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Cramdown or in Hipster-speak "Cram"

Presented by

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Cramdown or in Hipster-speak "Cram"[1]

I. Summary of Cramdown Components pursuant to Bankruptcy Code § 1129

Generally, Bankruptcy Code § 1129(a)(8) requires that a plan of reorganization must be accepted by each class of impaired claims or equity interests, or be unimpaired, in order for the plan to be confirmed consensually under the Bankruptcy Code. However, so long as at least one impaired class accepts the plan, Bankruptcy Code § 1129(b)(1) provides that a plan that satisfies all of the other applicable provisions of Section 1129(a) may be confirmed and non-accepting classes "crammed" despite the nonacceptance of the plan by other classes.

In order for a plan to be confirmed under Section 1129(b), the plan must satisfy two tests: (1) the plan must not unfairly discriminate against any impaired class of claims or interests that has not accepted the plan, and (2) the plan must be "fair and equitable" with respect to each impaired class of claims or interests that has not accepted the plan. For both tests, the analysis pertains to a class as a whole and not to individual creditors within a class.

a. No Unfair Discrimination

Pursuant to Bankruptcy Code § 1129(b)(1), a plan must not unfairly discriminate against any impaired class of claims or interests that did not accept the plan. A plan unfairly discriminates against a class if another class of equal rank in priority will receive greater value under the plan than a class that did not accept the plan, without reasonable justification for the disparate treatment.

Since the discrimination must be deemed "unfair" (something beyond mere discrimination) to fail this test, courts will analyze the facts and circumstances to determine a purpose for such discrimination in the plan. For example, in *In re Aztec Co*., the bankruptcy court outlined four factors that other courts have applied as a method for unfair discrimination analysis:

> (1) whether the discrimination is supported by a reasonable basis; (2) whether the debtor can confirm and consummate a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) the treatment of the classes discriminated against.[2]

[1] Written by Bradley Foxman and Garrick Smith, Associates of Vinson & Elkins LLP, and William L. Wallander, Partner of Vinson & Elkins LLP.

[2] *In re Aztec Co*., 107 B.R. 585, 590 (Bankr. M.D. Tenn. 1989); *see also In re 11,111, Inc*., 117 Bankr. 471, 478 (Bankr. D. Min. 1990); *In re Richard Buick, Inc*., 126 Bankr. 840 852 (Bankr. E.D.Pa. 1991) (finding reasonable basis for degree of discrimination in treatment of claimants contemplated by plan); *In re Union Fin. Servs. Group, Inc*., 303 B.R. 390, 422 (Bankr. E.D. Mo. 2003); *In re Buttonwood Partners, Ltd*., 111 B.R. 57, 63 (Bankr. S.D.N.Y. 1990).

While approaches may vary, many courts will look at the disparity of treatment proposed in the plan, and whether such disparity can be reasonably justified under the Bankruptcy Code.[3]

In some circumstances, a plan may provide for different treatment where classes of equal rank and priority receive the same recovery but pursuant to different terms and conditions without unfair discrimination.[4] The feasibility of the plan and the differences between the size and demands of certain classes may justify such discrimination. Additionally, some courts have allowed classes of equal rank and priority to receive different distributions under a plan if, for example, relations with one group of creditors is more critical to the continued operation of the business than another group of creditors and/or the reorganization effort relies on a certain class of creditors.[5] Again, feasibility of the plan and the justification for such differences will be important to the analysis.

b. Fair and Equitable

After demonstrating that a plan's treatment of a nonaccepting impaired class is not unfairly discriminatory, the second cramdown test is whether the plan's treatment of that class is "fair and equitable." The "fair and equitable" standard has at least two key subcomponents: (i) the absolute priority rule, and (ii) the rule that no creditor can be paid more than it is owed.

i. The Absolute Priority Rule

Under the "absolute priority rule," a nonaccepting class of creditors or interest holders cannot be compelled to accept less than full compensation if a more junior creditor or interest holder receives anything or retains its interest under the plan. The absolute priority rule prevents any junior class from receiving property so long as any nonaccepting senior class is not paid in full.[6] The absolute priority rule ensures that the priority rules set forth in Bankruptcy Code § 507 are followed. Thus, if all of a debtor's estate is distributed to nonaccepting senior classes, and

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[3] *In re 203 North LaSalle Street Ltd. P'ship*, 190 B.R. 567, 585-86 (Bankr. N.D. Ill. 1995), aff'd, 195 B.R. 692 (N.D. Ill. 1996) , aff'd, 126 F.3d 955 (7th Cir. 1997) , rev'd on other grounds, 526 U.S. 434, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 41 C.B.C.2d 526 (1999) ("First, any discrimination must be supported ... by a legally acceptable rationale ... . Second, the extent of the discrimination must be necessary in light of the rationale.").

[4] *In re LeBlanc*, 622 F.2d 872, 879 (5th Cir. 1980) (finding that unsecured creditors in trade with the debtor in bankruptcy belonged in a different class from an insider and family member and the distinction was not arbitrary or unfair); *Steelcase Inc. v. Johnston* (*In re Johnston*), 21 F.3d 323, 328, 30 C.B.C.2d 1634 (9th Cir. 1994) (upholding a plan provision that created different reserve requirements for different claims, noting that all claims were to be paid the same); *Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co., Inc*. (*In re U.S. Truck Co., Inc*.), 800 F.2d 581, 15 C.B.C.2d 553, 123 L.R.R.M. (BNA) 2849 (6th Cir. 1986) (upholding different treatment for labor union claim while labor union received same percentage recovery).

[5] *See*, *e.g.*, *In re Jersey City Med. Center*, 817 F.2d 1055, 1061 (3d Cir. 1987); *In re Kliegl Bros. Universal Elec. Stage Lighting Co*., 149 B.R. 306, 308 (Bankr. E.D.N.Y. 1992).

[6] *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) ("the absolute priority rule provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan"); Collier on Bankruptcy P 1129.03[4][a][i] (16th ed. 2016) (As some commentators have explained, a better statement of the absolute priority rule might be as follows: "[a] plan of reorganization may not allocate any property whatsoever to any junior class on account of the members' interest or claim in a debtor unless all senior classes consent, or unless such senior classes receive property equal in value to the full amount of their allowed claims, or the debtor's reorganization value, whichever is less.").

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