ALERT MEMORANDUM

In Issue of First Impression at the Circuit Level, Ninth Circuit Holds That Impaired Accepting Class Requirement Applies to Plan Confirmation on a "Per-Plan" Rather Than a "Per-Debtor" Basis

January 30, 2018

On January 25, 2018, the United States Court of Appeals of the Ninth Circuit (the "Ninth Circuit" or the "Court") held that section 1129(a)(10) of the Bankruptcy Code, which requires that to confirm a plan there must be at least one impaired accepting class, applies on a "per-plan" basis, rather than a "per-debtor" basis. *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props. Inc., et al. (In re Transwest Resort Props. Inc.)*, No. 16-16221, 2018 U.S. App. LEXIS 1947 (9th Cir. Jan. 25, 2018) (the "Opinion").[1] The Opinion is significant because under a "per-plan" approach, only a single impaired accepting class is required among all debtors covered under a joint plan. In other words, multiple debtors with a joint plan may cram their plan down on all creditors based on a single accepting class, even where the impaired accepting class has claims against different debtors than the crammed-down class. The Ninth Circuit is the first circuit court to address the "per-debtor" versus "per-plan" issue, and lower courts in the Southern District of New York and District of Delaware remain split on the proper approach.[2]

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

NEW YORK

James L. Bromley
+1 212 225 2264
jbromley@cgsh.com

Lisa M. Schweitzer
+1 212 225 2629
lschweitzer@cgsh.com

Sean A. O'Neal
+1 212 225 2416
soneal@cgsh.com

Luke A. Barefoot
+1 212 225 2829
lbarefoot@cgsh.com

Daniel J. (Dan) Soltman
+1 212 225 2187
dsoltman@cgsh.com

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

[1] The Opinion, which the Ninth Circuit marked for publication, is also available on the Ninth Circuit's website, at http://cdn.ca9.uscourts.gov/datastore/opinions/2018/01/25/16-16221.pdf. In addition to its holding with respect to section 1129(a)(10), the Ninth Circuit also joined most other courts to have addressed the question in holding that an undersecured creditor that makes an election, pursuant to section 1111(b)(2) of the Bankruptcy Code, to have the entirety of its claim treated as secured instead of bifurcated, need not be provided with a "due-on-sale" clause to satisfy the cramdown requirement in section 1129(b)(2)(A).

[2] *Compare, e.g., In re Charter Commc'ns*, 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009) ("it is appropriate to test compliance with section 1129(a)(10) on a per-plan basis, not, as the [objectors] argue, on a per-debtor basis"), *with, e.g., In re Tribune Co.*, 464 B.R. 126 (2011) ("[the Court finds] nothing ambiguous in the language of [section] 1129(a)(10), which, absent substantive consolidation or consent, must be satisfied by each debtor in a joint plan").

Background and Procedural History

The bankruptcy case[3] from which the Ninth Circuit opinion results included five separate debtors: Transwest Hilton Head Property, LLC ("THH"), Transwest Tucson Property, LLC ("TTP," and together with THH, the "Operating Debtors"), Transwest Hilton Head II, LLC ("THH II"), Transwest Tucson II, LLC ("TT II," and together with THH II, the "Mezzanine Debtors") and Transwest Resort Properties, Inc. ("TRP," together with the Mezzanine Debtors and the Operating Debtors, the "Debtors"). The corporate group was structured such that TRP, a holding company, was the sole equity owner of the two Mezzanine Debtors, which in turn were the sole equity owners of the two Operating Debtors, which owned and operated two resorts (the "Resorts"). The Resorts had been acquired by the Debtors in 2007, and were financed by (i) a $209 million loan to the Operating Debtors, secured by the Resorts (the "Operating Loan"), and (ii) a $21.5 million loan secured by the Mezzanine Debtors' interests in the Operating Debtors (the "Mezzanine Loan").[4]

The Debtors filed for bankruptcy in 2010, and the cases were jointly administered but never substantively consolidated. In 2011, the Debtors confirmed a plan under which a third-party investor (the "Third-Party Investor") would acquire the Operating Debtors for $30 million, eliminating the Mezzanine Debtors' equity interest in the Operating Debtors. Under the plan, (i) the Operating Loan was restructured to become a 21-year note with a principal amount of $247 million, with interest payments due each month; and (ii) no recovery was provided to the holders of Mezzanine Loan claims.

Although the Mezzanine Loan claims voted to reject the plan and objected to confirmation, several other impaired creditor classes holding claims against the Operating Debtors voted to accept. The bankruptcy court, applying the "per-plan" approach, held that the plan could be confirmed on that basis even though there was no impaired accepting creditor class for the Mezzanine Debtors. The Mezzanine Lender appealed the confirmation order, arguing that the plan could not be confirmed over their objection because no impaired creditor class holding debt against the Mezzanine Debtors had voted to approve the plan.

On appeal, the district court affirmed the bankruptcy court, holding that the plain language of section 1129(a)(10) requires only one impaired accepting class among all debtors in a joint plan (*i.e.*, adopting the "per-plan" approach). The Mezzanine Lender appealed to the Ninth Circuit.

The Opinion

In holding that the "per-plan" approach should apply, the Court began its analysis by examining the language of the statute, notably language in section 1129(a)(10) of the Bankruptcy Code that requires that at least one impaired accepting class "under the plan" approve "the plan." The Court held that:

> [section 1129(a)(10)] makes no distinction concerning or reference to the creditors of different debtors under 'the plan,' nor does it distinguish between single-debtor and multi-debtor plans. Under its plain language, once a single impaired class accepts a plan, section 1129(a)(10) is satisfied as to the entire plan. Obviously, Congress could have required plan approval from an impaired class

[3] *See In re Transwest Resort Props. Inc., et al.*, Case No. 10-37134 (Bankr. D. Ariz. filed Nov. 17, 2010).

[4] Opinion at *3-5.

> for each debtor involved in a plan, but it did not do so.[5]

The Court also rejected the Mezzanine Lender's argument that section 102(7) of the Bankruptcy Code, a rule of construction that "the singular includes the plural," required a "per-debtor" interpretation of section 1129(a)(10). The Court explained that applying this rule of statutory construction would effectively amend Section 1129(a)(10), and even if so amended, would not change the interpretation.[6]

Finally, the Court addressed the argument that although the plan was presented as a *jointly administered* plan, it was in fact *substantively consolidated* based on application of the "per-plan" approach. After finding that the issue was not raised before the bankruptcy court and thus not properly before it on appeal, the Ninth Circuit reinforced its reliance on its plain-language analysis and noted that "to the extent the [Mezzanine] Lender argues that the 'per[-]plan' approach would result in a parade of horribles for mezzanine lenders, such hypothetical concerns are policy considerations best left for Congress to resolve."[7] The plan also rejected other grounds to overturn the bankruptcy court.[8]

The Concurrence

Although the alleged propriety of substantive consolidation in the plan was not properly before the Ninth Circuit, one Circuit Judge wrote a concurrence acknowledging that some degree of substantive consolidation existed in the terms of the Debtors' plan. Specifically, the concurrence took the view that an appeal based on the statutory interpretation of section 1129(b)(10) was misplaced, and that the true problem was that the bankruptcy court failed to assess whether substantive consolidation was appropriate.

The concurrence's clear message was that creditors who believe that a plan is impermissibly substantively consolidated should object to the plan itself on those grounds, rather than attack the plan by challenging the statutory construction of the confirmation requirements.

Takeaways

The Opinion provides a few important takeaways for creditors of distressed companies and bankruptcy practitioners:

- Precedential Value as First Circuit-Level Ruling. While lower courts remain split on the question, the Opinion provides the first circuit ruling on the "per-plan" versus "per-debtor" issue. Although not binding outside of the Ninth Circuit, the opinion

[5] Opinion at *12.

[6] *Id.* at *12-13. The Court also examined and dismissed the Lender's contention that section 1129(a)(10) must apply on a "per-debtor" basis because other sections of the Bankruptcy Code must be read on a "per-debtor" basis, reasoning that "while a statute must be read as a whole, the [Mezzanine] Lender provides no support for its position that all subsections must uniformly apply on a 'per[-]debtor' basis, especially when the Bankruptcy Code phrases each subsection differently." *Id.* at *13 (internal citations and quotation marks omitted).

[7] *Id.* at *15.

[8] The Ninth Circuit also affirmed the district court's holding that a "due-on-sale" clause was not required in the case of a section 1111(b)(2) election. Although the Ninth Circuit agreed that the plain language of section 1111(b) did not require a "due-on-sale" provision, it did note that its "holding does not imply that 'due-on-sale' protection is irrelevant to whether a plan is 'fair and equitable' under section 1129(b). Although the [Mezzanine] Lender here waived any argument that the plan was not 'fair and equitable,' the availability of due-on-sale protection may inform whether a plan is confirmable in other reorganizations." *Id.* at *10 n.4.

will have persuasive weight for lower courts that have not previously weighed in on the divide in authorities.

- Potential Venue Implications. Although the Ninth Circuit is not generally perceived as a debtor-friendly jurisdiction, the Opinion may encourage debtors for whom section 1129(a)(10) presents a critical confirmation challenge to file bankruptcy in a Ninth Circuit court. This will be particularly important for debtors that have mezzanine structures, which typically involve one or more debtors with only one class of creditors. In addition, debtors incorporated in Delaware (where lower courts adopt the "per-debtor" approach), but whose operations are in the Ninth Circuit, may wish to factor in this Opinion when selecting a venue.

- Importance of Substantive Consolidation Analysis. Practitioners and courts may focus more closely on the questions raised in the concurrence, *i.e.*, whether a "per-plan" approach is a form of substantive consolidation and whether courts should carefully consider issues of substantive consolidation to avoid any unfairness that results from application of the "per-plan" approach. That said, it remains to be seen how much weight lower courts will give to the concurrence approach, particularly outside of the Ninth Circuit and in cases where the facts would not otherwise support a substantive consolidation argument.

- Coming Attractions. While the Opinion has precedential value writ large, it may have particular implications for the Commonwealth of Puerto Rico and its instrumentalities, several of which are currently in PROMESA proceedings. Although the First Circuit has never addressed the "per-plan" versus "per-debtor" issue, the Opinion could embolden the Commonwealth and its instrumentalities to pursue a jointly administered (but not substantively consolidated) plan without having an impaired accepting class holding debt against each instrumentality.

…

CLEARY GOTTLIEB