

BANKRUPTCY PRACTICE

BY JOHN J. RAPISARDI

'Vita': The Split Over the Indifferent Creditor Class Widens

A recent decision by the U.S. District Court for the Central District of Illinois in *In re Vita Corp.*¹ has renewed the debate over what courts should do when a class of creditors fails to register a single vote accepting or rejecting a chapter 11 plan of reorganization.

Vita followed those courts that have denied plan confirmation under §1129(a) of the Bankruptcy Code because of the failure of a creditor class to vote on a plan, effectively deeming voter apathy to be a form of plan rejection. Other courts, including the U.S. Bankruptcy Court for the Southern District of New York in the bankruptcy case of *Adelphia Communications Corp.*² have confirmed plans under §1129(a) notwithstanding the absence of votes by a class of creditors.

In light of the uncertainty imposed by this judicial conflict, there are certain practical steps that a debtor's counsel may take to reduce the risk that voter apathy will require a debtor to seek confirmation under the Bankruptcy Code's "cram down" provisions and potentially doom an otherwise confirmable plan.

Applicable Bankruptcy Law

Under chapter 11 of the Bankruptcy Code, a plan of reorganization sets forth the terms and conditions of a debtor's emergence from bankruptcy protection.

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The plan proposes a particular treatment of creditors' claims, and is served on creditors with a court-approved disclosure statement that provides material to inform their voting decision.

One requirement of a plan is that it must classify the claims of creditors into one or more classes. Generally, creditors are grouped into classes based on the common attributes of their claims or interests, and on whether the plan alters or impairs their legal, equitable, or contractual rights.

Among the conditions to confirmation set forth in Bankruptcy Code §1129(a) is the acceptance of the plan by all impaired classes. If an impaired class rejects the plan, the debtor may still seek to confirm the plan under the more onerous "cram down" requirements of Bankruptcy Code §1129(b), which provides additional requirements that must be satisfied with respect to the "deemed" dissenting class such as the "fair and equitable" and "unfair discrimination" rules.³

Whether a plan is accepted by the impaired classes of creditors is based on voting results at the class level. Plan acceptance by a class requires the favorable vote of creditors holding "at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors...that have

accepted or rejected such plan."⁴

Typically, after the bankruptcy court approves the disclosure statement, the debtor seeks court approval of procedures that govern the balloting and voting process, and in complex reorganizations may retain a claims agent to solicit voters, monitor the voting process, and tabulate the ballots. Bankruptcy Rule 3018(c) provides that only a creditor or its authorized agent may communicate its acceptance or rejection of a plan, and it must do so in writing.

If a class does not vote on a plan and is deemed by a bankruptcy court as having "rejected" as opposed to having "accepted" the plan, the debtor would have to "cram down" such class under the plan. As a practical matter, it would be far more convenient for the debtor to have a nonvoting class be deemed an "accepting" class. That is, if the class is deemed a dissenting class, the debtor must meet the greater evidentiary burden of proving the cram-down elements under Bankruptcy Code §1129(b) to confirm its plan.

The 'Vita' Decision

Vita Corp. (*Vita*), a restaurant business, filed a plan of reorganization that created nine classes of creditors, six of which were impaired. Three impaired classes voted in favor of the plan, while the creditors in the other three impaired classes failed to cast a single vote.

The *Vita* court confronted the question of whether it could confirm *Vita's* plan under Bankruptcy Code §1129(a) notwithstanding the lack of consensus among courts that have considered this issue. Among the cases that have endorsed plan confirmation on the basis that the plan satisfies §1129(a) notwithstanding a nonvoting-impaired class is *Heins v. Ruti-Sweetwater Inc.* (*In re Ruti-*

Sweetwater Inc.),⁵ decided by the U.S. Court of Appeals for the Tenth Circuit, the only court of appeals to decide this issue. A recent notable case following *Ruti-Sweetwater* was the U.S. Bankruptcy Court for the Southern District of New York's decision in *Adelphia*.

The contrary line of cases, holding that a plan has not been accepted by all impaired classes if one class has failed to vote at all, are more numerous. The leading cases on this side of the debate, the U.S. Bankruptcy Court for the Southern District of Florida's decision in *In re Townco Realty Inc.*⁶ and another Southern District of New York bankruptcy case, *In re Friese*,⁷ come out against confirmation under these circumstances.

The debtor in *Vita* cited the *Ruti-Sweetwater* and *Adelphia* decisions in support of its position that the nonvoting classes should be deemed to have accepted the plan, thus permitting confirmation under §1129(a). One of the key rationales of the *Ruti-Sweetwater/Adelphia* line of cases is the Bankruptcy Code's shift from its predecessor statute, the Bankruptcy Act, regarding the treatment of nonvoting creditors. The act explicitly deemed the absence of a vote as a vote rejecting the plan; the Bankruptcy Code, however, does not prescribe a specific treatment for nonvoting creditors.

In addition, this line of cases draws support from the Bankruptcy Code's vote-counting provisions for the principle that only actual votes matter. Significantly, both *Ruti-Sweetwater* and *Adelphia* were relatively complex cases involving plans supported by an overwhelming majority of creditors. In *Adelphia*, the nonvoting creditors represented an infinitesimal 0.0005 percent of the claims held by voting creditors. Finally, also critical to the decision in *Adelphia*, the debtors' plan and disclosure statement provided that any class of creditor that failed to vote would be deemed to have accepted the plan.

The *Townco/Friese* line of cases also relies heavily on the language of the Bankruptcy Code and the Bankruptcy Rules. These cases have held that §1129(a) unambiguously requires the affirmative acceptance of all impaired classes for confirmation under that provision. Courts following *Townco* often cite other sections of the Bankruptcy Code providing "deeming" language, such as §1126(f) (deeming an unimpaired class as having accepted the plan without voting), reasoning that Congress knew how to resolve the issue of

how to treat nonvoting classes with "deeming" language but chose not to.

These courts also stringently adhere to Bankruptcy Rule 3018(c)'s requirement that votes to accept or reject a plan be in writing, holding that the absence of a writing bars deeming it an acceptance. Finally, some of these courts also reason that the lack of any votes in a class is a "failure" of the classification scheme that the debtor proposed, and the debtor should bear the consequences of that structure. All these courts, by finding that the plan cannot be confirmed under §1129(a), force the debtor to seek confirmation under the "cram down" provisions of §1129(b) or to go back to the drawing board and propose a new plan.

The *Vita* court sided with the *Townco/Friese* line of cases, denying *Vita*'s motion to confirm its plan under 1129(a). The court observed that *Ruti-Sweetwater* was a "results-oriented" decision, citing another court's characterization of it as a "case of the tail wagging the dog."⁸

Practical Considerations

Both the *Ruti-Sweetwater/Adelphia* and *Townco/Friese* line of cases utilize statutory interpretation to deal with the nonvoting-impaired class. The continued existence of this judicial conflict does not provide comfort to prospective plan proponents. Except in the courts of the Tenth Circuit, there is no way to know how a plan process will turn out if an impaired class fails to vote.

The issue of voter apathy in the plan process has no clear answer in the Bankruptcy Code, and is a narrow yet significant issue that remains unsettled. Until more courts of appeals release opinions on this question, however, debtors may best be served by focusing their efforts on limiting their potential exposure to this issue. In that vein, there are certain practical steps that debtors should consider when drafting a plan and soliciting the votes of impaired creditors.

First, when drafting a plan, a debtor should carefully consider how it is classifying impaired creditors. A debtor should utilize its specific knowledge of the creditor body to ensure, if practicable, that each impaired class includes creditors it knows will support the plan or at least vote. Second, a debtor should draft and seek advance approval of voting procedures that deem a class' failure to vote to be an acceptance

of the plan. As *Adelphia* demonstrates, language in the disclosure statement and plan may aid a court in determining the voter apathy issue in favor of plan acceptance. Certainly, an explicit court order providing for this treatment in advance should be persuasive. Third, to address the concerns raised by courts that, under Bankruptcy Rule 3018(c), votes to accept or reject a plan must be in writing, a debtor might ask the court to designate it as an agent for the nonvoting class to execute and return a ballot after the voting deadline. This would be similar but not identical to Bankruptcy Rule 3004, which permits debtors to file a proof of claim on behalf of a creditor after the deadline for creditors to file proofs of claim has passed.

Conclusion

Formulating a consensual and confirmable plan of reorganization is the debtor's attorney's most significant and time-consuming goal. Taking certain steps during the plan formulation and solicitation processes may help ensure that substantial plan formulation efforts are not lost because of voter apathy among the creditor body. While *Adelphia* may appear to provide comfort to practitioners, cases such as *Vita* and *Friese* illustrate the uncertainty surrounding this issue outside of the Tenth Circuit. To limit the risk imposed by *Vita*, debtors should carefully craft voting procedures and creditor classes, as well as vigilantly monitor the voting process in order to ensure that no impaired class fails to vote.



1. 380 B.R. 525 (C.D. Ill. 2008).

2. 368 B.R. 140 (Bankr. S.D.N.Y. 2007).

3. Under the "cram-down" provisions, a debtor must prove that a plan is fair and equitable to the dissenting class and does not unfairly discriminate against such class. For example, if a plan provides that the recovery of a dissenting class differs from that provided for similarly situated classes, the debtor may demonstrate that the plan does not unfairly discriminate against the dissenting class on the ground that differing treatment among classes is necessary for a successful reorganization. The debtor may satisfy the fair and equitable rule by eliminating any classes that are junior to the dissenting class or by providing creditors in the dissenting class securities or promissory notes that are fully paid before equity holders may participate in any recovery. This requirement is known as the "absolute priority" rule.

4. 11 U.S.C. §1126(c).

5. 836 F.2d 1263 (11th Cir. 1988).

6. 81 B.R. 707 (Bankr. S.D. Fla. 1987).

7. 103 B.R. 90 (Bankr. S.D.N.Y. 1989).

8. *In re Higgins Slacks Co.*, 178 B.R. 853, 856 (Bankr. N.D. Ala. 1995).