, who are expected to not support the plan, then the joint classification would dilute and could ultimately nullify the trade creditors' votes against the plan. Another example is where a debtor seeks to separate a deficiency claim from the claims of other unsecured creditors to ensure that at least one impaired class votes in favor of the plan pursuant to section 1129(a)(10) of the Bankruptcy Code.[47] Gerrymandering the vote in this manner is generally frowned upon by courts.[48] For

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[44] 11 U.S.C. §1122(a) (emphasis added).

[45] 11 U.S.C. §1122(b) (emphasis added).

[46] See 11 U.S.C. § 1126(c) ("a class of claims has accepted a plan if such a plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one half in number of the allowed claims of such a class held by creditors").

[47] *See* 11 U.S.C. §1129(a)(10) ("If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan . . . .").

[48] See, e.g., Boston Post Rd. Ltd. P'ship v. FDIC (In re Boston Post Rd. Ltd. P'ship), 21 F.3d 477 (2d Cir. 1994) cert. denied, 513 U.S. 1109 (1994) (separate classification may be done only for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims); In re

example, in In re Greystone III Joint Venture, the debtor, a single-asset real estate entity, split a secured creditor's claim into two classes: one for the secured claim and one for the unsecured deficiency claim.[49] The debtor placed the unsecured deficiency portion of the claim in a different class than the debtor's unsecured trade claims.[50] The effect of this classification ensured that at least one impaired class would vote in favor of the plan, as required by section 1129(a)(10). The court found that this classification scheme was improper, noting that the Bankruptcy Code requires that claims that share common priority and rights in the debtor's estate be placed in the same class.[51] In rejecting this scheme, the Fifth Circuit proclaimed an oft-cited general rule regarding the classification of similarly situated creditors: "Thou shalt not classify claims differently in order to gerrymander an affirmative vote on a reorganization plan."[52]

B. Circumstances When Separate Classification is Warranted

There are certain circumstances, however, where a separate classification of equal creditors might be warranted. Under the Bankruptcy Code, although classes must contain "substantially similar" claims, such similar claims can be separated into different classes for "good business reasons."[53] For example, courts have found that a separate classification might be warranted where it is clear that a creditor's voting plans will be based primarily on "non-creditor interests."[54] Likewise, courts have also permitted the separate classification of substantially similar creditors when the plan proposes a different means of repayment to satisfy their claims.[55]

Generally, where creditors have conflicting interests, courts have found that their separate classification is warranted. In Century Glove, for instance, a creditor objected to the separate classification of institutional lenders from other general unsecured claims.[56] The district court found that a separate classification of similarly situated creditors was appropriate because the creditors had conflicting interests.[57] Specifically, the court noted that the institutional lender's interests conflicted with the unsecured creditors interests because the institutional lenders' claims

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Bryson Props., XVIII, 961 F.2d 496 (4th Cir. 1992), cert. denied, 506 U.S. 866 (1992) (reversing confirmation of plan where classification of claims was "clearly for the purpose of manipulating voting").

[49] In re Greystone III Joint Venture, 948 F.2d 1274 (5th Cir. 1991), cert. denied, 506 U.S. 821 (1992).

[50] Id. at 1278.

[51] Id.

[52] Id. at 1279.

[53] Id. at 1281.

[54] See Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co., Inc. (In re U.S. Truck Co., Inc.), 800 F.2d 581 (6th Cir. 1986) (noting that the "non-creditor" interest existed because the national union's primary concern was for its own reputation, not maximizing the value of its claim).

[55] See, e.g., In re Elmwood, Inc., 182 B.R. 845, 850 (D. Nev. 1995) (holding that separate classification between deficiency claims and general unsecured claims was warranted where the plan provided for a repayment of claims on a monthly and rolling basis based on the hierarchy of a class).

[56] In re Century Glove, Inc., 1993 WL 239489, at *6 (D. Del. Feb. 10, 1993).

[57] Id. at *6-7.

would be paid out of the proceeds of the debtor's adversary proceeding against other general unsecured creditors.[58]

Similarly, in In re U.S. Truck,[59] the Sixth Circuit found a classification of similarly situated creditors to be appropriate when those creditors had different interests. The appellant, the national division of Teamsters Union, argued that it should not be placed in a separate impaired class from a local Teamsters Union that consisted of debtor, U.S. Truck's, employees.[60] By placing the national Teamsters into a separate impaired class, U.S. Truck ensured that its plan would be confirmed under the cramdown provisions. The Sixth Circuit held that the national and local unions had completely different "non-creditor" interests: the local union was more concerned with its members' jobs, whereas the national union was more concerned with its own reputation.[61] Accordingly, it found that where some creditors have an interest to reject the plan, one which is tangential to their financial interest as creditors, and this interest conflicts with a substantial body of other creditors' interests, then separate classification may be appropriate.[62]

It is important to bear in mind, however, that classifying creditors simply to facilitate an affirmative vote on a plan is never a "valid justification" to warrant gerrymandering.[63] While the line between a valid and an improper classification can be somewhat blurry, courts will look closely at what appears to be an improper classification scheme.

C. Recent Cases Discussing Improper Classification

The issue of gerrymandering is necessarily fact-intensive and it is oft-litigated. Below are brief summaries of some recent and notable decisions on challenges to improper classification amongst equal creditors:

- In re Save Our Springs Alliance Inc., 632 F.3d 168 (5th Cir. 2011). The debtor's plan of reorganization treated all unsecured creditors alike, and yet separated these creditors into three classes. The debtor appealed the bankruptcy court's finding that the classification was improper, arguing that at least one of its creditors would vote based on a "non-creditor" interest to have the debtor dissolved. The debtor contended that this "non-creditor" interest stemmed from animosity towards the debtor. The Fifth Circuit rejected the debtor's contention, holding that a "non-creditor" interest did not exist here because there was no evidence of the creditor's animosity towards the debtor. Thus, the classification was found to be improper.

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[58] Id. at *6.

[59] U.S. Truck Co., Inc., 800 F.2d 581.

[60] Id. at 583.

[61] Id. at 587.

[62] See id.

[63] See In re Bryson Props., XVIII, 961 F.2d 496 (4th Cir. 1992) (reversing confirmation of plan where classification of claims was "clearly for the purpose of manipulating voting").

- In re Machne Menachem, 233 Fed. Appx. 119 (3d Cir. 2007). The debtor filed a plan of reorganization with two classes for unsecured creditors: one for "insider" unsecured creditors and another for general unsecured creditors. The son of the debtor's president then purchased a significant share of the general unsecured class, which was impaired, in order to vote the claims in favor of the plan. The Third Circuit found that this scheme violated section 1122 of the Bankruptcy Code. Specifically, the court emphasized that vote manipulation by the gerrymandering of classes "seriously undermines" the "critical confirmation requirements set out in Section 1129(a)(8) (acceptance by all impaired classes) and Section 1129(a)(10) (acceptance by at least one impaired class in the event of a 'cramdown')."[64] The court found that the debtor's arrangement for an insider to purchase claims of the general unsecured class only supported the conclusion that the overall classification scheme was a ploy to facilitate confirmation of the plan.

- SPCP Group, LLC v. Biggins, 2011 WL 4389841 (M.D. Fla. Sept. 21, 2011). SPCP, a secured creditor with a deficiency claim, objected to the plan's classification, arguing that it should not be placed in a separate class from the general unsecured creditors. The district court disagreed, finding that SPCP's claim was "hugely different" because SPCP would receive 118 percent of its allowed unsecured claim, whereas the other unsecured creditors would receive (at best) 100 percent.[65] Thus, the court held that where creditors are to receive different treatment under the plan, separate classification may be appropriate.

- In re Nickels Midway Pier LLC, 452 B.R. 156 (D. N.J. 2011). The district court held that debtor must demonstrate a valid business justification and reasonableness for separate classification of similarly situated creditors. Here, the court found that there was such "reasonableness" because one class of creditors agreed to subordinate their claims to all other creditors.

- In re Christian Love Fellowship Ministries, Intern., 2011 WL 5546926 (Bankr. E.D. Mich. Nov. 9, 2011). A creditor with an unsecured deficiency claim objected to its separate classification from trade creditors. The bankruptcy court held that trade creditors in this case were not unique because they did not have a collective bargaining agreement. Furthermore, much like the creditor with the unsecured deficiency claim, the trade creditors would have an ongoing relationship with the debtor. Thus, the court found that the plan's separate classification was improper.

- In re Draiman, 450 B.R. 777 (Bankr. N.D. Ill. 2011). Creditor, Dynegy, objected to its placement in a class that was separate from other allowed general unsecured claims. Dynegy, however, was placed in a class with other unsecured creditors with pending litigation against the debtor. Dynegy contended that its placement

[64] Menachem, 233 Fed. App'x. at 121.

[65] Biggins, 2011 WL 4389841 at *6.

with the unsecured creditors with pending litigation constituted gerrymandering, as it allowed the debtor's plan to be confirmed with one accepting impaired class. The debtor argued that separate classification was warranted because Dynegy had interests that differed from the unsecured creditors without pending litigation against the debtor. If the debtor obtained a successful outcome in Dynegy's suit against it, then the unsecured creditors would benefit because the debtor's estate would retain more distributable assets. The bankruptcy court rejected Dynegy's objection, holding that the separate classification was justified. Specifically, the court noted that Dynegy had interests that conflicted with the general unsecured claims, due, in part, to the fact that the unsecured creditors would benefit from the debtor's success in its litigation with Dynegy.

VI. COERCIVE PLAN PROVISIONS

If a debtor cannot classify groups of creditors in a way to garner enough support for its plan (without improper gerrymandering), it may resort to crafting an alternative scheme to gain enough support for its plan to be confirmable.[66] Such a scheme might take the form of giving a potentially recalcitrant group of creditors an offer they cannot refuse: either accept the plan and receive favorable treatment, or reject the plan and receive less value for its claims. These provisions, known as "deathtrap provisions" or "carrot and stick provisions," have a coercive effect: the creditor is essentially forced to accept the plan or else it will risk losing a favorable distribution.

A. The Debate over Deathtraps

Deathtrap provisions are clever plan devices used to quell objections to the plan. However, these provisions arguably conflict with provisions in the Bankruptcy Code. A plan is not confirmable if it "discriminate[s] unfairly," or if it is not "fair and equitable."[67] According to some courts, crafting a provision that treats a class of creditors differently if it votes in favor of the plan is not fair and equitable. Other courts have held that these provisions are a valid exercise of the debtor's discretion to craft provisions and to obtain votes necessary to confirm a plan. Although few courts have addressed this issue, those that have remain split as to whether "deathtrap" provisions are permissible under the Bankruptcy Code.

B. Cases Upholding Deathtraps

In In re Adelphia Comms., for example, equity security holders argued that the plan was not fair and equitable, and was thus unconfirmable, because a plan provision required that equity security holders vote in favor of the plan or else they would forfeit their distributions.[68] The bankruptcy

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[66] As discussed *supra*, a plan is not confirmable unless all impaired creditors vote in favor of the plan, see 11 U.S.C. §1129(a)(7)(A)(i), or if, at the very least, one impaired class of claims has accepted the plan. See 11 U.S.C. §1129(a)(10).

[67] 11 U.S.C. §1129(b)(1).

[68] In re Adelphia Comms., 368 B.R. 140, 275 (S.D.N.Y. 2007).

court held that "deathtrap provisions" are "wholly permissible."[69] Noting that the equity security holders' chances of recovery were slim and that the debtor was insolvent, the court held that the plan gave the equity security holders more than they were entitled to, even though the Bankruptcy Code does not require *any* distribution to be made to creditors like the equity security holders.[70] Thus, because the equity holders were not entitled to any distribution, the court found that the "deathtrap" provision did not violate the absolute priority rule.[71]

Likewise, in In re Zenith Electronics Corp., the bankruptcy court found that a deathtrap provision was permissible and comported with the Bankruptcy Code's overall policy of granting plan proponents discretion in crafting their own plans. The plan provided that if unsecured bondholders, who were otherwise entitled to no distributions under the plan, accepted the plan, they would be entitled to a pro rata distribution of $50 million of new senior debentures. If they voted against the plan, they would not be entitled to share in the distribution of new senior debentures.[72] The shareholders objected, arguing that the provision was not fair and equitable because the bondholders were not entitled to a distribution under the plan. The bankruptcy court disagreed, finding that the bondholders were senior to the equity holders and therefore the plan satisfied the absolute priority rule. The court found that there is no prohibition in the Bankruptcy Code against providing different treatment to creditors who accept the plan and that the different treatment was justified because "if the class accepts, the Plan proponent is saved the expense and uncertainty of a cramdown fight."[73] The court stated that such provisions do not conflict with the Bankruptcy Code's overall policy of "fostering consensual plans of reorganization and does not violate the fair and equitable requirement of section 1129(b)."[74]

The court in In re Drexel Burnham also found that deathtrap provisions do not conflict with the Bankruptcy Code, specifically the absolute priority rule.[75] In Drexel, three separate classes of equity holders were offered warrants if the classes, either individually or collectively, voted in favor of the plan and nothing if they individually voted to reject the plan.[76] The court held that it did not view the "carrot and stick . . . as forbidden by the Code or any law . . . ."[77] The court stated that it had "no conceptual problem with senior interests offering junior interests an inducement to consent to the Plan and waive whatever rights they have."[78] Thus, the court found that the provision was not discriminatory. However, even if the provision was discriminatory,

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[69] Id.

[70] Id.

[71] Id. at 274-75.

[72] In re Zenith Electronics Corp., 241 B.R. 92, 105 (Bankr. D. Del. 1999).

[73] Id.

[74] Id.

[75] In re Drexel Burnham Lambert Group, Inc., 138 BR. 714, 717 (Bankr. S.D.N.Y. 1992).

[76] Id. at 715.

[77] Id. at 717.

[78] Id.

the court held that it did not matter because the provision did not violate the absolute priority rule.[79] Specifically, the provision gave the "ostensibly equal" equity holders what they were entitled to—nothing—and no junior interests were receiving any property. Consequently, the court found that the deathtrap provision did not violate any section of the Bankruptcy Code.

C. MCorp*: Deathtrap Provisions Violate the "Fair and Equitable" Standard*

In In re MCorp. Finance, Inc., the bankruptcy court found that a deathtrap provision, which provided a distribution to equity holders only if they voted in favor of the plan, was discriminatory towards those who rejected the plan and was thus not confirmable under the Bankruptcy Code's cramdown provisions.[80] The court held that there is "*no authority* in the Bankruptcy Code for discriminating against classes who vote against a plan of reorganization" and that deathtrap provisions take away the shareholders' ability to "vote effectively," by coercing them to vote in favor of the plan.[81] Consequently, the court held that the deathtrap provision violated the "fair and equitable" standard under section 1129(b)(1) and therefore was not confirmable under the cramdown provisions. One key distinction between MCorp and the cases allowing death trap provisions is that in MCorp the distribution being taken away was not a gift.

III. POST-CONFIRMATION JURISDICTION

While the statutory basis for a bankruptcy court's jurisdiction does not change after confirmation of a plan of reorganization (i.e., jurisdiction is still governed by 28 U.S.C. § 1334),[82] bankruptcy courts generally recognize that the scope of their jurisdiction narrows after confirmation of a plan.[83] This necessarily follows from the fact that as time passes after confirmation, the panoply of matters that relate to the chapter 11 case will diminish.

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[79] Id.

[80] In re MCorp Financial Inc. 137 B.R. 219, 236 (Bankr. S.D. Tex. 1992) (holding that a deathtrap provision violated the absolute priority rule). See also In re Allegheny Intern., Inc., 118 B.R. 282, 304 n.15 (Bankr. W.D. Pa. 1990) (finding that a deathtrap provision was not fair and equitable because it discriminated against classes of creditors who voted against the plan).

[81] Id. (emphasis added).

[82] In all bankruptcy-based matters, the district court, and derivatively, the bankruptcy court, has jurisdiction "of all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. §§ 157, 1334(b). For a variety of reasons, courts must distinguish between these three bases of jurisdiction: (1) "arising under;" (2) "arising in;" and (3) "related to." See 1 COLLIER ON BANKRUPTCY ¶ 3.01[4][c]. A general discussion of bankruptcy court jurisdiction and an analysis of the myriad issues relating to the topic are outside the scope of this presentation.

[83] See Penthouse Media Group v. Guccione (In re General Media, Inc.), 335 B.R. 66, 73 (Bankr. S.D.N.Y. 2005) (finding that while section 1334 does not limit a bankruptcy court's jurisdiction after plan confirmation, "all courts that have addressed the question have ruled that once confirmation occurs, the bankruptcy court's jurisdiction shrinks").

The tests applied by the courts to determine "arising under" and "arising in" jurisdiction generally remain the same after plan confirmation and there is little dispute that a bankruptcy court typically may retain jurisdiction over matters that are shown to arise under or arise in the bankruptcy. "Related to" jurisdiction, on the other hand, has been applied more narrowly by some courts in the post-confirmation context. To refine the reach of this jurisdiction, some circuits have developed specific tests in determining whether post-confirmation jurisdiction exists.

A. Resorts International

In the seminal case of Resorts International,[84] the Third Circuit established the "close nexus" test, a standard that was eventually followed by several other Circuits. In Resorts, a litigation trust established under the debtor's confirmed chapter 11 plan commenced an adversary proceeding for malpractice against an accounting firm that had provided the trust with tax and accounting advice.[85] The trust alleged that the accounting firm erroneously reported in an audit that accrued interest on the litigation trust's accounts belonged to the debtor rather than the trust.[86] The debtor was not a party to the malpractice action and had assigned all of its rights, title and interest in the litigation trust's primary asset to the trust under its confirmed plan.[87] The firm, objecting to bankruptcy court jurisdiction over the action, argued that the trust was a distinct legal entity and not a continuation of the bankruptcy estate, and that the beneficiaries were no longer creditors of the estate.

The bankruptcy court agreed with the defendant and found no "related to" jurisdiction, a decision that was reversed by the district court. On appeal, the Third Circuit reversed the district court and held that the bankruptcy court did not have "related to" jurisdiction. The court reviewed various other courts' standards for "related to" post-confirmation jurisdiction and held that the "essential inquiry" in all of these standards is "whether there is a 'close nexus' to the bankruptcy plan or proceeding sufficient to uphold bankruptcy court jurisdiction over the matter."[88] This inquiry, now described as the "close nexus" test, was elucidated by the court: "Matters that affect the interpretation, implementation, consummation, execution, or administration of the confirmed plan will typically have the requisite close nexus."[89] Applying this test, the court found that the malpractice action lacked a close nexus to the bankruptcy plan or proceeding and affected only matters collateral to the bankruptcy process.[90] The court determined that resolution of trust's claims would not impact the estate and would not interfere with implementation of the plan.[91]

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[84] Binder v. Price Waterhouse & Co., LLP (In re Resorts Int'l), 372 F.3d 154 (3rd Cir. 2004).

[85] See id. at 156-57.

[86] See id. at 157.

[87] See id.

[88] Id. at 166-67.

[89] Id. at 167.

[90] Id. at 169.

[91] Id.

B. Adoption of "Close Nexus" Test and Alternative Tests

The Third Circuit's test has been adopted by the Ninth Circuit,[92] cited with approval by the Fourth Circuit,[93] and cited with approval by several district and bankruptcy courts in other jurisdictions.[94] Recently, the bankruptcy court for the district of Delaware affirmed the use of the close nexus test, finding "related to" jurisdiction where defendants in an adversary proceeding concerning a third-party dispute had filed proofs of claim against the debtor for a contingent right of contribution related to the dispute.[95]

The Fifth, Seventh and Eighth Circuits have applied narrower tests to post-confirmation jurisdiction. For instance, the Fifth Circuit has applied an "implementation or execution" test, reasoning that "[a]fter a debtor's reorganization plan has been confirmed, the debtor's estate, and thus bankruptcy jurisdiction, ceases to exists, other than for matters pertaining to the implementation or execution of the plan."[96] Courts in the Seventh Circuit also appear to apply a narrower test that is in line with the Circuit's jurisdictional standard for pre-confirmation jurisdiction.[97] The Eighth Circuit similarly has appeared to employ a narrower standard in assessing jurisdiction on a case by case basis.[98]

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[92] See State of Mont. v. Goldin (In re Pegasus Gold Corp.), 394 F.3d 1189, 1193-94 (9th Cir. 2005).

[93] See Valley Historic Ltd. Partnership v. Bank of New York, 486 F.3d 831, 837 (4th Cir. 2007).

[94] See, e.g., Kirschner, v. Grant Thornton LLP (In re Refco, Inc. Sec. Litig.), 2008 WL 1827644, *10-11, No. 07 Civ. 11604 (GEL) (S.D.N.Y., April 21, 2008) (unreported); Krys v. Sugrue, 2008 WL 4700920, *5, 08 Civ. 7416 (GEL) (S.D.N.Y. Oct. 23, 2008) (slip opinion); Thickstun Bros. Equip. Co., Inc. v. Encompass Servs. Corp. (In re Thickstun Bros. Equip. Co., Inc.), 344 B.R. 515, 520-522 (B.A.P. 6th Cir. 2006); Premium of Am., LLC v. Sanchez (In re Premium Escrow Servs., Inc.), 342 B.R. 390, 396-400 (Bankr. D. D.C. 2006).

[95] See In re Semcrude, L.P., Case No. 08-11525 (BLS), 2010 WL 5140487 (Bankr. D. Del. Dec. 13, 2010) (stating that the "'close nexus' standard is applied 'for the purposes of determining whether a federal court has jurisdiction over a non-core related-to proceeding in the post-confirmation context'") (internal citations omitted); see also, Logan v. Westchester Fire Ins. Co. (In re PRS Ins. Group, Inc.), 445 B.R. 402 (Bankr. D. Del. 2011) (reciting close nexus standard and finding that "[t]he mere potential to increase the assets of a post-confirmation trust is insufficient to establish the required 'close nexus'").

[96] Bank of Louisiana v. Craig's Stores of Texas, Inc. (In re Craig's Stores of Texas, Inc.), 266 F.3d 388, 390 (5th Cir. 2001) (declining to assume post-confirmation jurisdiction over the debtor's state law claims against a bank for the bank's alleged breach of an assumed contract between the parties because the claims did not bear upon interpretation or execution of the debtor's plan). Since this decision, the Fifth Circuit has continued to apply the "implementation or execution" test. See, e.g., U.S. Brass Corp. v. Travelers Ins. Group, Inc. (In re U.S. Brass Corp.), 301 F.3d 296, 304 (5th Cir. 2002); Lloyd Ward & Assocs., P.C. v. U.S. Trustee (In re Network Cancer Care, L.P.), 197 Fed. Appx. 284, 286 (5th Cir. 2006).

[97] See, e.g., Cytomedix, Inc. v. Perfusion Partners & Assocs., Inc., 243 F. Supp. 2d 786, 789-91 (N.D. Ill. 2003) (declining to exercise "related to" jurisdiction over patent law claims where outcome of case would not impact amount of property available for distribution or allocation of property among creditors); Federalphia Steel LLC Creditors' Trust v. Fed. Pipe & Steel Corp., 341 B.R. 872, 880-81 (Bankr. N.D. Ill. 2006) (rejecting "close nexus" analysis and declining to exercise related to jurisdiction over

One outlier is the First Circuit which, in the context of a liquidating plan, has applied a broader test than the "close nexus" test, essentially refusing to make a distinction between pre- and post-confirmation jurisdiction. In Boston Reg'l Med. Ctr., Inc. v. Reynolds (In re Boston Reg'l Med. Ctr., Inc.),[99] the First Circuit held that "when a debtor (or a trustee acting to the debtor's behoof) commences litigation designed to marshal the debtor's assets for the benefit of its creditors pursuant to a liquidating plan of reorganization, the compass of related to jurisdiction persists undiminished after plan confirmation."[100] The court analyzed Resorts International and Pegasus Gold and distinguished those cases based on their context: They involved reorganizing debtors whereas Boston Reg'l Med. Ctr. dealt with a liquidating plan and thus, "the specter of endless bankruptcy jurisdiction" was absent.[101]

C. Retention of Jurisdiction Provisions

Although post-confirmation jurisdiction is governed by statute, it can be impacted through the provision of a post-confirmation jurisdiction retention provision in a plan of reorganization. Jurisdiction retention provisions, which are contained in the vast majority of plans, may either attempt to expand the bankruptcy court's jurisdiction under 28 U.S.C. § 1334, or seek to contract the scope of jurisdiction that may potentially be available under that section (i.e., specifically exclude certain matters from the bankruptcy court's jurisdiction so that they may be litigated, if necessary, outside the bankruptcy court). Most bankruptcy courts will not countenance jurisdiction retention provisions that attempt to expand the court's authority beyond that allowed by statute,[102] but there is disagreement over whether jurisdiction retention provisions can effectively limit a court's jurisdiction.

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prepetition state laws claims where recovery on claims would not affect amount or allocation of estate property distributed to creditors).

[98] See, e.g., Norwest Equip. Fin., Inc. v. Nath (In re D & P Partnership), 91 F.3d 1072, 1074 (8th Cir. 1996) (finding that post-confirmation jurisdiction exists for matters relating to plan "administration and interpretation").

[99] 410 F.3d 100 (1st Cir. 2005)

[100] Id. at 107; but see PRS Ins. Group, Inc., 445 B.R. at 405 (finding potential to increase assets of a post-confirmation liquidating trust insufficient for post-confirmation jurisdiction).

[101] Id. at 106.

[102] See Valley Historic Ltd. P'ship. v. Bank of New York, 486 F.3d at 837 (explaining that jurisdiction must exist under section 1334 and that the debtor cannot "write its own jurisdictional ticket"); Resorts Int'l, 372 F.3d at 161 ("[I]f a court lacks jurisdiction over a dispute, it cannot create that jurisdiction by simply stating that it has jurisdiction in a confirmation or other order."); U.S. Brass Corp., 301 F.3d at 303 (5th Cir. 2002) ("In asserting jurisdiction, the bankruptcy court relied on both a broad retention-of-jurisdiction provision in the confirmed plan and its authority under the Bankruptcy Code to clarify and enforce its own orders. 'However, the source of the bankruptcy court's subject matter jurisdiction is neither the Bankruptcy Code nor the express terms of the Plan. The source of the bankruptcy court's jurisdiction is 28 U.S.C. §§ 1334 and 157.'" (citation omitted)); BWI Liquidating Corp., et al. v. City of Rialto and Rialto Utility Authority (In re BWI Liquidating Corp.), Adv. Proc. No. 10-50787 (MFW) (Bankr. D. Del. Sept. 28, 2010) ("Plan provisions that purport to preserve the bankruptcy court's jurisdiction are not alone sufficient to establish post-confirmation jurisdiction; instead the court must

1. *Are Jurisdiction Retention Provisions Necessary?*

Like those provisions which attempt to expand the bankruptcy court's post-confirmation jurisdiction, some court will similarly give no effect to a plan of reorganization's failure to include a jurisdiction retention provision. In other words, simply because a plan fails to include a jurisdiction retention provision or includes such a provisions but fails to specify what the court's post-confirmation jurisdiction will cover, does not mean that the court will not retain its statutorily-provided jurisdiction.[103] On the other hand, some courts find that jurisdiction retention provisions are necessary for the court to retain subject matter jurisdiction over certain "related to" matters during the post-confirmation period.[104] Similarly, plan provisions specifically excluding certain matters from a bankruptcy court's post-confirmation jurisdiction may be upheld.[105]

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determine whether "a matter affects the interpretation, implementation, consummation, execution, or administration of a confirmed plan . . . ." (citing Resorts, 372 F.3d at 168-69).

[103] See, e.g., U.S. Trustee v. Gryphon At The Stone Mansion, Inc., 216 B.R. 764, 769 (W.D. Pa. 1997), aff'd, 166 F.3d 552 (3d Cir. 1999) (holding that the absence of a jurisdiction retention provision did not limit the bankruptcy court's jurisdiction to decide issues related to the U.S. Trustee's request for payment of quarterly fees and finding that "the absence of a provision retaining jurisdiction in a confirmed plan does not deprive a bankruptcy court of jurisdiction"); Burlington Motor Carriers, Inc. v. Comdata Network, Inc. (In re Burlington Motor Holdings, Inc.), Civ. A. 99-573-GMS, 2002 WL 73490, at *1-2 (D. Del. Jan. 18, 2002) (holding that notwithstanding that avoidance actions were not specifically enumerated in jurisdiction retention provision in the confirmed plan, the bankruptcy court retained jurisdiction over avoidance actions); In re CSC Indus., Inc., 226 B.R. 402, 405 (Bankr. N.D. Ohio 1998) ("Despite no specific provision in the confirmed plan regarding the retention of jurisdiction, we conclude that the absence of such provision does not preclude this Court's jurisdiction.").

[104] See, e.g., Fairfield Communities, Inc. v. Daleske (In re Fairfield Communities, Inc.), 142 F.3d 1093, 1095 (8th Cir. 1998) (finding that a bankruptcy court may retain jurisdiction over issues relating to a plan's administration and interpretation if such jurisdiction is explicitly retained in the plan, notwithstanding that jurisdiction generally ceases to exist upon plan confirmation); Hosp. and Univ. Property Damages Claimants v. Johns-Manville Corp. (In re Johns-Manville Corp.), 7 F.3d 32, 34 (2nd Cir. 1993) (holding that "[a] bankruptcy court retains post-confirmation jurisdiction in a chapter 11 proceeding only to the extent provided in the plan of reorganization" and "[t]he bankruptcy court's post-confirmation jurisdiction is defined by reference to the Plan"); Penthouse Media Group v. Guccione (In re General Media, Inc.), 335 B.R. 66, 73-74 (Bankr. S.D.N.Y. 2005) (following Johns-Manville and mandating that a party seeking post-confirmation jurisdiction demonstrate that the matter has a "close nexus" to plan or proceeding and that the plan provides for retention of jurisdiction over dispute); Gallien v. Sanwa Leasing Corp. (In re Gallien), 214 B.R. 583, 585 (Bankr. E.D. Ark. 1997) ("[T]he [b]ankruptcy court lacks subject matter jurisdiction over adversary proceedings commenced post-confirmation unless the plan expressly provides for retention of such jurisdiction.) (citing Johns-Manville).

[105] See, e.g., Grossman v. Murray (In re Murray), 214 B.R. 271, 277 (Bankr. D. Mass. 1997) (finding lack of jurisdiction over adversary proceeding where post-confirmation jurisdiction retention provision intended only to have bankruptcy court retain jurisdiction over those adversary proceedings that were initiated prior to the confirmation date).

D. Preserving Causes of Action

In addition to post-confirmation jurisdiction retention provisions, chapter 11 plans frequently contain provisions that either settle claims against the debtor or permit the debtor to preserve causes of action post-confirmation.[106] When the debtor has a large number of claims or potential causes of action of its own, it may wish to pursue these claims post-confirmation. And, if there is substantial (either in number or in potential value) prepetition litigation or potential causes of action pending against it, the debtor may consider creating a litigation trust under its proposed plan. Section 1123(b)(3)(B) permits the plan to provide for "the retention and enforcement of causes of action" that are not settled under the plan, "by the debtor, the trustee or a representative of the estate" appointed for the purpose of pursuing and enforcing such claims.[107] Section 1123(b)(3)(B), therefore, provides the statutory authority for a debtor to preserve its causes of action post-confirmation.

1. *The "Unequivocal and Specific" Requirement for Claim Preservation*

While it is undisputed that a plan may provide for the preservation of claims post-confirmation,[108] courts do not agree on whether a debtor must specify which claims it seeks to preserve in its plan, or if, conversely, the debtor can merely provide a blanket reservation for all claims.[109] A majority of courts require *some* specificity as to which claims the debtor wishes to preserve.[110]

Even so, courts disagree over what exactly debtors must disclose in their plans in order to preserve their claims. Some courts permit "blanket reservations" of claims, wherein the debtor reserves the right to litigate a litany of claims under the Bankruptcy Code.[111] Other courts

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[106] See In re Tribune Co., No. 08-13141 (KJC), 2011 WL 5142420 (Bankr. D. Del. Oct. 31, 2011) (Noteholders' plan provided for the preservation of fraudulent conveyance claims through a litigation trust while debtors' plan provided a settlement of fraudulent conveyance claims).

[107] See 11 U.S.C. §1123(b)(3)(B).

[108] See, e.g., In re United Operating LLC, 540 F.3d 351 (5th Cir. 2008) ("[A] debtor may preserve its standing to bring such a claim . . . ."]; In re Acequia, Inc., 34 F.3d 800 (9th Cir. 1994) (noting that section 1123(b)(3)(B) expressly permits debtors to preserve causes of actions in their plans); Intern. Asset Recovery Corp. v. Thomson McKinnon Securities Inc., 335 B.R. 520, 525 (S.D.N.Y. 2005) ("[T]he Code permits the post-confirmation debtor to retain the powers of a trustee . . .[including] the ability to bring turnover proceedings.")

[109] Compare In re United Operating LLC, 540 F.3d at 355 ("Absent specific and unequivocal language in the plan, creditors lack sufficient information . . . to cast an intelligent vote.") with Matter of P.A. Bergner & Co., 140 F.3d 1111, 1117 (7th Cir. 1998) (noting that individual claims do not need to be listed specifically).

[110] See Spicer v. Laguna Madre Oil & Gas LLC (In re Texas Wyoming Drilling Inc.), 647 F.3d 547 (5th Cir. 2011).

[111] See, e.g., In re Acequia, Inc., 3 F.3d 800, 808 (9th Cir. 1994) (upholding a claim retention provision that provided that the debtor would "continue to litigate claims and causes of action which exist in favor of the debtor arising prior to and subsequent to the commencement of the case").

require "unequivocal and specific" language where the debtor must provide a factual basis for the preserved claim and the name of the putative defendant.[112] This split amongst the courts present debtors with uncertainty as to whether they should list specific claims in order to preserve them. While naming every cause of action in a plan out of an abundance of caution would appear to be the logical conclusion for a debtor, using such a degree of specificity and inadvertently omitting to name certain causes of actions could arguably be interpreted as an intentional omission.

(a) Cases Requiring Specific References to Claims

Some courts have interpreted section 1123(b)(3)(B) to require that a debtor must specifically list claims to obtain "unequivocal and specific" claim preservation. In D & K Properties Crystal Lake v. Mutual Life Insurance Company of New York, the Seventh Circuit held that a reservation of claims must be in writing and refer to specific claims within the plan of reorganization.[113] Consequently, the court held that the blanket reservation in the debtor's plan did not preserve claims under section 1123(b)(3) because the plan did not specifically list claims.

Likewise, in In re United Operating Systems LLC, the Fifth Circuit found that a blanket reservation did not comport with the "unequivocal and specific" requirement to preserve claims.[114] The debtor's plan contained a blanket reservation of "any and all claims" arising under the Bankruptcy Code and certain other specific claims under the Bankruptcy Code.[115] However, the plan made no reference to the preservation of certain common law causes of action, such as fraud, breach of fiduciary duty, and negligence. The debtor later sought to pursue those common law claims. The court held that a debtor "*must* provide a reservation that is specific and unequivocal."[116] Turning to the facts of the case, the court held that if the debtor "wanted to bring a post-confirmation action for maladministration of the estate's property during the bankruptcy, it was required to state as much clearly in the Plan."[117] According to the court, failure to provide such disclosure could thwart creditors from making informed decisions as to whether they should vote for a plan.[118]

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[112] See, e.g., Browning v. Levy, 283 F.3d 761, 774 (6th Cir. 2002); In re MPF Holding U.S. LLC, 443 B.R. 736, 747 (Bankr. S.D. Tex. 2011) ("[A] proper provision in any plan must expressly state (1) the name of the putative defendant; (2) the basis on which the defendant will be sued; and (3) that the suit will definitely be filed following confirmation).

[113] 112 F.3d 257, 259 (7th Cir. 1997). The court found that "a blanket reservation that seeks to reserve all causes of action reserves nothing. To hold otherwise would eviscerate the finality of a bankruptcy plan containing such a reservation, a result at odds with the very purpose of a confirmed bankruptcy plan." Id. at 261.

[114] 540 F.3d 351 (5th Cir. 2008).

[115] Id. at 355.

[116] Id. (emphasis added).

[117] Id. at 356.

[118] Id.

The bankruptcy court in In re Ice Cream Liquidation also adopted this line of reasoning, requiring debtors to provide greater specificity as to the causes of actions that they wish to preserve post-confirmation. The court noted that the plan made no mention of "turnover actions, actions to recover accounts receivable or the invalidation of setoffs," even though the plan specifically mentioned sections 544, 547, 548 and 550 of the Bankruptcy Code.[119] Notably, although the debtor's disclosure statement specifically referenced a preservation of the claims at issue, the court held that a debtor may only preserve claims under section 1123(b)(3)(B) with specific language in the plan.[120]

(b) Cases Permitting Blanket References

Other courts do not require specificity in the plan and permit debtors to preserve causes of action through "blanket reservations." Just one year after D&K Properties Crystal Lake, the Seventh Circuit held that a plan need not specifically list all claims in order to preserve them. In Matter of P.A. Bergner & Co., the Seventh Circuit held that a plan merely needs to list the type of claim, rather than list out all specific claims.[121] The court found that the "statute itself contains no such requirement" to list out all claims.[122]

Similarly, in In re Acequia, Inc., the Ninth Circuit permitted a blanket provision to preserve the debtor's causes of action. The plan provided that the debtor would "continue to litigate claims and causes of action which exist in favor of the debtor arising prior to and subsequent to the commencement of the case."[123] The court held that the blanket provision did not violate any provision of the Bankruptcy Code and therefore found it to be permissible.

2. *Texas Wyoming Drilling: The Role of Disclosure Statements*

More recently, courts have become less strict in their interpretation of section 1123(b)(3)(B) and are willing to look at a debtor's disclosure statement in determining whether the debtor provided "specific and unequivocal" preservation of their claims.[124] In In re Texas Wyoming Drilling, Inc., the Fifth Circuit held that a plan may preserve claims by stating a category of potential claims a post-confirmation debtor or trustee may pursue against third-parties.[125] The debtor's plan provided a blanket preservation of claims, while the disclosure statement provided language addressing the common law claims that the debtor wished to preserve.[126] The court held that

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[119] 319 B.R. 324, 333 (Bankr. D. Conn. 2005).

[120] Id. at 333-34.

[121] 140 F.3d 1111, 1117 (7th Cir. 1998).

[122] Id.

[123] In re Acequia, Inc., 3 F.3d 800, 808 (9th Cir. 1994).

[124] See, e.g., In re South Louisiana Ethanol LLC, 2012 WL 113817 (Bankr. E.D. La. Jan. 13, 2012)

[125] Spicer v. Laguna Madre Oil & Gas LLC (In re Texas Wyoming Drilling Inc.), 647 F.3d 547, 551 (5th Cir. 2011).

[126] Id. at 552.

there is no requirement for the plan to specifically identify potential defendants.[127] The court further found that the disclosure statement adequately addressed the common law actions to be preserved and thus found that such claims were preserved.[128]

3. *The Effect of Stern v. Marshall on Claim Preservation*

While debtors yield significant power in crafting their plans and retaining causes of actions, a recent Supreme Court case might inhibit the debtor's ability to draft provisions that provide for exclusive jurisdiction of claims in the bankruptcy court. In Stern v. Marshall, the Supreme Court held that it is unconstitutional for a bankruptcy court to issue a final judgment on state law counterclaims that are not necessarily resolved in the claims allowance process.[129] The case centered on a probate dispute between Anna Nicole Smith and her step-son, Pierce Marshall, about the estate of her deceased husband, J. Howard Marshall. Smith alleged that Pierce tortiously interfered with her expected gifts under J. Howard Marshall's will through his undue influence over his father, while Pierce counterclaimed that Smith defamed him. Smith subsequently filed for bankruptcy and Pierce filed a proof of claim against her estate for the defamation counterclaim. The court found that by filing a proof of claim, Pierce did not necessarily consent to resolution of Smith's claim in the bankruptcy court proceedings because Pierce's filing his proof of claim was his only means of recovering from Smith's estate.

The effect of Stern on claims preservation remains unclear, but at least one bankruptcy court has suggested that Stern limits the ability of a debtor to provide for exclusive jurisdiction in the bankruptcy court for its retained claims. In In re BearingPoint, Inc., the debtor's plan of reorganization provided that the bankruptcy court and the district courts in the Southern District of New York had exclusive jurisdiction over any claims against the debtor's former officers and directors.[130] Uncertain over whether he had authority to hear state law claims in light of Stern, Judge Gerber declined to exercise jurisdiction, stating that additional litigation over the bankruptcy court's ability to render a final judgment would increase the cost and time associated with resolving the claim.[131]

On the other hand, some recent decisions have found that Stern does not affect the ability of a debtor to retain jurisdiction in the bankruptcy court for its preserved claims.[132] In In re DPH

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[127] Id. at 552-53.

[128] Id.

[129] 131 S.Ct. 2594 (2011). A more extensive analysis of the Stern v. Marshall decision and its impact on bankruptcy court jurisdiction, both pre- and post-confirmation, is beyond the scope of this presentation. For a more fulsome description, see Hon. Brendan Shannon, Views from the Bench: Coping with Jurisdictional Challenges after *Stern v. Marshall*, AMER BANKR. INST. (2011), http://materials.abi.org/sites/default/files/2011/Nov/JurisdictionalChallengesStern.pdf.

[130] 2011 Bankr. LEXIS 2585 (Bankr. S.D.N.Y. July 11, 2011).

[131] Id. at *29.

[132] See, e.g., Ace Am. Ins. Co. and Pac. Employers Ins. Co. v. DPH Holdings Corp., et al., (In re DPH Holdings Corp.), No. 10-4170-bk, 2011 WL 5924410, at *2 (2d Cir. Nov. 29, 2011) (holding that a plan's

Holdings Corp, for example, the Second Circuit held that bankruptcy courts may exercise post-confirmation jurisdiction over matters that have a "close nexus" to a debtor's plan of reorganization where the plan contains a post-confirmation jurisdiction provision. In DPH, the court found a sufficiently close nexus where certain insurance companies filed an adversary proceeding against the debtor and the State of Michigan seeking a declaratory judgment that the insurance companies had agreed to provide only excess insurance coverage to the debtor, thereby making the debtor liable for the majority of the insurance claim amounts the Michigan state agencies were seeking. The Second Circuit, affirming the bankruptcy court and district court, denied the State of Michigan's attempt to dismiss the case on the grounds that the case dealt with a "non-core" issue and held that the bankruptcy court may exercise post-confirmation jurisdiction when "the plan provides for the retention of such jurisdiction."[133]

Thus, after BearingPoint, DPH Holdings and Stern, it is not entirely clear to what extent a debtor may craft a provision in its plan of reorganization that preserves state law claims.

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retention of jurisdiction entitled the bankruptcy court to exercise post-confirmation jurisdiction over an adversary proceeding); Walker, Truesdell, Roth & Assocs. v. Blackstone Group, L.P. (In re Extended Stay, Inc.), 2011 U.S. Dist LEXIS 131349 (S.D.N.Y. Nov 10, 2011) (denying motions seeking withdrawal of the reference of fraudulent transfer claims, citing considerations of efficiency).

[133] Id. The DPH plan provided for the retention of jurisdiction of claims, including insurance claims, against the debtor.