Jaunty Judicial Debates

Resolved: The absolute priority rule absolutely applies to all individual chapter 11 cases.

Laurie Selber Silverstein, Moderator
Potter Anderson & Corroon LLP; Wilmington, Del.

Pro: Hon. Helen Elizabeth Burris
U.S. Bankruptcy Court (D. S.C.); Spartanburg

Con: Hon. Michael B. Kaplan
U.S. Bankruptcy Court (D. N.J.); Trenton

Resolved: Bankruptcy courts are bound by the restraints of intercreditor agreements, regardless of the impact on stakeholders of the estate.

Laurie Selber Silverstein, Moderator
Potter Anderson & Corroon LLP; Wilmington, Del.

Pro: Hon. Richard E. Fehling
U.S. Bankruptcy Court (E.D. Pa.); Reading

Con: Hon. Kevin J. Carey
U.S. Bankruptcy Court (D. Del.); Wilmington

An Update on Second-Lien Financings and Intercreditor Agreements: Part I

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Feature

In previous articles[1] and *ABI's Handbook on Second Lien Loans and Intercreditor Agreements*,[2] the authors examined various provisions found in many intercreditor agreements used in second-lien financings as well as case law that has developed around the enforcement of Intercreditor or Subordination Agreements in bankruptcy proceedings. In Part I of this article, four recent bankruptcy court decisions are examined to advance our understanding of how bankruptcy courts are likely to deal with the issues presented by intercreditor or subordination agreements. Part II will look at other notable decisions, which also deal with miscellaneous issues relating to intercreditor or subordination agreements.

Ion Media

Mark N. Berman

The *Ion Media*[3] decision is decidedly in favor of bankruptcy courts enforcing the "stay silent" provisions in second-lien intercreditor agreements. In the court's view, plainly-worded contracts that establish priorities and limit obstructionist behavior should be enforced and creditor expectations should be appropriately fulfilled.

The issue in *Ion Media* was whether the first-lien lenders had a properly perfected security interest in the debtors' Federal Communications Commission (FCC) licenses. The intercreditor agreement anticipated that there might be assets of the debtors that were not subject to a perfected first lien, referring to these assets as "special property." If the FCC licenses were not subject to a properly perfected security interest, then the second-lien lenders as general unsecured creditors would receive a larger distribution. The value of the collateral available to first-lien lenders is always a key issue in a chapter 11 case. Value of collateral can be affected by the intrinsic nature of the collateral, how that collateral is used, or which assets are subject to the first-lien lender's perfected security interests and mortgages. In *Ion Media*, the extent of first lien lenders' collateral (*i.e.*, whether collateral included the FCC licenses, and their value) was key to the ability of the first-lien lenders to roll up first-lien debt into the debtor in possession (DIP) loan facility and was also key to the treatment afforded different classes of claims in the debtors' plan. One of the second-lien lenders thought they were being short-changed because the favorable treatment of the first-lien lenders was premised on the value attributable to those FCC licenses being included in the first-lien lenders' collateral.[4] In objecting to the DIP loan facility and later to the plan and disclosure statement, the second-lien lender was faced with overcoming the following "stay-silent" provisions of the intercreditor agreement:

Jo Ann J. Brighton

- No Contest Clauses:
  - "Each of the Secured Parties acknowledges and agrees (x) to the relative priorities as to the Collateral (and the application of the proceeds therefrom) as provided in the Security Agreement... and acknowledges and agrees that such priorities...shall not be affected or impaired in any manner whatsoever including, without limitation, on account of...(iii) any nonperfection of any lien purportedly securing any of the Secured Obligations...."
  - "[U]pon the commencement of a case under the Bankruptcy Code by or against any Grantor...(b) each secured party agrees not to take any action or vote in any way inconsistent with this Agreement so as to contest (1) the validity or enforcement of any of the Security Documents... (2) the validity, priority, or enforceability of the Liens, mortgages, assignments, and security interests granted pursuant to the Security Documents... or (3) the relative rights and duties of the holders of the First Priority Obligations..."
- Support for Plan Clause:
  - [Unless the first-lien lenders are paid in full, the second-lien lenders may not] "oppose, object to or vote against any plan of reorganization or disclosure statement the terms of which are consistent with the rights of

1 *See ABI Journal*, Volumes XXV, No. 1, 2, 4, 5 and 6.
2 See Berman and Brighton, *Handbook on Second Lien Loans and Intercreditor Agreements* (ABI, 2009).
3 *Ion Media Networks Inc., et al.*, 419 B. R. 585 (Bankr. S.D.N.Y. 2009).

4 The debtors' plan proposed to distribute $5 million in cash and warrants for 5 percent of the equity of the reorganized debtors to unsecured creditors, a class that included the second-lien lenders on the basis that their liens did not reach any value in the debtors' assets.

> the First Priority Secured Parties under the Security Agreement."

The first-lien lenders asserted that these clauses prohibited the second-lien lender from contesting either the DIP loan facility, approval of the disclosure statement or confirmation of the plan. In response, the second-lien lender asserted its right to act as an unsecured creditor under the following clause in pursuing oppositions to each event.

> – Rights as an Unsecured Creditor Clause:
>
> > – Except as otherwise specifically set forth in section 11 of this Agreement, the Second Priority Secured Parties may exercise rights and remedies as unsecured creditors against any Grantor in accordance with the terms of the Second Priority Documents and applicable law."

Bankruptcy Judge **James Peck** found that the second-lien lender did not have standing to object to the adequacy of the disclosure statement or to confirmation of the plan, having ceded that standing by the provisions of the intercreditor agreement.[5] Judge Peck cited *Hart Ski*,[6] *203 N. LaSalle*[7] and *Aerosol Packaging*[8] in finding that bankruptcy courts have "refrained from enforcing a creditor's waiver of bankruptcy rights in a pre-bankruptcy interecreditor agreement on public policy grounds," but he distinguished those cases because they involved the right to vote on a plan.[9] The *Ion Media* issues before the bankruptcy court did not affect the second-lien lender's right to vote. Judge Peck noted that voting is a special bankruptcy right, and bankruptcy courts appear reluctant to enforce clauses that restrict the free exercise of that right.

However, with the second-lien lender objecting to the plan and challenging the first-lien lenders' lien on the FCC licenses, the bankruptcy court required silence and denied the second-lien lender standing. The court focused on the "except as otherwise specifically set forth in section 11 of the Intercreditor Agreement" language that is at the beginning of the "Rights of an Unsecured Creditor Clause" to specifically limit those rights. The "Plan Support Clause" was found in § 11(b) of the intercreditor agreement.

The court seems troubled by the second-lien lender having objected despite clear limitations in the intercreditor agreement, as well as the motivations of the second-lien lender. Specifically, the court was influenced by the second-lien lender having acquired its claims post-petition at a steep discount and was proposing an alternative plan under which it would acquire the debtors' business. In a footnote, the court noted that violations of the intercreditor agreement that caused a material increase in the administrative expenses of the cases may be a measure of damages to be claimed against the second-lien lender. This is certainly an invitation to litigation and a warning to subordinated creditors who limit their rights as an unsecured creditor via the introductory language in the Rights of an Unsecured Creditor Clause.

Erickson

The Bankruptcy Court for the Northern District of Texas waded into the intercreditor enforcement debate stemming from a request by subordinated creditors to have an examiner appointed. In *Erickson Retirement Communities*,[10] subordinated creditors sought the appointment of an examiner to inquire into the debtors' pre-petition activity. The motion was filed approximately two months after the petition date. Before the court considered the motion, the debtor sold substantially most of its assets and proposed a plan relating thereto. As a result, one of the movants withdrew its support of the motion and the remaining two creditors limited the scope of the proposed examiner's duties so that the examiner, if appointed, would only inquire into the proper allocation of the proceeds of the auction. The examiner motion was opposed by, among others, the agent for the subordinated creditors. The bankruptcy court, following the majority rule, concluded that the appointment of an examiner was mandatory because the debtors' fixed, liquidated, unsecured debts exceeded $5 million,[11] unless the movants either lacked standing or had waived the right to do so. To examine the standing/waiver issue, the court looked at the subordination agreements and found several applicable provisions. The subordinated creditors had agreed, among other things:

- not to "exercise any rights or remedies or take any action or proceeding to collect or enforce any of the Subordinated Obligations" without "the prior written consent of the Agent" until the senior secured lenders had been "fully satisfied";
- to waive, "for the benefit of the Agent and the Lenders...any principles or provisions of law, statutory or otherwise, which are or might be in conflict with the terms of this Agreement and any legal or equitable discharge of the [subordinated] obligations hereunder";
- to an assignment to the agent for the subordinated creditors of their interests in the subordinated creditors' loan documents;
- that upon the request of the agent, to endorse and deliver over to the agent their loan documents (the agent had made the required request);
- not to oppose any agreement by the agent in any bankruptcy case to provide DIP financing or to allow cash collateral usage by the debtor; and
- not to take a contrary position to the agent with regard to DIP financing or cash collateral usage.

Because § 510(a) of the Bankruptcy Code dictates that subordination agreements are enforceable in bankruptcy cases to the same extent they are enforceable under applicable non-bankruptcy law, the court looked to Maryland law for instruction. The court found that the subordination agreement provisions prohibited the subordinated creditors from seeking the appointment of an examiner. To do so was, in the court's view, to seek to file an "action," to seek to enforce "remedies" and to pursue "collection" of their claims—each prohibited without the consent of the agent who was opposing their motion. Perhaps angered by the subordinated creditor trying to get in the way of a process that appeared acceptable to the vast majority of creditors, the court quoted *Ion Media* in saying that "[t]his is the very type of obstructionist

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5 The court suggests that rather than risk being in breach of the intercreditor agreement, the second-lien lender should have first sought a declaration that its interpretation of the intercreditor agreement should prevail. Having not done so, the court virtually invited the other parties in the case to pursue a claim against the second-lien lender for what it believed may have been damages measured by a material increase in administrative expenses in the cases.

6 5 B.R. 734 (Bankr. D. Minn. 1980).

7 246 B.R. 325 (Bankr. N.D. Ill. 2000).

8 362 B.R. 43 (Bankr. N.D. Ga. 2006).

9 The reference to *Hart Ski* is surprising because that case held that a junior lien-holder has the right to seek and receive adequate protection for its lien, despite a provision in an intercreditor agreement limiting its ability to assert that right.

10 425 B.R. 309 (Bankr. N.D. Tex. 2010).

11 See 11 U.S.C. §1104(c)(2). *See also In re Loral Space & Communications Ltd.*, No. 04-CV-8645RPP, 2004 U.S. Dist. LEXIS 25681, 2004 WL 297985, at *4 (S.D.N.Y. Dec. 23, 2004); *In re UAL Corp.*, 307 B.R. 80, 84 (Bankr. N.D. Ill. 2004); *In re Schepps Food Stores Inc.*, 148 B.R. 27, 30 (S.D. Tex. 1992).

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behavior that the agreement [is] intended to suppress."[12]

In an interesting discussion, the court cited to *Collin County v. Siemens Business Services Inc.*[13] for the proposition that "[i]t is well-settled that rights under statute may be contractually waived," but also noted the conflicting authority over the enforceability of a debtor's pre-petition waiver of the automatic stay or the ability of a debtor to commence a bankruptcy case. The *Hart Ski* and *203 N. LaSalle* decisions concluded that the pre-bankruptcy wavier of the right to seek adequate protection or the assignment of the right to vote were not enforceable. Therefore, it appears there is still much to be resolved in the context of the ability to enforce a specific pre-bankruptcy waiver of a bankruptcy right.

TCI 2 Holdings LLC

Just to make sure first-lien lenders do not get too comfortable with what appears to be a trend toward the enforcement of the "stay-silent" provisions of intercreditor and subordination agreements, we now turn to a Code provision that specifically limits the enforceability of those restrictions in the context of a plan proposing the cramdown[14] of a secured claim. The provision is § 1129(b)(1), the cramdown provision in chapter 11, that is introduced by the clause, "Notwithstanding section 510(a) of this title."

The bankruptcy court in *TCI 2*[15] was presented with two competing plans. The first was proposed by the first-lien lenders that were owed $488 million and proposed to convert the first lien claims into 100 percent of the reorganized debtors' equity with all other claims, including the $1.25 billion owed to second lien lenders, being wiped out. That plan was opposed by the second-lien lenders and unsecured creditors that proposed a cramdown plan that fixed the amount of the first-lien lenders' secured claims at the value of their collateral and gave them cash in the amount of $125 million plus a new note for $334 million payable over time at what they asserted was a market rate of interest and secured by a new first lien on the debtors' assets (*i.e.*, a cramdown of the first-lien position under § 1129(b)(2)(A)(i) of the Code). Under this alternative plan, the second-lien lenders were to receive the right to participate in a $225 million rights offering for 75 percent of the reorganized debtor's equity. The court had before it two confirmable plans and decided to prefer confirmation of the plan proposed by the second-lien lenders.[16]

However, in order to confirm the second-lien lenders' plan, the court had to address the first-lien lenders' objection that the second-lien lenders' plan violated provisions of the intercreditor agreement requiring that first-lien lenders be paid in full and in cash before second-lien lenders would be entitled to a distribution. The court overruled that objection because it found that the intercreditor agreement provisions restricting distributions to subordinate creditors were not enforceable when the plan could otherwise be confirmed by cramdown under § 1129(b)(2).[17]

The decision is presently under appeal. Left unresolved is whether the first-lien lenders can pursue a breach-of-contract action against the second-lien lenders for violating the intercreditor agreement. Left in place, and if no action is successful in an effort to hold the second-lien lenders from breaching the intercreditor agreement, the decision presents an inviting avenue for subordinated creditors to pursue an alternative that the intercreditor agreement would otherwise forbid. Also unresolved is whether an intercreditor-agreement provision prohibiting the subordinated creditors from proposing a cramdown plan (*i.e.*, waiving § 1129(b)(1)), might be enforceable.

Westpoint Stephens

When we last visited the confrontation between first- and second-lien lenders in *Westpoint Stephens*,[18] the District Court for the Southern District of New York had reversed a bankruptcy court order allowing a § 363 sale under which second-lien lenders would receive a controlling portion of the equity in the purchaser. The district court held that a sale of the debtor's assets with the distribution to second-lien lenders of equity in the purchaser violated an intercreditor agreement provision that required first-lien lenders to be paid in full and in cash before second-lien lenders received anything an account of their second lien position.[19] It ordered that the equity allotted by the plan to second-lien lenders be turned over to the first-lien lenders. On appeal to the Second Circuit, the second-lien lenders have now prevailed, at least in part, because of the statutory mootness doctrine.

The first-lien lenders had first obtained a stay of the sale, but later stipulated that the sale could close so long as the distribution of equity to second-lien lenders was delayed until the parties or the courts could resolve the right of second-lien lenders to a distribution before senior lenders. The Second Circuit found that the first-lien lenders had thereby lost the right to object to the second-lien lenders receiving equity. The Second Circuit determined that control of the purchaser was an integral part of the sale. As a result, with the sale closed, the distribution to second-lien lenders of a controlling interest in the purchaser was beyond the court's power to alter because it did not have jurisdiction to review the sale order to alter that integral part.[20] However, the Second Circuit ordered that 11 percent of the purchaser's equity, a percentage that would not alter the second-lien lender's control of the purchaser, could be taken away from second-lien lenders and ordered that it be turned over to the first-lien lenders. Solomon would have been proud.

Conclusion

As anticipated, the current economy has resulted in more instances where bankruptcy courts have been forced to consider the impact of intercreditor agreement provisions in chapter 11 cases. Some might discern a slight trend in favor of the enforceability of intercreditor agreements by bankruptcy

12 *Id.* at 315.

13 250 Fed.Appx. 45, 50 (5th Cir. 2007).

14 Also referred to as a "cram-up."

15 428 B.R. 117 (Bankr. D. N.J. 2010).

16 Section 1129(c) allows the court, when confronted by two confirmable plans, to consider the preferences of creditors and equity-securityholders in determining which plan to confirm. With unsecured creditors getting nothing under the first-lien lenders' plan, the preferences were obvious.

17 The *TCI 2* decision is in conflict with the decision in *In re Consul Restaurant Corp.*, 146 B.R. 979, 988 (Bankr. D. Minn. 1992), that a subordination agreement is enforceable in a cramdown context "under the discrimination and fair and equitable concepts of the statute."

18 600 F.3d 231 (2d Cir. 2010). *See also* Berman and Brighton, "Second Lien Financings: Part V—Who Gets What?," Vol. XXV, No. 6, *ABI Journal* (July/August 2006).

19 *In re Westpoint Stephens Inc.*, 333 B.R. 30, 45-54 (S.D.N.Y. 2005).

20 A contrary view is expressed in *Clear Channel v. Knupfer (In re PW LLC)*, 391 B.R. 25, 35-36 (9th Cir. B.A.P. 2008), where the court found a right to eliminate certain features of the sale even after it had closed. *But see In re Stadium Management Corp.*, 895 F.2d 845, 848-49 (1st Cir. 1990).

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courts as exemplified by *Ion Media* and *Erickson*. The *TCI 2* decision identifies quite a gaping hole in the senior lenders' ability to enforce the terms of an intercreditor agreement that will no doubt be used by enterprising counsel for debtors and subordinated lenders to cram down a plan on senior lenders. Just how far that avenue will take them will be left to future case law. In Part II, other decisions that affect the predictability of dealing with intercreditor agreements will be discussed. ■

Editor's Note: *The authors' book,* Handbook on Second Lien Loans & Intercreditor Agreements *(ABI, 2009), is available for purchase at http://bookstore.abi.org (members must log in first to obtain member price).*

An Update on Second-Lien Financings and Intercreditor Agreements: Part II

Feature

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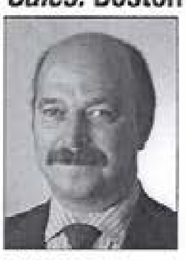
In previous articles[1] and the handbook,[2] we examined various provisions found in most versions of an intercreditor agreement used in second-lien financings, as well as most of the case law that has developed around the enforcement of intercreditor or subordination agreements in bankruptcy proceedings over the past five years. In Part I,[3] we examined four additional bankruptcy court decisions, handed down in late 2009 and 2010, that advanced one's understanding of how bankruptcy courts are likely to deal with the issues that intercreditor or subordination agreements present in the chapter 11 context. In Part II, we now look at an additional intercreditor decision from late 2010, some concerns raised by the *Lehman* decision on the rights of a derivative counterparty and the concept of "collective action," which has been used in several cases to overcome disagreements between two groups of creditors within the same level of priority and, therefore, without the benefit of an intercreditor agreement to guide the result.

Second-Lien Holders, § 363 Sales: Boston Generating



Mark N. Berman

In *In re Boston Generating*,[4] Judge **Shelly Chapman** entered an order upholding the right of the second-lien lenders to object to bidding procedures proposed for a § 363 sale despite language in the intercreditor agreement providing first-lien lenders with the "exclusive right to...make determinations regarding the... sale" of collateral. The court ruled that the language was not specific enough to extend to objections to bidding procedures for the sale. Judge Chapman cited *Ion Media* and *Erickson*,[5] where both bankruptcy courts refused to permit a second-lien lender to pursue a remedy in bankruptcy court, but distinguished each case. *Ion Media* was distinguished because the relevant intercreditor agreement contained specific language prohibiting the second-lien lender from objecting to a plan confirmation and the second-lien lender was viewed by the court as being both obstructionist and considerably out of the money. The *Erickson* case was distinguished because, even though the language of the intercreditor agreement was not specific in restricting the second-lien lender from requesting the appointment of an examiner, the lender was viewed as being obstructionist and out of the money. Overall, while Judge Chapman allowed the objection, she made it clear that she thought that clear provisions in intercreditor agreements should be enforced.

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Moreover, in a subsequent *Boston Generating* decision,[6] Judge Chapman allowed the second-lien lenders standing to object to the sale itself (which had the consent of the first-lien lenders). Specifically, the court stated:

> After extensive briefing and oral argument as well as detailed review of the Intercreditor Agreement, the Court finds no provision which can be read to reflect a waiver of the Second-Lien Agent's right to object to a 363 sale motion, either in its capacity as a Secured Party or in its capacity as an unsecured creditor. Here, the perfect storm of a poorly drafted agreement, the ill-defined scope of section 3.1(g)'s retained right to object as an unsecured creditor, and the fact that, pursuant to the Secured Parties' own stipulation, there is "no exercise of remedies" leads me to conclude that the Second-Lien Agent and Second-Lien Lenders have standing to object to the 363 sale.

The case provides a good reminder of the need for clear drafting of specific provisions in intercreditor agreements. Simply stated, the more specific that the intercreditor agreement is in listing a restriction on a second-lien lender's rights in bankruptcy, the more likely that restriction will be upheld. It is a great advertisement for getting bankruptcy attorneys involved in the drafting of these agreements.

Lehman Brothers Holdings[7]

It is almost impossible to let an update pass without at least mentioning something from Lehman. While the derivatives litigation that abounds in the Lehman cases do not involve second-lien financings and traditional intercreditor agreement disputes, some of the reasoning applied in the bankruptcy court's decisions may have implications for how bankruptcy courts might decide

1 *See* Jo Ann J. Brighton and Mark N. Berman, "Second-Lien Financings: Enforcement of Intercreditor Agreements in Bankruptcy," Parts 1-6, *Am. Bankr. Inst. J.*, Vol. XXV, No. 1, 2, 4-6 (February, March, April, June and July/August 2006).

2 Berman and Brighton, *Handbook on Second Lien Loans and Intercreditor Agreements* (ABI, 2009).

3 Berman and Brighton, "An Update on Second-Lien Financings and Intercreditor Agreements: Part I," XXIX *Am. Bankr. Inst. J.* 10, 40-41, 95-96; December/January 2011.

4 *In re Boston Generating LLC*, No. 10-14419 (SCC) (Bankr. S.D.N.Y. Oct. 12, 2010).

5 *In re Ion Media Networks Inc.*, 419 B.R. 585 (Bankr. S.D.N.Y. 2009); *In re Erickson Retirement Communities*, 425 B.R. 309 (Bankr. N.D. Tex. 2010).

6 *In re Boston Generating LLC*, 440 B.R. 302, 320, (Bankr. S.D.N.Y. 2010).

7 *Lehman Bros. Special Financing Inc. v. BNY Corporate Trustee Services Ltd. (In re Lehman Bros. Holdings Inc.)*, 422 B.R. 407, 416 (Bankr. S.D.N.Y. Jan. 25, 2010).

similar issues if presented in a second-lien-financing context.

Lehman Brothers Special Financing Inc. (LBSF) and a single purpose vehicle (SPV) holding collateralized debt obligations entered into a swap agreement. Obligations owed by the SPV to LBSF were secured by the assets of the SPV, which were held in trust by Bank of New York (BNY) as trustee. Regular swap payments due to LBSF by the SPV were, according to the swap agreement and trust, entitled to a priority of payment over payments due to the SPV's noteholders. However, in the event of a default, which included the filing of LBSF's bankruptcy as well as the bankruptcy filing by its parent, Lehman Brothers Holdings Inc. (LBHI), the payments due to noteholders took priority over payments due to LBSF (the so-called "flip provision"). The swap agreement was governed by the laws of England.

Noteholders sued BNY as trustee and LBSF in the English court system, seeking a declaratory judgment that the flip provision was enforceable under English law. During the pendency of the English litigation, LBSF commenced an adversary proceeding in bankruptcy court, seeking a determination that (1) the flip provision was an *ipso facto* clause made unenforceable against it by §§ 365(e)(1) and 541(c)(1)(B) of the Bankruptcy Code and (2) any action to enforce the flip provision would be a violation of the automatic stay.[8] The English courts, in the meantime, had determined that the flip provision was enforceable under English law. However, looking at the unique provisions of the Bankruptcy Code, the court reached three critical decisions.

First, following the familiar *Countryman* definition of "executory," it found that because the parties to the swap agreement still owed each other enough performance such that a failure by either party to perform would lead to a material breach excusing the nonbreaching party from continued performance, the swap agreement was an executory contract.[9] Second, it held that the flip provision was an *ipso facto* clause that was rendered unenforceable by both §§ 365(e)(1) and 541(c)(1)(B).[10] Third, it concluded that even though the flip provision might be enforceable under applicable nonbankruptcy law (*i.e.*, English law), enforcement of the flip provision against LBSF would violate the automatic stay.[11] The court reasoned that any act to enforce the priority flip would "violate the automatic stay because it would deprive LBSF and its creditors of a valuable property interest." As a postscript, on Sept. 20, 2010, the U.S. District Court for the Southern District of New York granted BNY's request to appeal Judge **James Peck**'s decision on the flip provision. However, the matter has since been settled among the parties, so there will be no further appeals in the U.S. or England.

Going forward, to create more predictability as to result, first-lien lenders would be best served by being as specific as possible in listing in the intercreditor agreement the specific bankruptcy rights to be silenced rather than relying on general language.

Lehman is not a dispute between lenders in the context of an intercreditor agreement. However, because the bankruptcy court concluded that provisions in agreements triggered by a bankruptcy filing, even a bankruptcy filing by a nonparty to the agreement, are unenforceable *ipso facto* clauses, the reasoning must be considered in the context of intercreditor agreements. Bankruptcy provisions in intercreditor agreements, applicable only when a bankruptcy filing occurs and therefore having the *ipso facto* taint, might suffer a similar fate if they implicate rights possessed by the debtor.

Collective Action

Most credit agreements and their related loan documents contain provisions authorizing the lenders' agent, with majority lender consent (determined by value), to take certain actions or refrain from taking certain actions on behalf of the syndicate of lenders. Such actions might include consenting to the debtor's sale of collateral, credit-bidding when the collateral is sold at auction, enforcing or forbearing from enforcing remedies, or foreclosing on the collateral. There now exists a significant string of cases where bankruptcy courts have focused on the provisions of the credit agreement or collateral-security agreement to bind recalcitrant minority lenders to the will of the majority lenders and/or the agent.

As seen in *Erikson Retirement*, a bankruptcy court may decide not to appoint an examiner at the request of a single second-lien lender who contractually gave to the lending syndicate's agent the right to pursue remedies on behalf of the lender syndicate, notwithstanding that the requirements for mandatory examiner appointment under § 1104(c) were otherwise met. Other examples include consenting to a § 363 sale with a distribution of consideration to subordinate creditors and providing a credit-bid when collateral was sold.[12] These cases severely limit the ability of a minority lender in a lending syndicate to object to action in a bankruptcy court that has the support of a majority of syndicate lenders and the agent.

The language in the credit agreements and their related loan documents is often quite broad, suggesting that a court wanting to side with the minority syndicate lender might use the same approach as *Boston Generating* to uphold the objection because the language was not specific in prohibiting the objection. Conversely, a court wanting to overcome the objection and permit a § 363 sale to proceed, as took place in *Chrysler* and *General Motors*, will seize on the general language to reign in the arguments advanced by a minority of lenders.

Conclusion

As anticipated, the current economy has resulted in more instances where bankruptcy courts have been forced to consider the impact of intercreditor agreement provisions in chapter 11 cases. While the general trend appears to

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8 *Id.*
9 *Id.* at 415.
10 There were several significant steps taken by the bankruptcy court to reach this conclusion. The flip provision existed in both the swap agreement and trust agreement, but the debtor was only a party to the swap agreement, and therefore, the court effectively found unenforceable as an *ipso facto* clause a provision in an agreement to which the debtor before it was not a party. Second, the flip provision was triggered by the LBHI filing that occurred before the LBSF filing so that by the time the swap counterparty filed its bankruptcy case, the flip had already occurred and the debtor's rights to payment were subordinated to the rights of noteholders. Third, the court found that the debtor's right to payment in priority to noteholders, even though it did not exist when the case was filed, was a property interest protected by the automatic stay.

11 *Id.* at 420.

12 *See, e.g., In re GWLS Holdings Inc.*, 2009 WL 453110, Case No. 08-12430 (Bankr. D. Del. Feb. 23, 2009); *In re Metaldyne Corp.*, 409 B.R. 671 (Bankr. S.D.N.Y. 2009), *aff'd*, 421 B.R. 620 (S.D. N.Y. 2009); *In re Chrysler LLC*, 405 B.R. 84, (Bankr. S.D.N.Y. 2009), *leave to appeal granted*, 2009 WL 1532960 (2d Cir. 2009), *aff'd*, 576 F.3d 108 (2d Cir. 2009), *cert. dismissed*, 130 S.Ct. 41, (2009), and *cert. granted*, judgment vacated, 130 S.Ct. 1015 (2009), and *judgment vacated*, 592 F.3d 370 (2d Cir. 2010), and *appeal dismissed*, 592 F.3d 370 (2d Cir. 2010); *In re General Motors Corp.*, 407 B.R. 463, 496, (Bankr. S.D.N.Y. 2009), *cert. denied*, 409 B.R. 24, 51, and *aff'd*, 430 B.R. 65 (S.D.N.Y. 2010); *In re Delphi Corp.*, 2009 WL 2482146 (Bankr. S.D.N.Y. July 30, 2009) (Drain, J.); *Bank of Am., Nat'l Assoc. v. 203 N. LaSalle St. P'ship (In re 203 N. LaSalle St. Ltd.)*, 246 B.R. 325 (Bankr. N.D. Ill. 2000) (Wedoff, Jr.); *see also Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318 (N.Y. 2007) (Kaye, C.J.) (holding that under New York law, credit agreement authorizing agent to assert all collection remedies precluded dissenting lender from seeking collection where agent, at request of required majority, granted forbearance); *see also* Marc Abrams and Rachel Strickland, "Lender 'Collective Action' Doctrine Provokes Controversy: A Consensual Solution for the Greater Good," *N.Y. L.J.*, Dec. 14, 2009 (describing positive aspects of collective action as providing (1) ease of administration, (2) fairness and (3) predictability). *See* Gonzalez, Drain, Peck, Abrams and Bernstein, "Bankruptcy Court Jurisdiction over Intercreditor Issues and Subordinate Financing Agreements," *ABI Views from the Bench*, Oct. 1, 2010, p. 38-39.

An Update on Second-Lien Financings and Intercreditor Agreements: Part II

from page 29

be in favor of enforcement at some level, every case will be reviewed on a case-by-case basis and be somewhat dependent on the facts. Unfortunately, at the present time, too many of the cases are in conflict and, as a result, a single rule is impossible to discern.[13] Going forward, to create more predictability as to result, first-lien lenders would be best served by being as specific as possible in listing in the intercreditor agreement the specific bankruptcy rights to be silenced rather than relying on general language. Conversely, second-lien lenders would appear to be advantaged by: (1) using more general language; (2) being in a position to prove to the court that the value of the assets is sufficient to entitle them (or as in *Boston Generating* nearly entitle them) to some distribution; and (3) avoiding the label of being obstructionist to the reorganization process. ■

Editor's Note: *The book is available for purchase at bookstore.abi.org (ABI members must log in first to obtain the member price).*

13 At an earlier date, we considered there to be a general trend in favor of the enforceability of intercreditor agreement provisions in bankruptcy cases. *Boston Generating* has forced a reconsideration of that conclusion.

Feature

By Jeffrey N. Pomerantz, Peter M. Gilhuly, Kimberly A. Posin and Shirley S. Cho

Delaware Bankruptcy Court Weighs In on Intercreditor Agreements

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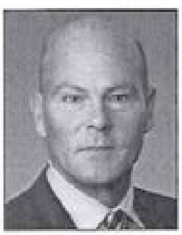

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In a recent noteworthy decision, the U.S. Bankruptcy Court for the District of Delaware weighed in on two issues that frequently arise in bankruptcy sales of overencumbered property: (1) whether a junior lienholder has standing to object to a sale notwithstanding the terms of an intercreditor agreement, and (2) whether a court may authorize a sale of property free and clear of junior out-of-the-money liens where the junior lienholders do not consent to the sale.

In *CyberDefender Corp.*,[1] GR Match LLC (GRM), the first-lien lender, was owed more than $16 million on an undisputed secured basis on account of pre-petition debt plus an additional $4 million on a post-petition secured basis as the debtor-in-possession (DIP) lender. The debtor also owed approximately $5 million to individual noteholders on account of two secured note issuances (the "junior lienholders"). The debtor, GRM and the junior lienholders were parties to intercreditor agreements that, *inter alia*, contained broad subordination provisions and language preventing the junior lienholders from interfering with GRM's rights and remedies.

When no other bidders came forward to purchase the debtor's assets despite an extensive marketing process, the debtor sought to sell its business to GRM for a $12 million credit-bid plus $500,000 in cash, cancellation of all first-lien indebtedness and the assumption of various cure obligations. Although the subordinated notes were issued on a secured basis, given the value of the debtor's business and the sale of the debtor to GRM in exchange for a credit-bid, the junior lienholders were completely undersecured, and hence unsecured within the meaning of § 506(a) of the Bankruptcy Code.

Nonetheless, the junior lienholders objected to the debtor's proposed sale, arguing that§ 363(f) of the Code did not permit a sale free and clear of their liens unless they consented or their liens were paid in full.

Did the Junior Lienholders Lack Standing to Object to the Sale?

Before it could reach the question of whether the proposed sale satisfied the requirements of § 363(f)(3), Judge **Brendan Shannon** considered whether the junior lienholders had standing to object to the sale. GRM argued that the junior lienholders lacked standing to object to the sale based on the terms of the intercreditor agreements. Under the intercreditor agreements, the junior lienholders agreed to (1) subordinate their liens on the debtor's assets to the pre-existing liens of GRM, (2) refrain from taking any actions to enforce their rights against the debtor and (3) refrain from exercising any remedies to which they might otherwise be entitled until GRM's senior loans are paid in full.

Section 510(a) of the Bankruptcy Code provides that "[a] subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law."[2] *In re Ion Media Networks Inc.* was the first in a series of bankruptcy court decisions ruling on the enforceability and parameters of waivers found in pre-petition intercreditor agreements among lenders. Judge **James Peck** of the U.S. Bankruptcy Court for the Southern District of New York found that the intercreditor agreement constituted an enforceable contractual waiver of standing to challenge the validity of senior liens on FCC licenses. As the court put it, "[a] t bottom, the language of the Intercreditor Agreement demonstrates that the Second-Lien Lenders agreed to be 'silent' as to any dispute regarding the validity of liens granted by the Debtors in favor of the First-Lien Lenders and conclusively accepted their relative priorities regardless of whether a lien ever was properly granted in the FCC Licenses."[3]

In *In re Erickson Retirement Communities LLC*, the agent for the senior secured lender argued that the subordinated entities "lack standing and/or have waived their right" to pursue a motion for appointment of an examiner "because they essentially agreed to stand still, be 'silent seconds' and yield in all respects to the senior, secured lenders until the senior secured lenders are paid in full."[4] The agent further argued that the request for an examiner was "an indirect demand for payment" in violation of the parties' subordination agreement.[5] Because "subordination agreements are interpreted and enforced in accordance with general contract principles," the

1 Case No. 12-10633 (BLS) (Bankr. D. Del).

2 11 U.S.C. § 510(a). *See also In re Electrical Components International Inc.*, 2010 Bankr. LEXIS 5797, at * 26 (Bankr. D. Del. April 27, 2010); *In re Erickson Retirement Communities LLC*, 425 B.R. 309, 314 (Bankr. N.D. Tex. 2010); *In re Ion Media Networks Inc.*, 419 B.R. 585, 595 (Bankr. S.D.N.Y. 2009).

3 *Ion Media*, 419 B.R at 594.

4 *Erickson*, 425 B.R. at 314.

5 *Id.*

court determined that a reasonable person in the position of the subordinated party would understand the meaning of the subordination agreement to be that until the senior lenders are paid in full, the subordinated parties must "stand still."[6] The subordination agreement at issue in *Erickson* provided that the subordinated creditors could not "exercise any rights or remedies or take any action or proceeding to collect or enforce any of the Subordination Obligations" without prior written consent from the agent for the senior secured lenders until the senior loan was satisfied in full.[7]

In *Boston Generating*, Judge **Shelley Chapman** determined that an intercreditor agreement did not prohibit second-lien lenders from objecting to a § 363 sale process where the intercreditor agreement did not contain an "express or intentional waiver of [such] rights."[8] The bankruptcy court distinguished *Ion Media* and *Erickson*, noting that the facts before it required a different outcome because the proposed 363 sale would effectively deprive the second-lien lenders of the opportunity to vote, in "an economically meaningful way, on a plan"; in addition, the second-lien lenders were on the "cusp" of a recovery and were not engaging in the type of obstructionist behavior displayed in *Ion Media*.[9] The court further stated that second-lien lenders do retain certain rights under a typical intercreditor agreement, including the right to appear and be heard in a bankruptcy case as unsecured creditors.[10]

More recent cases, such as *In re Centaur LLC, et al.*[11] and *Boston Generating*, trend toward disfavoring standing arguments in light of the Bankruptcy Code's inclusiveness of all parties in interest and the bankruptcy court's use of the "bankruptcy imperative" to guard certain core rights such as the right to vote on a reorganization plan and, in some instances, the right to be heard as a creditor. Both *Centaur* and *Boston Generating*, however, focused on whether there had been an explicit waiver of a right.

GRM argued that a reasonable person would understand the intercreditor agreements to categorically prevent the junior lienholders from (1) objecting to the sale as an action to enforce the debtor's obligations to the junior lienholders, (2) an attempt to exercise remedies and (3) a prohibited effort to interfere with the disposition of GRM's collateral. At bottom, GRM argued that the junior lienholders' objections were improperly aimed at slowing down the sale process and "gaining leverage to enhance or create recoveries" for themselves—"the very type of obstructionist behavior that the agreements are intended to suppress."[12]

Judge Shannon was intrigued by these issues and commented that it was a very close call whether to entertain the junior lienholders' objections to the sale. On the one hand, Judge Shannon commented that the debtor, being a party to the intercreditor agreement, was important and provided a nexus to the bankruptcy estate to permit enforcement under § 510(a). On the other hand, he struggled with the constitutional due-process implications of denying a creditor the right to be heard in the bankruptcy case and drew a distinction in the case law between waiver and standing. Judge Shannon ultimately allowed the junior lienholders to be heard in connection with their objection to the sale, but stressed that his determination was only for purposes of the sale hearing and that it may not be his ultimate conclusion if the matter was raised in another context or in another case. Judge Shannon's willingness to let the junior lienholders be heard was likely also influenced by his decision to overrule their substantive objections and authorize the sale over their objections.

The Split of Authority under § 363(f)(3)

Section 363(f)(3) provides that property may be sold under § 363(b) free and clear of liens if "such interest is a lien and the price at which the property is to be sold is greater than the aggregate *value of all liens* on such property."[13] The junior lienholders' objection to the sale was based on the Ninth Circuit Bankruptcy Appellate Panel's (BAP) 2003 decision in *Clear Channel Outdoor Inc. v. Knupfer (In re PW LLC)*.[14] In *Clear Channel*, the Ninth Circuit BAP ruled that the debtor could not sell its assets free and clear of nonconsenting junior liens under § 363(f)(3) without satisfying the junior debt in full. The *Clear Channel* court reasoned that Congress's use of the phrase "aggregate value of all liens" as opposed to the "aggregate value of all claims secured by liens" in § 363(f) was significant and justified interpreting the statute to mean the face value, as opposed to the economic value of liens.[15]

The *Clear Channel* decision highlights a split of authority with the Southern District of New York and other jurisdictions. *In re Beker Indus Corp.*[16] and its progeny have held that "value" in § 363(f)(3) means the value of the collateral underlying the lien—*i.e.*, the "actual value"—rather than the face amount of such lien.[17] In determining actual value, the measuring stick is the market value of the underlying collateral, which dictates the value of the lien pursuant to § 506(a).[18]

Judge Shannon overruled the junior lienholders' objection when he ruled that "the Courts that have construed and followed the *Beker* analysis have it right...that the value of those liens is determined by reference to Section 506, and that it is in fact the value of the collateral, not the face value of the asserted lien."[19] Judge Shannon also ruled that a sale free and clear of the junior liens was authorized under § 363(f)(5) because the junior lienholders could be compelled to accept a monetary satisfaction of their claim, whether under a cramdown or a state court judicial foreclosure proceeding. The *CyberDefender* ruling is significant as it represents the decision of an influential bankruptcy court weighing in on the *Beker/Clear Channel* split. abi

6 *Id.* at 314-15.
7 *Id.* at 313.
8 *In re Boston Generating LLC*, 440 B.R. 302, 316-19 (Bankr. S.D.N.Y. 2010).
9 *Id.* at 320.
10 *See id.* at 317.
11 Case No. 10-10799 (Bankr. D. Del.) (KJC).
12 *Erickson*, 425 B.R. at 315; *see also Ion Media*, 419 B.R. at 595.

13 11 U.S.C. § 363(f)(3) (emphasis added).
14 391 B.R. 25 (9th Cir. B.A.P. 2008).
15 The objecting junior lienholders also relied on *Criimi Mae Servs. LP v. WDH Howell LLC (In re WDH Howell LLC)*, 298 B.R. 527, 532-34 (D.N.J. 2003), which was an earlier district court opinion that paralleled the *Clear Channel* decision on § 363(f)(3).
16 63 B.R. 474, 475-78 (Bankr. S.D.N.Y. 1985).
17 *See* 63 B.R. at 476 ("value" means "actual value as determined by the Court, as distinguished from the amount of the lien"). *See, e.g., In re Hatfield Homes Inc.*, 30 B.R. 353, 355 (Bankr. E.D. Pa. 1983); *In re Oneida Lake Dev. Inc.*, 114 B.R. 352, 356-57 (Bankr. N.D.N.Y. 1990); *In re Collins*, 180 B.R. 447, 451 (Bankr. E.D. Va. 1995) (holding that term "value" in § 363(f)(3) should be given same definition as "value" under § 506(a), and therefore "means actual value as determined by the Court, rather than the face amount of the lien"); *In re Nettax Inc.*, 335 B.R. 85, 92 (D. Md. 2005); *In re Boston Generating LLC*, 440 B.R. at 332-33.
18 *See In re Boston Generating LLC*, 440 B.R. at 332 ("Under *Beker* and the many decisions of other Bankruptcy Courts following its reasoning, I find that section 363(f)(3) is satisfied. To hold otherwise would effectively mean that most section 363 sales of encumbered assets could no longer occur either (a) absent consent of all lienholders (including those demonstrably out of the money) or (b) unless the proceeds of the proposed sale were sufficient to pay the face amount of all secured claims in full.").
19 May 2, 2012 Hearing Tr. at 67:14-18.

C

United States Bankruptcy Court,
W.D. Arkansas,
El Dorado Division.
In re Ernest Gregory O'NEAL and Nancy Mapes O'Neal, Debtors.

No. 1:11–bk–72792M.
April 12, 2013.

Background: Confirmation hearing was held on individual Chapter 11 debtors' proposed plan.

Holdings: The Bankruptcy Court, James G. Mixon, J., held that:
(1) proposed Chapter 11 plan that, with limited exceptions, failed to specify the name of any creditor or the class to which that creditor was assigned, that did not indicate whether certain classes were impaired or unimpaired, and that failed to provide any treatment for one creditor's claim, could not be confirmed;
(2) creditors' unsecured deficiency claims, even assuming that senior creditor was not fully secured, were not "substantially similar"; but
(3) "absolute priority" rule did not apply in Chapter 11 case filed by individual debtors.

Confirmation denied.

West Headnotes

[1] Bankruptcy 51 3566.1

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3566 Confirmation; Objections
51k3566.1 k. In general. Most Cited Cases

Bankruptcy court has mandatory, independent duty to determine whether proposed Chapter 11 plan satisfies all of the requirements for confirmation. 11 U.S.C.A. § 1129(a).

[2] Bankruptcy 51 3549

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3548 Requisites of Confirmable Plan
51k3549 k. Contents in general. Most Cited Cases

Proposed Chapter 11 plan that, with limited exceptions, failed to specify the name of any creditor or the class to which that creditor was assigned, that did not indicate whether certain classes were impaired or unimpaired, and that failed to provide any treatment for one creditor's claim, did not comply with Bankruptcy Code provision governing the contents of plan, and could not be confirmed. 11 U.S.C.A. §§ 1123(a), 1129(a)(1).

[3] Bankruptcy 51 3550

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3548 Requisites of Confirmable Plan
51k3550 k. Classification of claims. Most Cited Cases

Claims are "substantially similar," and may be placed in the same class, if they are similar in legal character or effect as claim against Chapter 11 estate; only the nature of claim is relevant to its classification in proposed Chapter 11 plan. 11 U.S.C.A. § 1122(a).

[4] Bankruptcy 51 3550

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3548 Requisites of Confirmable Plan
51k3550 k. Classification of claims. Most Cited Cases

Even if court were to accept individual Chapter 11 debtors' last minute creative accounting, after objection was filed to classification of creditor claims in their proposed plan, and to value the non-publicly-traded stock that secured a creditor's claim not at $609,000 but at zero, creditor's resulting unsecured claim, as a now undersecured creditor with first priority security interest both in stock and in other assets whose value was less than amount of its claim, was not "substantially similar" to unsecured claim of creditor with junior security interests in these same assets, whose rights were totally subordinate to those of the first creditor; while, depending upon value placed on the stock, both creditors had unsecured deficiency claims, these claims were not substantially similar and should not have been placed in same class, thus affecting whether plan was accepted by class. 11 U.S.C.A. § 1122(a).

[5] Bankruptcy 51 ⚿3558

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3558 k. Good faith and legality. Most Cited Cases

Bankruptcy 51 ⚿3559

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3559 k. Feasibility in general. Most Cited Cases

Contradictory provisions in individual Chapter 11 debtors' proposed plan, in providing, on the one hand, that it was to last for five years, while also providing for full payment of $1.66 million claim at rate which would not result in full payment in less than 15 years, rendered the plan impossible to perform, and also affected its "good faith" as not representing debtors' actual plan for repaying their debts to creditors, so as to prevent plan from being confirmed. 11 U.S.C.A. § 1129(a)(3).

[6] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of priority. Most Cited Cases

Bankruptcy 51 ⚿3565

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3563 Fairness and Equity; "Cram Down."
51k3565 k. Unsecured creditors and equity holders, protection of. Most Cited Cases

By its plain terms, "absolute priority" rule does not apply in Chapter 11 case filed by individual debtors, so that debtors' retention of property of the estate, which would revest in them on confirmation, would not prevent them from "cramming down" plan that would result in less than a 100% distribution on unsecured claims. 11 U.S.C.A. §§ 1115, 1129(b)(2)(B)(ii).

***838** Stephen L. Gershner, Davidson Law Firm, Little Rock, AR, for Debtors.

ORDER

JAMES G. MIXON, Bankruptcy Judge.

On June 15, 2011, Ernest O'Neal and Nancy O'Neal (Debtors) filed a voluntary petition for relief under the provisions of Chapter 12 of the United States Bankruptcy Code. On June 28, 2011, the case was converted to a case under Chapter 11 on the Debtors' motion.

The Debtors filed a second amended Chapter 11 plan of reorganization on May 1, 2012. An objection to confirmation was filed by Arkansas Development Finance Authority (ADFA). A hearing on confirmation was conducted in Little Rock, Arkansas, on September 13, 2012. After the confirmation hearing, the matter was taken under advisement. Briefs have been filed by the Debtors and ADFA.

The proceeding before the Court is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(L) and the Court has jurisdiction to enter a final judgment in this case.

I.
BACKGROUND

The Debtors, husband and wife, reside in Ashley County, Arkansas, and conduct a large farming operation. In 2012, the Debtors farmed a total of 1,700 acres consisting of 1,250 acres of cotton, 400 acres of corn and 79 acres of soybeans. (Debtors' Ex. 7; Tr. at 23 & 51.) The Debtors farming operation is performed by the

***839** Debtors individually and two entities created by them. The Debtors individually own 615 acres of farm land in Ashley County, Arkansas, and a personal residence in Wilmot, Arkansas. The Debtors own 100% of the stock in Earnest O'Neal, Inc., which in turn owns 208 acres of farm land in Ashley County, Arkansas, and all of the farming equipment and machinery used in the Debtors' farming operation. (Tr. at 23.) The Debtors created O'Neal Farm Partnership (the Debtors are equal partners), which is used to conduct the farming operation. The partnership owns no property except crops when they exist. The balance of the 1,700 acre farming operation is conducted by the partnership on rented land. (Tr. at 24.)

The Debtors and Earnest O'Neal, Inc., together own 823 acres of farm land which the Debtors value at $2,700.00 per acre for a total value of $2,235,600.00. The Debtors value the farm land owned by them individually at $1,660,050.00 and value the farm equipment owned by Earnest O'Neal, Inc., at $452,075.00. (Tr. at 27.) The Debtors value their personal residence at $60,000.00. (Tr. at 116.)

The Debtors' second plan of reorganization creates seven classes of creditors and one class of interest holders.

Class I
ADMINISTRATIVE CLAIMS

This class consists of creditors holding administrative claims. The plan does not state the name of any Class I creditor or the amount of any claim. This class is to be paid in full upon confirmation if the claim is pre-confirmation; post-confirmation claims are to be paid upon Court approval. The class is designated as unimpaired.

Class II
PRIORITY TAX CLAIMS

This class consists of creditors holding priority tax claims. The plan states that no allowable Class II claims exist although it states that the Internal Revenue Service has filed a claim for $5,100.00 for 2008 income taxes which the Debtors dispute. The plan further provides that if any claims are filed and allowed they will be paid in five equal installments with interest beginning one year from the date of confirmation. The class is designated as impaired

Class III
UNITED STATES FARM SERVICE AGENCY

This class consists of the claim of Farm Service Agency (FSA) in the sum of $160,000.00. The plan treats this class as a secured claim to be paid according to the terms of a note dated July 28, 2009. The note was not introduced into evidence, although an addendum to the note was introduced which referred to the original note. (Debtors' Ex. 8.) The addendum is dated April 23, 2010, and reflects the debt to be $155,960.00 and calls for installment payments in annual amounts of $11,225.00, with a final installment due July 28, 2025. Interest is computed at 3.75% per annum on the unpaid principal balance. The plan provides that the claim will be paid "in accordance with contract terms." The amount scheduled on the petition is $152,298.00. The class is designated as unimpaired.

Class IV
DELTA TRUST & BANK

This class consists of the claim of Delta Trust & Bank (Delta). The treatment of this claim is convoluted and at times contradictory. The claim in this class is treated as secured.

The plan states that Delta is owed a total of approximately $2,058,000.00 secured in part by land owned by the Debtors individually, rents from the Debtors' farm land, the Debtors' stock in Earnest ***840** O'Neal, Inc., and life insurance policies. Treatment of this class provides: "This creditor shall be paid the value of its collateral or $1,661,800.00.... This claim shall be paid at the contract rate of 6.75% per annum in three annual [sic] installments of $183,056.71 beginning March 27, 2013 and the same day of each year thereafter until paid." FN1 The balance of the $2,058,000.00 claim ($396,200.00) and the balance of an unpaid crop production loan from 2009 ($179,652.00) is treated as unsecured, notwithstanding that the balance of the claims are fully secured by assets of Earnest O'Neal, Inc., and the life insurance policies valued at $28,408.00.FN2 The plan states that it shall not affect the obligation of non debtor entities to comply with original contract terms with Delta. The plan also states, "[a]lthough the Debtors are confident that in the absence of a default the loan will be renewed by DTB [Delta] at the expiration [sic] renewal of the loan and interest rate shall be subject to negotiation."

> FN1. The Debtors may have meant to say that $183,056.71 was to be paid annually not in three payments of $183,056.71 per year, or that payments of $183,056.71 will be paid for three years beginning March 29, 2013. The note (No. 7701355) calls for payment of all principal and interest on March 27, 2012. (Debtors' Ex. 4.)

> FN2. The life insurance policies were scheduled on the petition and the Court assumes these are cash surrendered values.

CLASS V
DELTA TRUST & BANK

This class consists of the claim of Delta in the sum of $42,245.00 secured by a mortgage on the Debtors personal residence in Wilmot, Arkansas. The plan states that the note matures February 15, 2013, and that "the loan will be extended until through [sic] the life of the plan subject to annual interest adjustments and shall be paid at in [sic] accordance with current contract terms." The plan then states, "[e]xcept as modified herein, the loan documents ... remain in full force and effect." The class is stated to be impaired.

Class VI
UNSECURED CLAIMS

This class consists of allowed unsecured claims. The plan proposes to pay this class pro rata from farming operations. The first payment will be made on or before January 31, 2013, and, thereafter, on January 31st of each year over the life of the plan. No amount of payment is stated in the plan and no creditors are named as unsecured creditors in this class. The plan also does not state whether or not the class is impaired.

Class VII
EQUITY SECURITY HOLDERS

This class consists of the Debtors individually and provides that all property of the estate shall vest in them upon confirmation of the plan. The plan does not state whether the class is impaired or unimpaired.

MEANS OF EXECUTION

The plan proposes to pay creditors from income generated by the combined farming operations of the Debtors and their two wholly owned entities, Earnest O'Neal, Inc. and O'Neal Farm Partnership. The plan length is stated to be for five years. The farming operation will be conducted by the farm partnership by leasing farm equipment owned by Earnest O'Neal, Inc. for a lease payment sufficient to pay all indebtedness owed by the corporation to creditors holding security interests in the farming equipment. The farming partnership will also lease 280 acres of farmland ***841** owned by the corporation for $44,300.00 per year and lease the Debtors' 618 acres of farm land for $94,300.00. The plan also states that:

> profits (income) of OFP (Ernest O'Neal Farm Partnership) will first pay its claims and the profits (income) of EOI (Ernest O'Neal, Inc.) will first pay its obligations in the ordinary courts [sic]. The remaining profits will be used to pay the O'Neals [sic] living expenses, and to fund the plan. Pre petition secured claims will be paid first, thereafter, holders of administrative expense claims and priority and unsecured creditors shall be paid in accordance with the priorities of the bankruptcy code. Ernest O'Neal is 63 years old and Nancy O'Neal is 61. If the O'Neals draw social security before completion of the plan it will be applied toward their living expenses and will increase disposable income.

The plan further provides that the farming operation will be financed through periodic production loans over the life of the plan. The production lender will be Delta and the collateral for the production loans will be all of the assets of the Debtors, O'Neal Farms, Inc., and Ernest O'Neal Farm Partnership. The Debtors' production loan will also be subject to a 90% guaranty by the FSA. The Debtors anticipate that Delta will continue to provide production financing.

THE BALLOTS

The summary of the voting by creditors resulted in the following:

Class IV	Delta	$1,661,800.00	Accepts
Class VI	Delta	$ 42,425.00	Accepts
Class VII	Delta	$ 575,852.00	Accepts
	Deere & Company	$ 260,693.18	Accepts
	Agro Distribution, LLC	$ 358,232.90	Accepts
	ADFA	$ 498,590.92	Rejects

(Debtors' Ex. 1.)

II.
ARGUMENT

The Debtors argue that the result of the voting is that all classes of creditors accepted the plan notwithstanding ADFA's rejection and, therefore, the plan should be confirmed because the plan meets all of the requirements of 11 U.S.C. § 1129(a).

ADFA argues that its claim should not have been put in the same class with Deere & Company's claim of $260,693.18 and Delta's claim of $575,852.00; therefore, the plan does not comply with the requirements of 11 U.S.C. §§ 1122 and 1129(a). ADFA further argues that if its claim had been properly classified the resulting class would not have been deemed to have voted to accept the plan pursuant to 11 U.S.C. § 1126(c); therefore, the plan may only be confirmed pursuant to 11 U.S.C. § 1129(b)(2)(B)(i), (ii) (the cram down). ADFA argues that since the Debtors are retaining pre-petition property under a plan which does not propose to pay the rejecting junior class of unsecured creditors in full, it violates the absolute priority rule contained in 11 U.S.C. § 1129(b)(2)(B)(i), (ii) and, therefore, cannot be confirmed.

III.
DISCUSSION

For a Chapter 11 plan of reorganization to be confirmed, the requirements of 11 U.S.C. § 1129(a) must be met. This section has 16 prerequisites for confirmation ***842** and all must be met except 11 U.S.C. § 1129(a)(8), which provides that each class must accept the plan or be unimpaired. The plan may still be confirmed over the dissent of one or more classes of impaired creditors if the plan complies with all requirements of 11 U.S.C. § 1129(a) and the cramdown standard set forth in 11 U.S.C. § 1129(b).

[1] In addition to the considerations of objections raised by parties in interest, this Court has a mandatory independent duty to determine whether the plan has met all of the requirements of confirmation. *United Student Aid Funds, Inc. v. Espinosa,* 559 U.S. 260, 130 S.Ct. 1367, 1381, 176 L.Ed.2d 158 (2010) (stating that bankruptcy court has obligation to ensure Chapter 13 plan complies with the Code even if the creditor fails to object); *Burnett v. Burnett (In re Burnett),* 646 F.3d 575, 581 (8th Cir.2011) (recognizing that bankruptcy court, pre-confirmation, bears an independent duty to assure compliance with Title 11 even if no objection is lodged); *Williams v. Hibernia Nat'l Bank (Matter of Williams),* 850 F.2d 250 (5th Cir.1988) (citing *In re Holthoff,* 58 B.R. 216, 218 (Bankr.E.D.Ark.1985)) (acknowledging court's independent duty to determine whether the plan has met all the necessary requirements for plan confirmation).

A.
11 U.S.C. § 1123

[2] 11 U.S.C. § 1129(a)(1) provides that the plan must comply with the applicable provisions of this title. 11 U.S.C. § 1123(a) which is an applicable provision of Chapter 11 provides in relevant part as follows:

> Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—
>
> (1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind spe-

cified in section 507(a)(2), 507(a)(3), or 507(a)(8) of this title, and classes of interests;

(2) specify any class of claims or interests that is not impaired under the plan;

(3) specify the treatment of any class of claims or interests that is impaired under the plan;

(4) 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 of such particular claim or interest....

This plan does not comply with section 1123, and, therefore, cannot be confirmed. The Debtors' plan fails to specify, with the exception of Delta and FSA, the name of any creditor and the class to which the creditor is assigned. The plan fails to provide any treatment for the claim of Deere & Company, even though the evidence presented was that Earnest O'Neal, Inc., and the Debtor, Mr. O'Neal, are primarily liable on several contracts. (Debtors' Ex. 11.) It is not clear from the record what the total liability of these contracts are. Three contracts are refinance loan contracts and it is unclear what collateral is being refinanced because the product identification number is not on the original security agreements. All of the contracts are secured by a security interest in favor of Deere & Company. The Debtors claim that the farm equipment was purchased by O'Neal Farms, Inc. and is therefore owned by O'Neal Farms, Inc. Deere & Company filed a proof of claim for $306,039.72 as a secured creditor and voted to accept the plan. Deere & Company's ballot does not state whether the claim is secured or unsecured. (Debtors' Ex. 1). Deere & Company later amended ***843** its proof of claim to the amount of $260,693.18 because it received some payments since the filing of the claim. (Tr. at 13.)

The Debtors' plan also does not provide any treatment for its current crop production loan owed to Delta which on the date of the confirmation hearing was the sum of $1,126,867.77. The original note was dated February 28, 2012, in the principal sum of $1,100,000.00. The maker of the note is O'Neal Farm Partnership and is guaranteed by the Debtors individually. (Debtors' Ex. 7.) The note is secured by real estate owned by the Debtors and O'Neal Farm, Inc., and crops produced by O'Neal Farm Partnership.[FN3]

FN3. The Debtor, Mr. O'Neal, testified that he sold corn produced in 2012 and made a partial payment on the crop production loan during 2012 in the sum of $430,000.00.

The description of the treatment of Delta's secured claim in Class VI is contradictory. The note matures on February 15, 2013, and all principal and interest are due. The plan states that this “loan will be extended until through [sic] the life of the plan”, which is five years, “subject to annual interest adjustment.” The plan then states, “[e]xcept as modified herein, the loan documents relative to this claim remain in full force and effect.” Plaintiff's Exhibit 6 is the note which was in the original principal sum of $50,337.00 dated May 6, 2004. The note is payable in full each year and has been renewed each year since 2004. Principal has been reduced as of April 17, 2012, to $41,497.99.[FN4] If the plan is to pay the claim according to the “current contract terms” it will require payment in full of $41,479.99, and, therefore, cannot be “extended” over the five year life of the plan.

FN4. The first page of Debtors' Exhibit 6 is barely legible, and, therefore, this figure may not be accurate.

On the bankruptcy schedules the Debtors listed a debt owed individually to the USDA for $25,000.00. The claim is listed as secured by real estate owned by Earnest O'Neal, Inc. The creditor filed a claim for $26,095.20. (Debtors' Ex. 9.) The plan makes no provision for the treatment of this claim, nor does it assign the creditor to any class in violation of 11 U.S.C. §§ 1129(a)(1) and 1123(a).

B. CLASSIFICATION OF ADFA CLAIM

11 U.S.C. § 1122(a) provides as follows:

[e]xcept as provided in subsection (b) of this section, a plan may place a claim ... in a particular class only

if such claim ... is substantially similar to the other claims ... of such class.

[3] “Substantially similar” means similar in legal character or effect as a claim against the estate, and only the nature of the claim is supposed to be relevant to classification. 7 Collier on Bankr.¶ 1122.03[3] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.); see also *John Hancock Mut. Life Ins., Co. v. Route 37 Bus. Park Assoc.,* 987 F.2d 154 (3rd Cir.1993); *In re Holthoff,* 58 B.R. 216 (Bankr.E.D.Ark.1985); *Beal Bank, S.S.B. v. Waters Edge Ltd. P'ship,* 248 B.R. 668 (D.Mass.2000).

[4] Exhibit A of the Debtors' disclosure statement reflects a compilation of the Debtors' assets and their respective values. (Debtors' Ex. 12.) The Debtors' total assets are stated to be valued at $2,497,800.00 and liabilities are $2,949,700.00 leaving a net worth of negative $451,900.00. Among the assets listed is the Debtors' interest in Earnest O'Neal, Inc., which is valued at $609,000.00. The ***844** so-called unsecured claim of Delta for $575,852.00, which the Debtors placed in Class VII along with the objecting creditor ADFA, is actually secured by the stock owned by the Debtors in Earnest O'Neal, Inc. ($609,000.00) plus three life insurance policies owned by the Debtors whose values are listed on the petition at a total of $28,381.00. Therefore, using these numbers, Delta has no unsecured claim and cannot be properly classified with other unsecured claims in Class VII.

If Delta's claim had been properly classified as secured in a separate class, then claims totaling $618,926.08.18 or about 55% accepted the plan and claims totaling $498,590.92 or about 45% rejected the plan in Class VII. With Delta in its own class, at least $745,011.33 worth of claims in Class VII (two-thirds of the total amount) would have to vote to accept the plan. Therefore, the plan failed to acquire the necessary two thirds vote to accept and Class VII is deemed to have rejected the plan. See 11 U.S.C. § 1126(c) (two thirds of amount of claims voting in class must accept for the class to accept).

However, at trial, the Debtors' counsel, relying on some last minute creative accounting, introduced an additional compilation which valued Earnest O'Neal, Inc. at zero. (Debtors' Ex. 12)(this additional compilation was attached to the initial compilation attached to Exhibit A of the Debtors' disclosure statement). The second set of numbers was accomplished by transferring $738,200.00 of the debt owed by the Debtors to Delta to the account of Earnest O'Neal, Inc. The Debtors and O'Neal Farms, Inc. are co-makers of the note and both are primarily liable. This change in presentation resulted in a calculation that Earnest O'Neal, Inc., has a negative net worth of $63,200.00 and the Debtors have a negative net worth of $345,000.00. The accountant was asked about the change in the numbers, but her testimony never explained why the change in presentation was made:

Q. And then, when we go down to the liabilities; again, were these numbers as of December 31st of 2011?

A. Yes.

Q. Have you subsequently updated this document.

A. Yes. We prepared an update, dated, I believe, August 27, of 2012.

Q. And if you'll turn over to the second to last page in Exhibit 12.

A. Yes, sir.

Q. Would this document be your update?

A. Yes, sir.

Q. Okay. And can you go through and explain the assets that you've described on the first page of your update?

A. Okay. On value, Earnest O'Neal, it's stated as zero, because that reflects the difference in the presentation as far as the secured debt on the land and the cash cotton entities and gin receive—gin rebate receivable are no longer reflective because they're not in existence any more. And that is the change in the assets. The liabilities have been changed to reflect the debt payments that have been made since December 31st. And that's the—that's the majority of the changes.

Q. All right. And if you will flip over to the following page, would this be your calculation as to why Earnest O'Neal, Inc., has a zero value?

A. That's correct.

Q. Okay. Let's go back to—I'm flipping you back and forth a little.

A. Okay.

Q. Let's go back to the first page of your August 27 analysis. You ***845** show—for the O'Neals, you show a note payable of 1,661,800, Delta Trust.

A. That's correct.

Q. And you've been in the courtroom today and you would agree that would be the value that they're proposing to pay under their plan, at least as for Earnest O'Neal, Inc.'s—Earnest and Nancy O'Neal's interest in the property?

A. Yes.

(Tr. at 99–100.)

Even if the stock in Earnest O'Neal, Inc., should properly be valued at zero according to accounting standards, Delta's unsecured claim is not substantially similar to the unsecured claim of ADFA. Delta has a security interest in all of the Debtors' stock in Earnest O'Neal, Inc., whether it is valued at zero or $609,000.00. Therefore, according to state law it has the right to liquidate the stock upon any default by the Debtors regardless of whether Earnest O'Neal, Inc. defaults. See Ark.Code Ann. § 4–9–601, et seq. If Delta purchased the stock at a liquidation sale, it could then liquidate Earnest O'Neal, Inc. in an attempt to satisfy its entire claim including the portion that has been classified as unsecured. The Debtors would have no control over Earnest O'Neal, Inc. This is a fundamental difference from the rights of ADFA, whose claim to the Debtors' assets including the stock in Earnest O'Neal, Inc., is totally subordinate to Delta's rights. See *John Hancock Mut. Life Ins., Co. v. Route 37 Bus. Park Assoc.,* 987 F.2d 154, 158 (3rd Cir.1993) (" section 1122(a) expressly provides only that claims that are not 'substantially similar' may not be placed in the same class"); *In re Coram Healthcare Corp.,* 315 B.R. 321 (Bankr.D.Del.2004)(claims that comprise one class are claimants of equal rank entitled to share pro rata in values remaining after payment of secured and priority claims).[FN5]

FN5. ADFA argued that the Debtors classification of its claim was the result of impermissible gerrymandering. 11 U.S.C. § 1122 does not require similar claims to always be put in the same class. Gerrymandering occurs most frequently when similar claims are put in different classes to impermissibly manipulate the requirements of Chapter 11 such as obtaining a class of impaired creditors to comply with the requirements of 11 U.S.C. § 1122. See *Windsor on the River Assoc., Ltd. v. Balcor Estate Fin., Inc. (In re Windsor on the River),* 7 F.3d 127 (8th Cir.1993) ("a claim in not impaired if the alteration of rights in question arises solely from the debtor's exercise of discretion"). Gerrymandering involves what would appear to be a proper classification for what are improper purposes, whereas here we have an improper classification. Since the claims in question are not substantially similar, the issue of gerrymandering is never reached.

C.
ADDITIONAL REASONS THE PLAN CANNOT BE CONFIRMED

[5] The plan of reorganization is impossible to perform. Because the Debtors are individuals, the provisions of 11 U.S.C. § 1141(d)(5)(A) apply. This section states that in a case where the debtor is an individual:

> unless after notice and a hearing the court orders otherwise for cause, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on completion of all payments under the plan.

The plan proposes that it is to last five years and unsecured creditors are to receive a distribution described as "pro rata." The plan proposes to pay the secured claim of Delta the sum of $1,661,800.00 over the five-year life of the plan and the Debtors must complete the plan payments to enable the Debtors to discharge the unpaid claims in Class VII. ***846** The Debtors' plan proposes to pay Delta the sum of $183,056.71 "until paid." This includes interest accruing at the rate of 6.75% per annum on the unpaid principal. To amortize $1,661,800.00 at 6.75% per annum with annual payments of $183,056.71 requires 15 years of payment and cannot be done in five years.[FN6] If the plan was construed to mean the claim was to be paid over three years at $183,056.91 per year, the secured claim will be paid even less.

FN6. The proposed treatment of the creditor in Class III will take 12 years to complete.

Further, the written plan is not proposed in good faith in violation of the requirements of 11 U.S.C. § 1129(a)(3) because it is not the Debtors' actual plan which Mr. O'Neal freely admitted in his testimony:

Q. Now, with respect to your payments to Delta Trust under your plan, you don't expect to have Delta Trust paid a million six over five—over a five year period, do you?

A. No.

Q. And has it been your practice on the large Delta Trust loan—not your production loan—that the loan would be for a one, two, three year period, and then you would go into the bank and they would renew it for another period?

A. That's correct.

Q. And has that been your course of dealing with Delta Trust?

A. Yes.

Q. And do you have any expectation that Delta Trust will change that procedure?

A. No.

Q. And, in fact, wouldn't—isn't it true that the Delta Trust loan would be a very long term continuing obligation even after your plan is completed?

A. Yes. Hopefully, as the Judge asked me, I can get it refinanced at a cheaper interest rate.

(Tr. at 95.)

Nowhere in the plan does it specifically state or even intimate that the Debtors are proposing to discharge their personal liability to Delta on all but $1,661,800.00 of the debt they owe. The Debtors owe Delta secured debts in excess of $2,058,000.00 (not including the Debtors' home).[FN7]

FN7. The Debtors total debt is $2,949,700.00. (Debtors' Ex. 13.)

The plan does not propose to actually pay Class VII anything. The projections made by Debtors accountant on Debtors' Exhibit 13 show that over the five-year life of the plan, payments totaling $62,000.00 can be paid to creditors in Class VII. The plan, however, does not require any specific amount of payment. It says only pro rata. The Debtors' accountant admitted that any sums left over which would be available to make the $62,000.00 payments to the Class VII creditors over five years could legitimately be used to defray next year's crop production costs leaving nothing for unsecured creditors. This is exactly what the Debtor did with the proceeds of the 2011 crop. (Tr. at 62)("No, we had to produce this year's crop. The money went into this year's crop production, if there was any.") In reality, the Debtor will never have any disposable income. Therefore, the Debtors cannot comply with 11 U.S.C. § 1129(a)(15)(B) which provides:

The court shall confirm a plan only if all of the following requirements are met:

(15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan—

***847** (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5–year period beginning on the date that the first payment is due under the plan, *or during the period for which the plan provides payments,* whichever is longer." (Emphasis added).

D.
THE ABSOLUTE PRIORITY RULE

[6] Section 11 U.S.C. § 1129(b)(2)(B)(ii) represents the codification of the fair and equitable concept derived from railroad reorganization cases in the late 19th century which includes the absolute priority rule. *Case v. Los Angeles Lumber Products Co.,* 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939); *N. Pac. Ry. Co. v. Boyd,* 228 U.S. 482, 33 S.Ct. 554, 57 L.Ed. 931 (1913); ***Dill Oil Co., LLC v. Stephens (In re Stephens),* 704 F. 3d 1279, 1282 n. 1 (10th Cir. 2013)**. Prior to 2005, in order for a plan to be crammed down, the absolute priority rule required a dissenting creditor to be paid in full if the debtor was to retain any property.

In 2005, 11 U.S.C. § 1129(b)(2)(B)(ii) was amended and a new section 1115 was added which defines property in an individual Chapter 11. The added language in 11 U.S.C. § 1129(b)(2)(B)(ii) is in italics below:

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.*

The issue is stated in Collier on Bankruptcy:

The added language permits individual debtors to retain "property included in an estate under section 1115 " even if a dissenting class of unsecured creditors could otherwise contend such retention violated [the] absolute priority rule.

The scope of this exception turns on the scope of the phrase "included in the estate under section 1115." Section 1115, also added in 2005, specifies that property of the estate for individual chapter 11 debtors is different than property of the estate for all other chapter 11 debtors. It specifically states:

(a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541—

...

(2) earnings from services performed by the debtor after the commencement of the case....

Section 1115 thus creates more "property of the estate" in individual chapter 11 ***848** cases filed after the effective date of the 2005 legislation than in similar cases filed before the change. It achieves this by first specifying all property covered by section 541, and then by adding to that base one category of property previously excluded by section 541(a)(6): an individual's postpetition income from services.

As a result, section 1129(b)(2)(B)(ii)'s phrase "included in the estate under section 1115 " includes, at a minimum, such postpetition income from services. Whether it includes more depends on the meaning given "included" and the construction of section 1115.

If "included" in section 1129(b)(2)(B)(ii) means only property which is added by section 1115 then it has a

> very narrow meaning: it refers only to postpetition income from personal services—and not to property originally specified in section 541. If, however, "included" anticipates that section 1115 supplants entirely section 541, and assumes that the property of the estate in an individual's chapter 11 case can only be found in section 1115, then it has a very broad meaning, essentially exempting individuals from the absolute priority rules as to unsecured creditors.

7 Collier on Bankruptcy ¶ 1129.04[3][d] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.)

Prior to BAPCPA, property of a Chapter 11 estate did not include earnings from post-petition personal services (e.g., fees earned by professionals such as physicians or attorneys). Property which was acquired post-petition was still property of the estate if it was proceeds, products, offspring, rents or profits of or from property of the estate. See 11 U.S.C. § 541(a)(6).

In the most recent opinion on the meaning of 11 U.S.C. §§ 1129(b)(2)(B)(ii) and 1115, the Tenth Circuit Court of Appeals observed:

> To date the Bankruptcy Appellate Panel from the Ninth Circuit and five bankruptcy courts (one of which was affirmed by a district court) have adopted a "broad view", holding that the BAPCPA amendments eliminate the APR [Absolute Priority Rule] as applied to an individual's *entire* estate.[FN8] In contrast, the Fourth Circuit and seventeen bankruptcy courts have reached the opposite conclusion, holding that the BAPCPA amendments only exempt from the APR that property which § 1115 *adds* to an individual estate—not the pre-petition property already defined by § 541.[FN9]

> FN8. *In re Friedman,* 466 B.R. 471 (9th Cir. BAP 2012); *SPCP Grp., LLC v. Biggins,* 465 B.R. 316 (M.D.Fla.2011) (affirming unpublished decision of bankruptcy court); *In re Shat,* 424 B.R. 854 (Bankr.D.Nev.2010); *In re Johnson,* 402 B.R. 851 (Bankr.N.D.Ind.2009); *In reRoedemeier,* 374 B.R. 264 (Bankr.D.Kan.2007); *In re Tegeder,* 369 B.R. 477 (Bankr.D.Neb.2007).

> FN9. *In re Maharaj,* 681 F.3d 558 (4th Cir.2012) (affirming the bankruptcy court's decision in 449 B.R. 484 (Bankr.E.D.Va.2011)); *In re Lee Min Ho Chen,* 482 B.R. 473 (Bankr.D.P.R.2012); *In re Tucker,* 479 B.R. 873 (Bankr.D.Or.2012); *In re Arnold,* 471 B.R. 578 (Bankr.C.D.Cal.2012); *In re Lively,* 467 B.R. 884 (Bankr.S.D.Tex.2012); *In re Borton,* No. 09–00196–TLM, 2011 WL 5439285 (Bankr.D.Idaho Nov. 9, 2011); *In re Lindsey,* 453 B.R. 886 (Bankr.E.D.Tenn.2011); *In re Kamell,* 451 B.R. 505 (Bankr.C.D.Cal.2011); *In re Draiman,* 450 B.R. 777 (Bankr.N.D.Ill.2011); *In re Walsh,* 447 B.R. 45 (Bankr.D.Mass.2011); *In re Stephens,* 445 B.R. 816 (Bankr.S.D.Tex.2011); *In re Karlovich,* 456 B.R. 677 (Bankr.S.D.Cal.2010); *In re Gelin,* 437 B.R. 435 (Bankr.M.D.Fla.2010); *In re Steedley,* No. 09–50654, 2010 WL 3528599 (Bankr.S.D.Ga. Aug. 27, 2010); *In re Mullins,* 435 B.R. 352 (Bankr.W.D.Va.2010); *In re Gbadebo,* 431 B.R. 222 (Bankr.N.D.Cal.2010); see also *In re Friedman,* 466 B.R. at 476 (discussing the bankruptcy court's determination—in an unpublished February 17, 2011 order—that the APR applies to individual Chapter 11 debtors).

849** ***Dill Oil Co., LLC v. Stephens (In re Stephens), **704 F. 3d 1279 (10th Cir. 2013).**

Both the Fourth Circuit and the Tenth Circuit found the language of section 1129(b)(2)(B)(ii) and 1115 ambiguous because the provisions were susceptible to more than one meaning and, therefore, sought to determine Congress' intent. See *In re Maharaj,* 681 F.3d 558 (4th Cir.2012) and ***In re Stephens,*** **704 F. 3d 1279 (10th Cir. 2013).** The Fourth Circuit stated the issue as follows:

> There are two competing constructions of the "included in the estate" language. On one view the phrase "included in" means the equivalent of "added

to," since property of the estate has long been defined under section 541. On another view, however, the language "included in" means something closer to "referenced" in § 1115, in which case § 541 was merely "absorbed" and "superceded" into § 1115 for individual chapter 11 debtors. See, e.g., *Kamell,* 451 B.R. at 509. On the face of the statute either construction is plausible.

In re Maharaj, 681 F.3d 558, 569 (4th Cir.2012).

Supporting the narrow view that the BAPCPA amendments did not abrogate the absolute priority rule is the rule of statutory construction which disfavors implied repeal of existing statutes unless clearly expressed. See *Hui v. Castaneda,* 559 U.S. 799, 130 S.Ct. 1845,1853, 176 L.Ed.2d 703 (2010) ("As we emphasized, repeals by implication are not favored and will not be presumed unless the intention of the legislature to repeal is clear and manifest.") The Tenth Circuit pointed out that in 1952 Congress eliminated the fair and equitable requirement expressly although it was later reinstated in the 1978 bankruptcy code. ***In re Stephens,* 704 F. 3d 1279, 1282 (10th Cir. 2013)**. The *Maharaj* court observed that Congress could have easily repealed the absolute priority rule as to individuals by stating so rather than utilize the awkward and convoluted manner the supporters of the broad view claims that it did. *In re Maharaj,* 681 F.3d 558, 565–66 (4th Cir.2012). Also, Congress could have simply raised the Chapter 13 [and Chapter 12] debt limits. ***In re Stephens,* 704 F. 3d 1279, 1286 (10th Cir. 2013)**; *In re Maharaj,* 681 F.3d 558, 573 (4th Cir.2012) The *Maharaj* court rejected the argument that Congress was trying to provide greater benefits to individual debtors and noted the house reports and other provisions of BAPCPA were proposed reforms that were meant to address abuses of the bankruptcy system by debtors. *In re Maharaj,* 681 F.3d 558, 574 (4th Cir.2012). The court stated:

It is for this reason that we agree with the *Gbadebo* court's assessment that "no one who reads BAPCPA as a whole can reasonably conclude that it was designed to enhance the individual's 'fresh start.' " 431 B.R. at 229.

In re Maharaj, 681 F.3d 558, 574 (4th Cir.2012). The court then concluded with a final observation:

Moreover, we remain unconvinced that the doom and gloom scenario presented by Debtors is an accurate picture of the state of bankruptcy law. Debtors assume that, if the absolute priority rule is left intact, consensual confirmation is virtually impossible. To the contrary, plan acceptance is still very much a possibility, even within the confines of the absolute priority rule. Debtors "may negotiate a consensual plan, pay higher ***850** dividends, pay dissenting classes in full, or comply with the [absolute priority rule] by contributing prepetition property." *Friedman,* 466 B.R. at 491 (Jury, J., dissenting) (citing *Kamell,* 451 B.R. at 512; *Gbadebo,* 431 B.R. at 229–30).

In re Maharaj, 681 F.3d 558, 575 (4th Cir.2012).

The Ninth Circuit Bankruptcy Appellate Panel determined that the language of Section 1129(b)(2)(B)(ii) is not ambiguous "within the contextual statutory scheme and logic of plan confirmation requirements of Chapter 11", explaining that,

"Included" is not a word of limitation. To limit the scope of estate property in §§ 1129 and 1115 would require the statute to read, "included, except for the property set out in Section 541 " (in the case of 1129(b)(2)(B)(ii)), and "in addition to, but not inclusive of the property described in Section 541 " (in the cases of § 1115). A plain reading of § 1129(b)(2)(B)(ii), and 1115 together mandates that the absolute priority rule is not applicable in individual chapter 11 debtor cases.

Friedman v. P+P, LLC (In re Friedman), 466 B.R. 471, 481–483 (9th Cir. BAP 2012). This view was not shared by one member of the three member court who vigorously dissented. In brief, the Ninth Circuit BAP concluded that the new section 1115 constitutes a definition of property of an individual Chapter 11 estate which includes property previously defined as property of a Chapter 11 estate by section 541 and additional property, particularly property from income earned post petition from personal services.

The *Friedman* court pointed out that Chapter 13 does not contain an absolute priority rule and pointed to several BAPCPA amendments to individual Chapter 11s which are similar if not identical to Chapter 13. *In re Friedman,* 466 B.R. 471, 483 (9th Cir. BAP 2012). These provisions include section 1123(a)(8) which adds a requirement to individuals that the plan must provide payments of all or such portion of earnings from personal services or other future income of the debtor, resembling section 1322(a)(1). Section 1129(a)(15) was added which states that the plan must contribute an amount equal to the Debtors' projected disposable income over the longer of five years or the plan payment period upon objection by any unsecured creditor, resembling section 1325(b). Section 1141(d)(5)(A) was added, whereby the discharge is not granted until completion of all payments under the plan, resembling section 1328(a). Section 1141(d)(5)(B) was also added, whereby a discharge is permitted for cause before completion of payments, resembling the hardship discharge located in section 1328(b). Finally, section 1127(e) was added that permits modification of a plan after substantial consummation, resembling section 1329(a). *In re Friedman,* 466 B.R. 471, 483 (9th Cir. BAP 2012).

Other support has been found in the fact that section 1115 mirrors section 1306 which was part of the original 1978 code which gave the definition of property of the estate a broader definition in a Chapter 13 than the definition of property of the estate in Chapter 11 and Chapter 7. See *In re Friedman,* 466 B.R. 471 (9th Cir. BAP 2012); Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA,* 2007 U. Ill. L. Rev. 67, 75–76 (2007).

The weakness of the narrow view is illustrated if one were to ask the question: "If Congress was not attempting to write out of individual Chapter 11 cases the absolute priority rule, what was the purpose of all of the BAPCPA amendments to Chapter 11, including section 1115, which were obviously borrowed from Chapter ***851** 13?" FN10 Chapter 13 has no absolute priority rule and would not be of much use if it did. The means test for Chapter 7 debtors created by BAPCPA was designed to move debtors who could pay something to their creditors to reorganization chapters. Here, these Debtors have no recourse to either Chapter 13 or Chapter 12 because of the debt limits imposed by Congress.

> FN10. The clarity with which the amendments added to the bankruptcy code by BAPCPA were drafted has been criticized by courts and legal scholars alike. See Henry J. Sommer, *Trying to Make Sense Out of Nonsense; Representing Consumers under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,* 79 Am. Bankr. L.J. 191 (Spring 2005).

Section 1129(b)(2)(B)(ii) with respect to individual debtors eliminates the application of the absolute priority rule from property described in section 1115. Section 1115 provides that all property described in Section 541 and property from post petition personal services is included in an individual Chapter 11 estate. Section 1115 is written word for word like section 1306 and courts interpreting section 1306 have never bifurcated this section into two species of property as the narrow view does in individual Chapter 11. To read section 1115 and section 1129(b)(2)(B)(ii) as exempting only future income from the absolute priority rule renders ineffective any practical application of section 1115, especially in light of the additional requirements of section 1129(a)(15)(B). When considered in the context of all the applicable sections, section 1115 accomplishes nothing of substance under the narrow view. As one author paraphrased the explanation of the Ninth Circuit BAP in *Friedman:*

> [I]t would be "illogical" to require individual debtors to devote five years of disposable income to their plans, but remove the debtors' means of providing that income, which would be the result if the application of the absolute priority rule were to prevent debtors from retaining valuable prepetition business as- sets.

Andrew G. Balbus, *Continued Disagreements Over the Application of the Absolute Priority Rule to Individuals in Chapter 11: Friedman and Maharaj,* 21 Norton Bankr. L. & Prac. 755, 761 (2012).

Valid arguments can be made in support of both interpretations and no analysis of this issue is free from doubt. However, since there does not appear to be any other logical reason for all of the changes made exclusively to Chapter 11 for individuals except to make it work like Chapter 13, this Court concludes that Congress did intend for section 1115 to define all property of an individual Chapter 11 case (just as § 1322 does). Therefore, by the express terms of amended § 1129(b)(2)(B)(ii) the absolute priority rule does not apply to any property of the estate of individual Chapter 11 debtors. [FN11]

FN11. However, even without the absolute priority rule, the 2005 amendments created new hurdles for confirmation of a plan by an individual debtor. The Debtors cannot obtain a discharge in five years without paying their secured debt over the life of the plan. In Chapter 13 and Chapter 12 certain long term debts can be extended after the discharge has been granted. See 11 U.S.C. § 1322(b)(5); 11 U.S.C. § 1222(b)(9); 11 U.S.C. § 1225. The Chapter 12 and Chapter 13 plan is limited to a maximum of five years. Chapter 11 plans can last as long as 20 years or more, whatever time is needed to pay a reamortized long term secured debt. For corporations, the discharge is granted upon confirmation. See 11 U.S.C. § 1141. The BAPCPA amendments did not limit the length of an individual Chapter 11 plan. In fact, in several places, the amendments recognize specifically the plan may be required to last more than five years. See, e.g., 11 U.S.C. § 1129(a)(15)(B). However, the discharge is granted to an individual only upon completion of the plan payments. 11 U.S.C. § 1141(d)(5).

***852** *IV.*
CONCLUSION

Therefore, for these reasons the proposed plan is not confirmed. The Debtors are granted thirty (30) days to file a modified plan consistent with this opinion. If no such plan is timely filed and no motion to convert to Chapter 7 is filed, the case will be dismissed by subsequent Order of this Court.

IT IS SO ORDERED.

Bkrtcy.W.D.Ark.,2013.
In re O'Neal
490 B.R. 837

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United States Court of Appeals,
Tenth Circuit.
Arvin E. STEPHENS; Karen J. Stephens, f/d/b/a Ninnekah Quick Mart, Debtors.
Dill Oil Company, LLC; Danny Dill; Nancy Dill, Appellants,
v.
Arvin E. Stephens; Karen J. Stephens, f/d/b/a Ninnekah Quick Mart, Appellees,
National Association of Consumer Bankruptcy Attorneys, Amicus Curiae.

No. 11–6309.
Jan. 15, 2013.

Background: Individual Chapter 11 debtors sought plan confirmation. Creditors objected, contending that plan violated absolute priority rule. The United States Bankruptcy Court for the Western District of Oklahoma confirmed plan. Creditors appealed. The United States Bankruptcy Appellate Panel of the Tenth Circuit sua sponte certified case for direct appeal.

Holdings: The Court of Appeals, Paul J. Kelly, Jr., Circuit Judge, held that:
(1) Court of Appeals would decline to apply doctrine of equitable mootness, and
(2) as an issue of first impression, amendments to Bankruptcy Code did not impliedly repeal absolute priority rule as it applied to individual Chapter 11 debtors.

Reversed and remanded.

West Headnotes

[1] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of priority. Most Cited Cases

"Absolute priority rule" included within Chapter 11 plan confirmation requirement that cram-down plan be fair and equitable bars junior claimants, including debtors, from retaining any interest in property when a dissenting class of senior creditors has not been paid in full. 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[2] Bankruptcy 51 ⚿3781

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3781 k. Moot questions. Most Cited Cases

Doctrine of "equitable mootness" allows a court to decline to hear a bankruptcy appeal, even when relief could be granted, if implementing the relief would be inequitable.

[3] Bankruptcy 51 ⚿3781

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3781 k. Moot questions. Most Cited Cases

Equitable mootness, permitting court to decline to hear bankruptcy appeal if implementing relief would be inequitable, is a discretionary, prudential doctrine.

[4] Bankruptcy 51 ⚿3776.5(5)

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3776 Effect of Transfer
51k3776.5 Supersedeas or Stay
51k3776.5(5) k. Effect of want of stay; conclusiveness of sale. Most Cited Cases

Bankruptcy 51 ⚿3781

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3781 k. Moot questions. Most Cited Cases

Bankruptcy 51 ⚷3783

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3783 k. Presumptions and burdens of proof. Most Cited Cases

Party seeking to prevent court from reaching merits of bankruptcy appeal, based on equitable mootness, bears burden of proving that following factors weigh in favor of dismissal: (1) whether appellant sought and/or obtained a stay pending appeal, (2) whether appealed plan has been substantially consummated, (3) whether rights of innocent third parties would be adversely affected by reversal of confirmed plan, (4) whether public-policy need for reliance on confirmed plan, and need for creditors generally to be able to rely on bankruptcy court decisions, would be undermined by reversal of plan, (5) what, if challenge were upheld, would impact likely be upon successful reorganization of debtor, and (6) whether, based upon quick look at merits of challenge to plan, argument is legally meritorious or equitably compelling.

[5] Bankruptcy 51 ⚷3776.5(5)

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3776 Effect of Transfer
51k3776.5 Supersedeas or Stay
51k3776.5(5) k. Effect of want of stay; conclusiveness of sale. Most Cited Cases

Failure of creditors challenging confirmation of Chapter 11 plan to seek stay pending their appeal did not alone preclude Court of Appeals from granting relief, pursuant to equitable mootness doctrine.

[6] Bankruptcy 51 ⚷3776.5(5)

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3776 Effect of Transfer
51k3776.5 Supersedeas or Stay
51k3776.5(5) k. Effect of want of stay; conclusiveness of sale. Most Cited Cases

Bankruptcy 51 ⚷3781

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3781 k. Moot questions. Most Cited Cases

Fact that Chapter 11 plan had been substantially consummated did not act as blanket discharge of judicial duty to examine carefully each request for relief on appeal by creditors challenging plan confirmation.

[7] Bankruptcy 51 ⚷3776.5(5)

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3776 Effect of Transfer
51k3776.5 Supersedeas or Stay
51k3776.5(5) k. Effect of want of stay; conclusiveness of sale. Most Cited Cases

Bankruptcy 51 ⚷3781

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3781 k. Moot questions. Most Cited Cases

Court of Appeals would decline to apply doctrine of equitable mootness to secured creditors' appeal challenging confirmation of individual debtors' Chapter 11 plan on ground that plan violated absolute priority rule, even though creditors did not seek stay pending appeal, debtors claimed that plan had been substantially consummated, and reversal would likely compel conversion of case to one under Chapter 7 and preclude successful reorganization; non-party creditors would likely not be adversely affected by reversal, appealing creditors had approximately $1,800,000 at stake, issue was one of public importance for which there was no controlling decision in circuit, and creditors' argument appeared to be legally meritorious. 11 U.S.C.A. § 1112.

[8] Bankruptcy 51 ⚷3782

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3782 k. Conclusions of law; de novo review. Most Cited Cases

On appeal presenting question of statutory interpretation, Court of Appeals reviews bankruptcy court's determination de novo.

[9] Statutes 361 ⚷1079

361 Statutes
361III Construction
361III(A) In General
361k1078 Language
361k1079 k. In general. Most Cited Cases
(Formerly 361k188)

Statutes 361 ⚷1105

361 Statutes
361III Construction
361III(C) Clarity and Ambiguity; Multiple Meanings
361k1103 Resolution of Ambiguity; Construction of Unclear or Ambiguous Statute or Language
361k1105 k. Purpose and intent; determination thereof. Most Cited Cases
(Formerly 361k190)

Statutes 361 ⚷1111

361 Statutes
361III Construction
361III(C) Clarity and Ambiguity; Multiple Meanings
361k1107 Absence of Ambiguity; Application of Clear or Unambiguous Statute or Language
361k1111 k. Plain language; plain, ordinary, common, or literal meaning. Most Cited Cases
(Formerly 361k188)

In deciding question of statutory interpretation, starting point is always the language of the statute itself, and if the language is clear and unambiguous, the plain meaning of the statute controls; if, on the other hand, the text is "ambiguous," in that it is capable of being understood by reasonably well-informed persons in two or more different senses, court must inquire further to discern Congress's intent.

[10] Statutes 361 ⚷1499

361 Statutes
361VII Repeal
361k1498 Implied Repeal
361k1499 k. In general. Most Cited Cases
(Formerly 361k158)

Repeals by implication are not favored, and will not be presumed unless the intention of the legislature to repeal is clear and manifest.

[11] Statutes 361 ⚷1401

361 Statutes
361IV Operation and Effect
361k1401 k. In general. Most Cited Cases
(Formerly 361k212.5)

Where a party contends that legislative action changed settled law, that party has the burden of showing that the legislature intended such a change.

[12] Bankruptcy 51 ⚷3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of priority. Most

Cited Cases

Amendments to Bankruptcy Code made by Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) did not impliedly repeal absolute priority rule as it applied to individual Chapter 11 debtors. 11 U.S.C.A. §§ 1115, 1129(b)(2)(B)(ii).

***1281** James Bellingham of Bellingham & Loyd, P.C., Oklahoma City, OK, for Appellants.

James Brunson of AG–LAW, PC, Oklahoma City, OK, for Appellees.

Tara Twomey of National Consumer Bankruptcy Rights Center, San Jose, CA, for Amicus Curiae.

Before KELLY and HOLMES, Circuit Judges, and MARTINEZ [FN*], District Judge.

> FN* The Honorable William J. Martinez, United States District Judge, District of Colorado, sitting by designation.

PAUL KELLY, JR., Circuit Judge.

This appeal presents an issue of first impression for our circuit: whether the 2005 amendments to the Bankruptcy Code exempt individual Chapter 11 debtors from the absolute priority rule. The bankruptcy court answered this question in the affirmative. It therefore confirmed the Debtors' proposed plan of reorganization over certain creditors' objections that the plan violated the absolute priority rule. On appeal, the bankruptcy appellate panel certified the case for direct appeal. Exercising our jurisdiction under 28 U.S.C. §§ 158(d)(2)(A) & 158(a)(1), we now reverse the bankruptcy court's order confirming the plan and remand for further proceedings.

Background

[1] On June 30, 2010, Arvin E. Stephens and Karen J. Stephens, f/d/b/a/ Ninnekah Quick Mart, LLC (collectively, "Debtors") filed for relief under Chapter 11 of the Bankruptcy Code. Aplt.App. 28. Dill Oil Company, LLC and Danny and Nancy Dill (collectively, "the Dills") objected to confirmation on the ground that the proposed plan violated the absolute priority rule ("APR"), [FN1] which bars junior claimants, including debtors, from retaining any interest in property when a dissenting class of senior creditors has not been paid ***1282** in full. *Id.* at 28, 30; *see Search Mkt. Direct, Inc. v. Jubber (In re Paige),* 685 F.3d 1160, 1183 (10th Cir.2012) (discussing APR).

> FN1. The APR originated in the late 1800s as a judicial invention that was primarily employed in the context of railroad reorganizations. *See* Jonathan C. Lipson, *The Expressive Function of Directors' Duties to Creditors,* 12 Stan. J.L. Bus. & Fin. 224, 250–52 (2007); *see also N. Pac. Ry. Co. v. Boyd,* 228 U.S. 482, 504–08, 33 S.Ct. 554, 57 L.Ed. 931 (1913). The Bankruptcy Act of 1898 codified the common law APR by requiring that a reorganization plan be "fair and equitable." In 1952, Congress revoked the "fair and equitable" requirement. H.R. Rep. 82–2320, at 1981–82 (1952), *reprinted in* 1952 U.S.C.C.A.N.1960, 1982; *see also* Pub.L. No. 456, 66 Stat. 420, 433 (1952). However, in 1978, Congress adopted the Bankruptcy Code, which again codified the APR as applied to all reorganizations under Chapter 11 (including individual debtors). *See Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 202, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988). Accordingly, "no Chapter 11 reorganization plan [could] be confirmed over the creditors' legitimate objections ... if it fail[ed] to comply with the [APR]." *Id.* This rule remained undisputed until BAPCPA's 2005 enactment.

Debtors owned a chain of convenience stores for which the Dills were the primary supplier of gasoline and gas station products. Aplt.App. 28.

Due to the rising price of gas and a diminishing customer base, Debtors' stores began operating at a loss. *Id.* at 120. Eventually, Debtors became liable to the Dills for approximately $1.8 million. *Id.* at 28. In December 2008, Debtors executed mortgages in favor of the Dills on various tracts of real estate, including a house and farmlands. *Id.* at 28, 120. The Dills' mortgages, however, were subordinate to existing mortgages on the properties. *Id.* at 28.

On December 30, 2010, Debtors filed a proposed plan of reorganization. *Id.* at 17. Pursuant to the plan, the Dills would be paid approximately $15,000 as a secured creditor, but their remaining claim would be considered unsecured. *Id.* at 28. Under the plan, Debtors would retain possession and control of their property; the Dills would receive a monthly payment for five years, totaling about 1% of their unsecured claim. *Id.* at 29, 76.

The Dills subsequently filed an objection to Debtors' proposed plan. *Id.* at 29, 97, 198. Because their vote constituted approximately 96% of Class 8's claims, the Dills' rejection precluded approval of the plan under § 1129(a). *Id.* at 102, 132.

On May 20, 2011, the bankruptcy court entered an order confirming the plan under § 1129(b)'s "cram down" mechanism. *Id.* at 17, 29. The Dills argued that the plan was unconfirmable because it violated the APR. *Id.* at 29. The bankruptcy court rejected this contention, holding instead that the plain language of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") abrogated the APR as to individual Chapter 11 debtors. *Id.* at 21–22.

The Dills timely filed a notice of appeal on June 1, 2011, seeking reversal of the confirmation order. *Id.* at 25, 32. The Dills proceeded to the bankruptcy appellate panel ("BAP"), which sua sponte issued a certification of final order for direct appeal to this court based on its determination that the case presents a question of public importance for which there is no controlling law. *Id.* at 25. We granted permission to appeal. *Id.* at 15.

Discussion

A. *Should this Appeal Be Dismissed Under the Doctrine of Equitable Mootness?*

[2][3][4] Debtors urge us to dismiss this appeal under the doctrine of equitable mootness, which "allows a court to decline to hear a bankruptcy appeal, even when relief could be granted, if implementing the relief would be inequitable." *In re C.W. Mining Co.,* 641 F.3d 1235, 1239–40 (10th Cir.2011). Equitable mootness is a discretionary, prudential doctrine. *See id.* at 1240. We have held that a court should apply the doctrine when reaching the merits would be unfair or impractical, taking into consideration the following questions:

> (1) Has the appellant sought and/or obtained a stay pending appeal? (2) Has the appealed plan been substantially consummated? (3) Will the rights of innocent third parties be adversely affected by reversal of the confirmed plan? (4) Will the public-policy need for reliance on the confirmed bankruptcy plan—and the need for creditors generally to be able to rely on bankruptcy court decisions—be undermined by reversal of the plan? (5) If appellant's challenge were upheld, what would be the likely impact upon a successful reorganization of the debtor? And (6) based ***1283** upon a quick look at the merits of appellant's challenge to the plan, is [the argument] legally meritorious or equitably compelling?

In re Paige, 584 F.3d 1327, 1339 (10th Cir.2009). The party seeking to prevent the court from reaching the merits bears the burden of proving these factors weigh in favor of dismissal. *See id.* at 1339–40.

[5][6] The Dills did not seek a stay pending their appeal, but this factor alone does not preclude the court from granting relief. *See id.* at 1339 (citing *In re Inv. Co. of the Sw., Inc.,* 341 B.R. 298, 308 (10th Cir. BAP 2006)). And although the plan has, according to Debtors, been substantially consummated, this does not act as a "blanket discharge of [the] judicial duty to examine carefully each request for relief." *In re AOV Indus., Inc.,* 792 F.2d

1140, 1148 (D.C.Cir.1986); *see also In re Paige,* 584 F.3d at 1342 (explaining that substantial consummation is "not dispositive").

[7] Instead, "[t]he effects that reversal will have on *non-party creditors* is probably the foremost concern in our analysis." *In re Paige,* 584 F.3d at 1343 (emphasis added); *see also In re SI Restructuring, Inc.,* 542 F.3d 131, 135–36 (5th Cir.2008). "The other factors are often given much less weight and, in some cases, completely ignored." *In re Paige,* 584 F.3d at 1339. Here, reversal will likely compel conversion to a Chapter 7 proceeding. *See* 11 U.S.C. § 1112; Aplee. Br. 27–28. According to Debtors, the Dills will receive little or nothing under Chapter 7 due to superior liens on non-exempt assets. *See* Aplee. Br. 28. But the Dills' argument—which Debtors have not disputed—is that under Chapter 7 either: 1) the secured creditors will receive their property; or 2) Debtors will reaffirm the creditors' secured debts and retain the property. *See* Aplt. R. Br. 14. In either scenario, we find it unlikely that non-party creditors will be adversely affected in any significant way, and Debtors have failed to convince us otherwise. *See In re Paige,* 584 F.3d at 1343–44.

Although we recognize that Debtors have devoted substantial time and resources toward the plan's implementation, and we appreciate that reversing the confirmation order will likely preclude a successful reorganization, we also note that the Dills have approximately $1.8 million at stake. Moreover, this case involves a "matter of public importance" for which "there is no controlling decision" in this circuit, Aplt.App. 25, and we believe the Dills' argument is legally meritorious. As the BAP emphasized in its certification order, "[u]ntil the meaning of the BAPCPA amendments to Chapter 11 is clarified, debtors and creditors in every individual Chapter 11 case must anticipate the possibility of the expense and delay associated with litigation over this issue." *Id.* at 34. Because of the private and public interest in resolving this legal issue, we decline to apply the doctrine of equitable mootness. *See In re Paige,* 584 F.3d at 1348.

B. *Does BAPCPA Repeal the Absolute Priority Rule with Respect to Individual Chapter 11 Debtors?*

[8][9] This appeal presents a question of statutory interpretation. Accordingly, we review the bankruptcy court's determination de novo. *In re Kirkland,* 572 F.3d 838, 840 (10th Cir.2009). "[T]he starting point is always the language of the statute itself. If the language is clear and unambiguous, the plain meaning of the statute controls." *United States v. Quarrell,* 310 F.3d 664, 669 (10th Cir.2002) (citation omitted). If, on the other hand, the text is ambiguous—i.e., "capable of being understood by reasonably well-informed persons in two or more different senses"—we must inquire further to discern Congress's intent. *See id.* (quotation omitted).

***1284** 1. *Is the statutory language clear and unambiguous?*

We begin our analysis by focusing exclusively on the language of the Bankruptcy Code. *See Ransom v. FIA Card Servs., N.A.,* —— U.S. ——, 131 S.Ct. 716, 723, 178 L.Ed.2d 603 (2011). Section 1129 of the Code sets out the general requirements for confirmation of a reorganization plan. Section 1129(a) allows for confirmation where each class of creditors consents. Alternatively, § 1129(b) provides a "cram-down" mechanism, whereby a plan may be confirmed without the consent of each class if, among other things, the plan is "fair and equitable." Section 1129 outlines the "fair and equitable" criteria, which include the absolute priority rule. Specifically, § 1129(b)(2)(B)(ii), as amended by BAPCPA, provides that:

> the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115,* subject to the requirements of subsection (a)(14) of this section.

(emphasis added).

Section 1115, which BAPCPA added, in turn states:

(a) *In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541*[FN2]—

FN2. Section 541 defines property of the estate to include "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541. Section 103, in turn, provides that § 541 applies in Chapter 11 cases, including those which involve individual debtors. *See* 11 U.S.C. § 103(a).

(1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or controverted to a case under chapter 7, 12, or 13, whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.

(b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

(emphasis added).

Although a number of courts have held this language to be unambiguous, they have reached starkly different conclusions regarding the "plain" meaning. *Compare SPCP Grp., LLC v. Biggins,* 465 B.R. 316, 322 (M.D.Fla.2011) ("The plain reading of this statute" is that § 1115 "includes ... property specified in section 541."), with *In re Steedley,* No. 09–50654, 2010 WL 3528599, at *2 (Bankr.S.D.Ga. Aug. 27, 2010) ("Nothing in the plain language of § 1115 suggests that it subsumes § 541."). The very existence of this dichotomy seems indicative of the text's ambiguity. Indeed, several courts have recognized that §§ 1115 and 1129(b)(2)(B)(ii) are susceptible to two different yet plausible interpretations. *See, e.g., In re Maharaj,* 681 F.3d 558, 569 (4th Cir.2012); *In re Lindsey,* 453 B.R. 886, 903 (Bankr.E.D.Tenn.2011).

To date, the Bankruptcy Appellate Panel for the Ninth Circuit and five bankruptcy courts (one of which was affirmed by a district court) have adopted a "broad view," holding that the BAPCPA amendments eliminate the APR as applied to an individual's *entire* estate.[FN3] In contrast, the ***1285** Fourth Circuit and seventeen bankruptcy courts have reached the opposite conclusion, holding that the BAPCPA amendments only exempt from the APR that property which § 1115 *adds* to an individual estate—not the pre-petition property already defined by § 541.[FN4]

FN3. *In re Friedman,* 466 B.R. 471 (9th Cir. BAP 2012); *SPCP Grp., LLC v. Biggins,* 465 B.R. 316 (M.D.Fla.2011) (affirming unpublished decision of bankruptcy court); *In re Shat,* 424 B.R. 854 (Bankr.D.Nev.2010); *In re Johnson,* 402 B.R. 851 (Bankr.N.D.Ind.2009); *In re Roedemeier,* 374 B.R. 264 (Bankr.D.Kan.2007); *In re Tegeder,* 369 B.R. 477 (Bankr.D.Neb.2007).

FN4. *In re Maharaj,* 681 F.3d 558 (4th Cir.2012) (affirming the bankruptcy court's decision in 449 B.R. 484 (Bankr.E.D.Va.2011)); *In re Lee Min Ho Chen,* No. 11–08170 BKT, 2012 WL 5463256 (Bankr.D.P.R. Nov. 9, 2012); *In re Tucker,* 479 B.R. 873 (Bankr.D.Or.2012); *In re Arnold,* 471 B.R. 578 (Bankr.C.D.Cal.2012); *In re Lively,* 467 B.R. 884 (Bankr.S.D.Tex.2012); *In re Borton,* No. 09–00196–TLM, 2011 WL 5439285 (Bankr.D.Idaho Nov. 9, 2011); *In* *re Lindsey,* 453 B.R. 886 (Bankr.E.D.Tenn.2011); *In re Kamell,* 451 B.R. 505 (Bankr.C.D.Cal.2011); *In re Draiman,* 450 B.R. 777 (Bankr.N.D.Ill.2011); *In re Walsh,* 447 B.R. 45 (Bankr.D.Mass.2011); *In re Stephens,* 445 B.R. 816 (Bankr.S.D.Tex.2011); *In re Karlovich,* 456 B.R. 677 (Bankr.S.D.Cal.2010); *In re Gelin,* 437 B.R. 435 (Bankr.M.D.Fla.2010); *In re Steedley,* No. 09–50654, 2010 WL 3528599 (Bankr.S.D.Ga. Aug. 27, 2010); *In re Mullins,* 435 B.R. 352 (Bankr.W.D.Va.2010); *In re Gbadebo,* 431 B.R. 222 (Bankr.N.D.Cal.2010); *see also In re Friedman,* 466 B.R. at 476 (discussing the bankruptcy court's determination—in an unpublished February 17, 2011 order—that the APR applies to individual Chapter 11 debtors).

According to the broad view, § 1115 incorporates and supercedes § 541. Under § 1115, an individual's estate includes post-petition property and earnings in addition to the pre-petition property established by § 541. *In re Tegeder,* 369 B.R. 477, 480 (Bankr.D.Neb.2007); *see also In re Shat,* 424 B.R. 854, 863 (Bankr.D.Nev.2010) ("Initially, Section 1115 creates a baseline estate of all the property covered by Section 541. It then adds to that [post-petition property]."). When § 1129(b)(2)(B)(ii) references the property "included by" § 1115, it "refer[s] to all property Section 1115 itself references." *In re Shat,* 424 B.R. at 863. Section 1115 thus absorbs § 541 for individual Chapter 11 cases. *Id.* at 865. Therefore, the APR no longer applies to *any* property of an individual debtor's estate.

In contrast, the narrow view holds that § 1115 merely adds to—but does not replace— § 541's definition of estate property for individual debtors. *See, e.g., In re Draiman,* 450 B.R. 777, 821 (Bankr.N.D.Ill.2011). Section 1115 "includes" in the estate only that property which was not already included by § 541. *See In re Gbadebo,* 431 B.R. 222, 229 (Bankr.N.D.Cal.2010). In other words, § 1115 includes only post-petition property and earnings. *In re Draiman,* 450 B.R. at 821. In support of the narrow view, several courts have pointed to § 1115's grammatical structure. *See, e.g., In re Arnold,* 471 B.R. 578, 602 (Bankr.C.D.Cal.2012) (explaining that because the phrase, "in addition to the property specified in section 541 " is "not the direct object of the transitive verb, 'includes,' " the phrase therefore "is not an answer to the question what is included as 'property of the estate' under § 1115 "). Accordingly, only post-petition property added by § 1115 is exempt from the APR; the APR continues to apply to § 541's pre-petition property.

After examining the divergent interpretations of the statutory language, we agree with the Fourth Circuit that "either construction is plausible." *In re Maharaj,* 681 F.3d at 569. In light of this linguistic ambiguity, we endeavor to ascertain Congress's intent. *See United States v. Hohri,* 482 U.S. 64, 69–71, 107 S.Ct. 2246, 96 L.Ed.2d 51 (1987).

***1286** 2. *Is there a clear Congressional intent to repeal the absolute priority rule as applied to individual Chapter 11 debtors?*

Nowhere in BAPCPA's sparse legislative history is there an explanation of what changes result from § 1115. *See In re Lindsey,* 453 B.R. at 903; Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA,* 2007 U. Ill. L.Rev. 67, 90. Consequently, courts have reached opposite conclusions regarding the legislative objective. *Compare In re Shat,* 424 B.R. at 862–65, *with In re Gbadebo,* 431 B.R. at 229–30. In deciphering Congress's intent, we recognize BAPCPA's aim of curbing the abusive practices of unscrupulous debtors, *see* H.R.Rep. No. 109–31, pt. 1, at 3–5 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 90–92, but we remain mindful that "a central purpose of the Code" is to provide the honest but unfortunate debtor with a "fresh start," *Grogan v. Garner,* 498 U.S. 279, 286–87, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (quotations and citation omitted). This inherent tension makes it difficult to identify a singular objective behind § 1115.

Advocates of the broad view emphasize that the BAPCPA amendments evince an intent to model Chapter 11 on Chapter 13, which has no absolute priority rule. *See In re Friedman,* 466 B.R. at 483; *In re Shat,* 424 B.R. at 868. In support, they cite a number of provisions that are essentially copied from Chapter 13. *See, e.g., In re Roedemeier,* 374 B.R. 264, 275–76 (Bankr.D.Kan.2007). Further, proponents of the broad view emphasize that abolishing the APR with respect to individual debtors does not leave unsecured creditors without any power or protection. Instead, unsecured creditors can rely on the safeguards of § 1129(a)(15)'s disposable income test, *see In re Shat,* 424 B.R. at 863–64, and § 1129(a)(7)'s "best interests" test, *see* Amicus Br. of Nat'l Ass'n of Consumer Bankr.Attorneys at 6.

In contrast, those ascribing to the narrow view argue that, "[e]ach one of these new provisions," even where modeled on Chapter 13, "appears designed to impose *greater* burdens on individual chapter 11 debtor's rights so as to ensure a greater payout to creditors." *In re Gbadebo,* 431 B.R. at 229 (emphasis added); *see also* H.R.Rep. No. 109–31, pt. 1, at 2–5, 80–81. Narrow view proponents urge that if Congress intended to abolish the APR with respect to individual debtors, "it would have done so in a far less convoluted way." *In re Maharaj,* 681 F.3d at 565–66. For instance, Congress could have raised Chapter 13's debt ceiling or expressly exempted individual debtors at the beginning of § 1129(b)(2)(B)(ii). *See In re Karlovich,* 456 B.R. 677, 682 (Bankr.S.D.Cal.2010). Moreover, BAPCPA's legislative history lists several debtor protections but makes no mention of eliminating the APR. *See* H.R.Rep. No. 109–31, pt. 1, at 2, 17–18. Advocates for the narrow view argue that, had Congress intended such a drastic change, it surely would have included the amendment in its list of debtor protections. *See In re Maharaj,* 681 F.3d at 572. Instead, the amendments are best understood as preserving the status quo. *See, e.g., id.* at 569–70 (noting that the exemption of post-petition property and earnings ensures that the APR operates as it did prior to BAPCPA's passage).

[10][11][12] Because both the statutory language and Congress's intent are ambiguous, we heed the presumption against implied repeal. "[R]epeals by implication are not favored and will not be presumed unless the intention of the legislature to repeal is clear and manifest." *Nat'l Ass'n of Home Builders v. Defenders of Wildlife,* 551 U.S. 644, 662, 127 S.Ct. 2518, 168 L.Ed.2d 467 (2007) (quotations omitted). ***1287** Where a party contends "that legislative action changed settled law," that party "has the burden of showing that the legislature intended such a change." *Green v. Bock Laundry Mach. Co.,* 490 U.S. 504, 521, 109 S.Ct. 1981, 104 L.Ed.2d 557 (1989). These interpretive principles are particularly critical in bankruptcy cases, where parties rely on settled rules in conducting and structuring business. Thus, "[p]re-BAPCPA bankruptcy practice is telling because we will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Hamilton v. Lanning,* —U.S. ——, 130 S.Ct. 2464, 2473, 177 L.Ed.2d 23 (2010) (quotation omitted). Here, the statutory language and legislative history lack any clear indication that Congress intended to erode a pillar of creditor bankruptcy protection. *See Hui v. Castaneda,* 559 U.S. 799, 130 S.Ct. 1845, 1853, 176 L.Ed.2d 703 (2010); *Dewsnup v. Timm,* 502 U.S. 410, 419–20, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). Especially in light of the fact that Congress *has* expressly repealed the APR in the past, *see* H.R. Rep. 82–2320, at 1981–82, we decline to find an implied repeal here.

We therefore REVERSE the bankruptcy court's order confirming the plan and REMAND for further proceedings.

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