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Eleventh Circuit Stops Plan Confirmation Stampede

By Michael L. Cook

"When a modification to a Chapter 11 reorganization plan materially and adversely affects the treatment of a class of claim or interest holders, those claim or interest holders are entitled to a new disclosure statement and another opportunity to vote." *In re America-CV Station Group, Inc.*, 2023 WL 109967 (11th Cir. Jan. 5, 2023). In this case, the U.S. Court of Appeals for the Eleventh Circuit just upended a hastily confirmed reorganization plan. Its holding should stop the stampede known as the "confirmation express." The bankruptcy court had summarily approved a plan modification that "materially and adversely affected" the rights of objecting pre-bankruptcy shareholders (Shareholders), depriving them of procedural protections and impairing their substantive rights. In reversing, the Eleventh Circuit directed "the bankruptcy court to fashion an equitable remedy …." *Id.* at *8.

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Relevance

Debtors routinely modify reorganization plans shortly before a confirmation hearing. These modifications usually are either immaterial or are consensual. In the words of the Eleventh Circuit, modifying the plan "before confirmation is relatively easy: the 'proponent of a plan may modify such plan any time before confirmation.'" *Id.* at *4, quoting Bankruptcy Code (Code) §1127(a). "Easy modification allows negotiated outcomes to quickly become part of the plan," said the court.

There is an important limit, though, to easy plan modification. Aside from substantive and procedural constraints, discussed below, a creditor or equity holder of a corporate debtor or LLC is entitled to procedural protections if the bankruptcy court finds that the modification "materially and adversely changes the way that claim or interest holder is treated." *Id.*, quoting *In re New Power Co.*, 438 F.3d 1113, 1117-18 (11th Cir. 2006). When the parties appear to have accepted a plan and a confirmation hearing approaches, however, courts and most parties are eager to have the court confirm the plan quickly and move on, ignoring objections from interested parties, dismissing them as noise. That is apparently what happened in *America-CV*.

Facts

The Shareholders in *America-CV* argued that, despite a materially adverse change to the plan, "the bankruptcy court [skipped the required] review for materiality and adversity, as well as the new disclosure and voting that would follow from

a correct decision on those issues." In the original unmodified plan, the Shareholders held the "exclusive opportunity to obtain 65.8% of the equity interests in the reorganized" debtors. But the plan modification stripped them "of this equity, thereby materially and adversely" changing the way the Shareholders were treated under the original plan.

The bankruptcy court had deemed the Shareholders "as having rejected" the plan under Code §1126(g) ("if … plan provides that the … interests of [a] class do not entitle" the interest holders to "receive or retain any property under the plan on account of" their interests, they are "deemed not to have accepted a plan."). But the original plan here gave the Shareholders voting rights and new equity interests in exchange for a substantial capital contribution "because of their status as pre-petition equity holders." *Id*. at *5.

The Shareholders received notice of a plan modification "just hours before the confirmation hearing." *Id*. at *8. Although the Shareholders understood that their financial contribution was to be made on the plan's effective date, *after* entry of the confirmation order, the debtor told them at the last minute that their contribution had to be made *before* the confirmation hearing. They still made the required contribution, but the debtor, under the control of its chief executive officer (CEO) who was also a competing shareholder, "filed an emergency motion" to modify the reorganization plan in favor of the CEO. The proposed modification gave the CEO "all of the equity" in the reorganized debtor. The debtor never served the emergency motion on the Shareholders, although they apparently learned of it later and objected. "[U]p to the confirmation hearing, the debtors assured the [Shareholders] that they would 'try to resolve the situation'" *Id*. at *2. According the Eleventh Circuit, though, the debtor's counsel had "falsely assured" the Shareholders "that he wanted to be helpful and would try to resolve the situation — all while moving full speed ahead on the modification in the bankruptcy court." *Id*. at *8.

Eleventh Circuit Analysis

No Shareholder Rejection of Original Plan. Despite the bankruptcy court's finding that the Shareholders would receive nothing, the unmodified original plan entitled the Shareholders to receive property (new equity) on account of their pre-bankruptcy equity interests in exchange for a cash contribution. Still, the bankruptcy court "confirmed the modified plan … via a 'cramdown' over the deemed dissent" of the Shareholders, relying on Code §1126(g) (deemed rejection) and §1129(b) *Id*. at *6. By giving the Shareholders voting rights in the original plan, however, the debtors conceded that the Shareholders "were entitled to receive or retain property," making Code §1126(g) inapplicable. The bankruptcy court thus "had no basis for deciding that [the Shareholders] had rejected the unmodified [original] plan." Because of their pre-bankruptcy status as shareholders, they thus "received an exclusive opportunity to obtain equity in the reorganized" debtor. *Id*. at *5, *citing Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 M. LaSalle St. P'ship*, 526 U.S. 434, 437, 442 (1999). In short, the bankruptcy court had wrongfully denied the Shareholders "a new disclosure statement and vote" on the modified plan.

Additional Disclosure and Voting Required. Bankruptcy Rule 3019(a) provides that if "the proposed modification [of a plan] does not adversely change the treatment of the claim of any creditor or the interest of *any* equity security holder who has not accepted in writing the modification, it shall be deemed accepted by all creditors and equity security holders who have previously accepted the plan." (emphasis added). Still, said the court, Bankruptcy Rule 3019(a) "requires addition-

al disclosure and voting if the modification materially and adversely affects any creditor or interest holder, not just those voting to accept a plan." *Accord*, *New Power*, 438 F.3d at 1118 (if plan "materially and adversely" changes treatment, "the claim or interest holder is entitled to a new disclosure statement and another vote").

The Rule's Rationale. The Shareholders had accepted the original plan. Because the proposed modification materially and adversely affected their treatment, they were entitled to and would benefit from "added disclosure and revoting because [they] can change [their] vote to reject the [modified] plan. A new disclosure statement with additional time to vote would have given the [Shareholders] an opportunity to object to the modification on substantive grounds." *Id*. at *7.

Additional Substantive Problem With Modified Plan: Unequal Treatment. The proposed modification would strip the Shareholders of the exclusive opportunity to obtain an equity interest in the reorganized debtor and reallocate that opportunity to the CEO, another member of the shareholder class. In other words, "one member [of the shareholder class] received property under the plan and the others received nothing," which was "improper." §1123(a)(4) requires that a reorganization plan 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 ….". The modified plan here treated the Shareholders less favorably than the CEO. The bankruptcy court, therefore, "improperly" confirmed the modified plan.

Bankruptcy Court's Independent Obligation. The substantive error here shows that the confirmation process here was anything but "harmless," as the debtor argued. Bankruptcy courts have an "independent duty" when reviewing a plan for confirmation to insure that the requirements of Code §1129 are met "with regard to impaired dissenting classes … in a chapter 11 cram down." *Id*. at *7, quoting *In re Lett*, 632 F.3d 1216, 1229 (11th Cir. 2011). *Accord*, *In re Perry*, 2021 WL 4298192 (S.D.N.Y. Sept. 21, 2021) (independent obligation to ensure Plan's compliance with Code). Had the Shareholders received the "additional disclosure to which they were entitled, they could have [rejected] the modified plan …." Significantly, explained the court, the debtor's counsel misled the Shareholders in order to have the bankruptcy court confirm the modified plan.

Remedy. The debtor "substantially consummated" the plan after confirmation, but the debtor failed to appeal from the district court's order that the appeal was not equitably moot. The Eleventh Circuit therefore assumed that "effective judicial relief could be granted," but left the remedy "to the bankruptcy court in the first instance.

Comment

The message on plan modification is clear: bankruptcy courts should not be part of the stampede to plan confirmation. No champagne for counsel until the court does the required independent review for statutory compliance before entering a confirmation order. And, finally, "… it's important for lawyers representing a bankruptcy debtor to turn square corners." *In re Zilog, Inc.*, 450 F.3d 996, 997 (9th Cir. 2006).

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