

# It only takes one: voting for the reorganization plan

By Howard N. Madris

John F. Kennedy often joked that during the 1960 West Virginia presidential primary, he received a telegram from his father, Joe Kennedy, pleading, "Don't buy another vote, I won't pay for a landslide." So too, in a Chapter 11 bankruptcy case, a debtor does not need to obtain a landslide of creditor votes in favor of its reorganization plan. Rather, the accepting vote of merely one creditor class may be sufficient for plan confirmation, even if all other classes of creditors vote against the plan. Therefore, a prudent debtor should engage in pre-bankruptcy planning, and in post-petition negotiations, to ensure that it has a friendly creditor voting class: particularly in a small bankruptcy case where the debtor has a limited number of creditor classes. Otherwise, a hostile creditor may be able to defeat the debtor's plan, thereby facilitating the debtor's liquidation.

Bankruptcy Code Section 1129 sets forth various prerequisites to confirmation of a Chapter 11 plan. These include, among other conditions, that the plan is proposed in good faith, that it is feasible (i.e., that the debtor can generate sufficient revenue to fund it), and that it does not unfairly discriminate against creditors. Nonetheless, even if a plan satisfies these requirements, it must still satisfy the voting requirement in order to be confirmed.

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Section 1129(a)(10) provides that a plan cannot be confirmed unless at least one impaired class of creditors votes to accept it. The requirement that a creditor be "impaired" means that the treatment proposed to the creditor under the plan must differ from the treatment it would receive outside of bankruptcy. Moreover, similarly situated creditors (for instance, unsecured creditors) must typically be placed in the same class, whereas each secured creditor belongs in its own separate class. Further, Section 1126(c) provides that for an impaired class to accept a plan, the plan must be approved by a majority of voting creditors in the class, and those accepting class members must also hold at least two-thirds of the allowed claims of those who voted in the class.

Before filing for Chapter 11, a prudent debtor's attorney should survey the prospective creditor body and determine whether there is an impaired class that is likely to vote for the debtor's plan. Given that each secured creditor is in its own voting class, the debtor could satisfy the voting requirement if even one of

the secured creditors votes for its plan. Alternatively, if all the secured creditors appear to be hostile, the debtor could create a potential accepting secured class, for instance, by borrowing money from a friendly lender pre-petition to purchase a small amount of office equipment, and granting the lender a security interest in the equipment.

Similarly, counsel should analyze the claims of the members of the unsecured creditor class. For instance, under Section 1126(c), the negative vote of a hostile unsecured creditor holding more than one-third of the claims in dollar amount in that class can, by itself, block the class from accepting the plan. Moreover, even if the debtor procures the affirmative votes of unsecured creditors holding two-thirds in dollar amount of the allowed unsecured claims, it must still obtain a numerical voting majority in the unsecured class, in order for that class to approve the plan. Thus if the unsecured class appears hostile to the debtor on the petition date, the debtor should negotiate with the class members during the bankruptcy case, in order to obtain their support.

Nonetheless, even if the debtor believes that the unsecured class can constitute the impaired accepting class, the debtor must be wary. Where there is no secured creditor who will vote for the debtor's plan, an aggressive secured creditor can purchase unsecured claims in order to control the voting process, and thereby obtain a stranglehold on the debtor's ability to confirm a plan. For instance, in the case of *In re Figter Ltd.*, 118 F.3d 635 (9th Cir.), cert. denied, 522 U.S. 996 (1997), the lone secured creditor opposed the debtor's proposed plan. The only other impaired class consisted of the unsecured creditors. The secured creditor purchased the claims of 21 of the 34 unsecured creditors and voted each claim against the plan, such that the unsecured class collectively rejected the plan.

The debtor argued that the secured creditor purchased the unsecured claims in bad faith and that the votes should thus be disqualified from the vote count. The debtor also argued that even if the votes were not disqualified, the 21 votes should be treated as one vote because they were all assigned to the same purchaser, the secured creditor. However, the 9th U.S. Circuit Court of Appeals, affirming the lower courts, held that the claims were not purchased in bad faith. While a party cannot purchase claims for an "ulterior motive" (for instance, to shut down its competitor), the secured creditor's purchase of the unsecured

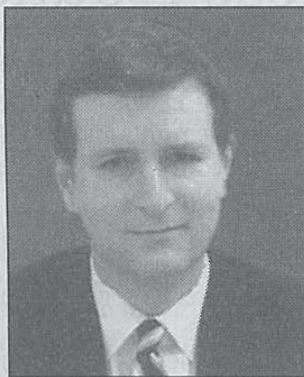
claims to derail the debtor's plan was for the legitimate economic goal of protecting its secured claim, which the secured creditor did not believe would be treated properly under the plan. Further, the 9th Circuit held that the creditor was entitled to cast 21 unsecured votes and not just one, because each of the voted claims arose from a separate transaction.

Recently, a secured creditor employed the *Figter* tactic of buying claims in order to quash a plan, in the case *In re IGVS*, 2:10-62985-ER (Bankr. C.D. Cal. 2010). *IGVS* was a single asset real estate case in which the debtor's schedule of creditors filed early in the case reflected that the debtor had three secured creditors: namely the senior and junior lienholders, and Los Angeles County as the holder of a claim of approximately \$5,000. The schedules also reflected that the debtor had two unsecured creditors. One was owed about \$8,500, and the other was owed approximately \$900.

Upon the senior lienholder's request, the bankruptcy court set a "bar date" deadline for creditors to file claims. Once the bar date passed, alleged creditors could not step forward late in the plan confirmation process to assert new found claims. The debtor then proposed a plan, which as expected, listed each secured creditor in its own class, with the two unsecured creditors in the unsecured class. The senior secured creditor then purchased the \$8,500 unsecured claim and voted it to reject the plan.

The final vote tally reflected that the debtor lacked an impaired accepting class. All three unsecured creditors rejected the plan. (Los Angeles County, as is its typical practice, did not vote. Its non-vote was deemed a rejection of the plan.) While the holder of the \$900 unsecured claim voted for the plan, the unsecured class collectively rejected the plan, as it was deadlocked at one vote for the plan and one vote against. Indeed, because the plan lacked an impaired consenting class, the court never even considered the disputed issue of whether the debtor's proposed business plan was feasible. The court denied confirmation, and granted the secured creditor relief from stay to foreclose on the real property.

In sum, to obtain confirmation of a Chapter 11 plan, a debtor need not procure the overwhelming approval of its creditors. One impaired consenting class will satisfy the voting requirement. However, satisfying that requirement may prove to be elusive, particularly in a small case where the secured creditor is willing to purchase unsecured claims.



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