# BARRY L. ZARETSKY

## Roundtable Discussion

November 18, 2013

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# AVOIDING CHAPTER 22: PREDICTING SUCCESS IN CHAPTER 11

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Presentation by Edward I. Altman
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**Barry L. Zaretsky Roundtable Discussion**

*Avoiding Chapter 22:*
*Predicting Success in Chapter 11*

November 18, 2013

Table of Contents


1. Hypothetical
2. Discussion Slides
3. Presentation: Edward I. Altman, *Avoiding Chapter – Predicting Success in Chapter 11*
4. Memorandum: Brendan Buschman, Zaretsky Fellow, *Feasibility, Debt Levels and Recidivism*
5. Memorandum: Lauren Lipari, Zaretsky Fellow, *Raising Feasibility*
6. Memorandum: Douglas Keeton, Zaretsky Fellow, *Finding Feasibility*
7. Memorandum: Kevin Cooper, Zaretsky Fellow, *Chapter 11 Post-Confirmation Default Remedies*

**Barry L. Zaretsky Roundtable Discussion**

**November 18, 2013**
**6:30 pm**

**Brooklyn Law School**
**Forchelli Conference Center**
**205 State Street**
**Brooklyn, NY 11201**

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**Barry L. Zaretsky Roundtable Discussion**

***Hypothetical***

Large Corp ("LC") filed for bankruptcy several months ago and is in the early stages of drafting its plan of reorganization. LC is in the business of manufacturing widgets. The widget business took a nosedive in the wake of the financial crisis of 2008, and has been slow to recover. The company has produced an operating profit for the last three quarters, but the debt accumulated during the crisis forced them to file. The creditors have seen the recent encouraging results, and are reluctant to take a haircut. However, LC needs to invest money in their aging factory, employees have not received a raise in several years and are threatening to leave.

**1.** The debtor has met with its various creditors, and, while they are willing to wait for payment, they are very reluctant to write down principle, or take equity positions. A number of cranky suppliers, and a few tort claimants are unwilling to negotiate at all. In order to obtain the necessary class acceptances, the debtor is considering proposing a 100% plan, with relatively modest payments in the first year, but considerable increases in years 2 and 3. Current earnings will cover the payments in the first year, just barely. Years 2 and 3 will require significant business improvements. **What are the advantages, risks and disadvantages to proposing such a plan?**

2. You are the cranky supplier mentioned in part 1. The debtor has proposed a 100% plan, and the other members of the class are going to vote to accept it. You are, of course, happy with the prospect of 100% payment, but you are concerned that the debtor will have trouble making the payments called for in years 2 and 3, and that the need to save up for those payments will preclude needed investment in capital assets. You estimate that if the debtor were liquidated, you'd get at best 30%, but you are afraid that this plan will ultimately lead to liquidation as well, and that the distribution might in fact be even less.

   a. **What objections can you raise?**
   b. **Which of these objections can be raised at the disclosure hearing, and which must wait until the confirmation hearing?**
   c. **What evidence/proof will you need to develop?**
   d. **Is the effort justified by the cost?**
   e. **How might the Z-Score, or other financial metrics help?**

**3.** You are the bankruptcy Judge in the LC bankruptcy. The debtor has proposed the plan described above. Nobody is objecting. Even the cranky supplier has been convinced to go along. You're not quite sure how. You look at the plan and you do not see how the debtor can possibly make the payments in years 2 and 3 without remarkable changes to the underlying business conditions. You

are concerned that the debtor is just kicking the can down the road. You would like to see the debtor shed more debt, but nobody is objecting to the plan.

a. **What are your options?**
b. **Can you raise this issue at the disclosure hearing? If so, how?**
c. **Can you raise this issue at confirmation?**
    i. **If so, how?**
    ii. **What would the consequences be of denying confirmation?**
d. **Do you have any options short of denying confirmation?**
e. **Does the Z-Score help you in raising the issue and/or deciding what to do?**

4. The debtor confirmed the plan described above. Now they can't make the payments. **What happens next?**
    a. **Is this really a new case?**
    b. **Would it have been better to have liquidated the debtor earlier?**

*Barry L. Zaretsky Roundtable Discussion*
*Predicting Success in Chapter 11: Avoiding Chapter 22*

# Feasibility, Debt Levels and Recidivism

**Brendan Buschman, Class of 2015**
**Zaretsky Fellow**

## Introduction

Between 1984 and 2009, approximately one-third of the large public companies that emerged from bankruptcy as going concerns sought bankruptcy relief a second time.[1] Some of these companies filed a third or even a fourth bankruptcy petition.[2] The meaning of these subsequent bankruptcies has been much debated. Some have argued that the multiple filings reveal a failure of the bankruptcy system to ensure that the debtors shed enough debt to survive after they emerge from the initial Chapter 11 proceedings.[3] Some have argued that the second filings were caused by external market conditions faced by those companies rather than the capital structure on exit from bankruptcy.[4] Yet others have argued that high number of repeat filers reveals judicial reluctance to scrutinize the feasibility of a proposed plan.[5] In this memo we review this literature.

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[1] Edward I. Altman, *Post-Chapter 11 Bankruptcy Performance: Avoiding Chapter 22*, Journal of Corp. Fin., Summer 2009, at 53, 55-56 (hereinafter "Altman").
[2] Altman, 55–56.
[3] Altman, 62.
[4] Gutzeit & Yozzo, 36.
[5] LoPucki & Kalin, 259.

1. **Were Repeat Filers Overleveraged at Plan Confirmation?**

Professor Edward Altman argues that companies that file repeatedly do so primarily because they exited their first Chapter 11 still laden with too much debt.[6] Altman examined the capital structure of eighty-six companies that emerged from Chapter 11 during the period 1993 and 2009.[7] Forty-five companies in this group did not file another bankruptcy petition, forty-one were repeat filers, and five of the forty-one repeat filers filed a third bankruptcy.[8] Altman undertook this study with the hypothesis that his Z-Score model, a tool used to predict the likelihood of a company entering a first bankruptcy,[9] would also work to predict the viability of a company emerging from its first bankruptcy.[10]

Altman found that the Z-Score was an effective predictor of whether a company emerging from bankruptcy would file again.[11] A company's score is the result of four variables:[12] retained earnings, earnings before interest and taxes, working capital, and book value of equity.[13] Lower Z-Scores suggest a higher level of debt relative to earnings and assets. Repeat filers emerged from bankruptcy with, on average, $3.70 of debt for every dollar of equity, whereas one-time filers emerged from bankruptcy with, on average, $1.35 of debt for every dollar of equity.[14] Altman also calibrated his Z-Score to provide a Bond Rating Equivalent, and he found that the cases that did not refile had an

[6] Altman, 62.
[7] Altman, 61.
[8] Altman, 61.
[9] Altman, 56.
[10] Altman, 58.
[11] Altman, 61.
[12] Altman, 58, 62.
[13] Altman, 58, 62.
[14] Altman, 62.

average Bond Equivalent Z-Score of B+ at confirmation, while the group of cases that refiled had a Bond Equivalent Z-Score of CCC.

Altman argues that "the prescription for future successful reorganizations is clear:"[15] shed more debt. An overleveraged company will be less resilient should it run into cash flow problems, and may be unable to attract new investors, because those new investors will know that much of their investment will be used to pay off existing creditors.[16] But Altman concedes that such a prescription may not easily be administered.[17] Senior lenders could help a company reduce debt by accepting a debt-for-equity exchange, but senior lenders are often reluctant to assume the risks that can come with such exchanges.[18] Thus, although a reduction of debt in an initial bankruptcy case will lead to fewer repeat filings, achieving that debt reduction may not be easy.

**2. Was Repeat Filing Caused Instead by Underlying Market Conditions?**

Gina Gutzeit and John Yozzo responded to Altman's conclusions about excessive debt in an article, "What's New with Chapter 22?"[19] First, Gutzeit and Yozzo challenge Altman's premise that a company's subsequent filing reveals a failure of the bankruptcy system that is "not supposed to happen."[20] Second, Gutzeit and Yozzo point to market conditions, not excessive debt, as the cause of repeat filings.[21]

Gutzeit and Yozzo, however, do not believe a repeat filing necessarily reveals a problem unsolved by the initial bankruptcy.[22] Some of Altman's repeat filings occurred

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[15] Altman, 62.
[16] Altman 62, citing Stewart Myers, "Determinants of Corporate Borrowing."
[17] Altman, 62.
[18] Altman, 62.
[19] Gina Gutzeit & John Yozzo, "What's Wrong with Chapter 22?", ABI Journal, September 2013.
[20] Gutzeit & Yozzo, 36.
[21] Gutzeit & Yozzo, 36.
[22] Gutzeit & Yozz, 36.

between 8 and 20 years after the first filing. They note that repeat filings that occur more than five years after the initial bankruptcy should not be regarded as indicators of the success of the initial reorganization, because so much time has passed that the subsequent filing must be the result of other causes.[23]

Gutzeit and Yozzo argue instead that the cause of most repeat filings is market conditions. They studied seven of the nineteen companies that emerged from bankruptcy during the Great Recession of 2008-2009 and then re-filed.[24] The companies they studied cited did shed considerable amounts of debt in connection with their plan. Gutzeit and Yozzo note that six of the seven companies studied achieved significant debt reduction in their initial bankruptcies; "often [the debtor eliminated] two-thirds of pre-petition debt or more."[25] Still, this debt reduction did not prevent a repeat filing. For example, SuperMedia, which publishes the *Yellow Pages* directories, filed first in 2009 because of a rise in digital media, and then in 2013 because it was still unable to keep up with digital competition.[26] Similarly, *The Journal Register* filed first in 2009 as digital media competitors ate into its print newspaper sales and again in 2013 when its own digital media package flopped.[27] In these cases, changes in their industry, not failure to shed debt, created the need to file again.[28] Thus, Gutzeit and Yozzo concluded that market conditions, not debt reduction, lead to repeat filings.[29]

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[23] Gutzeit & Yozzo, 36.
[24] Gutzeit & Yozzo, 36–37, 74–75.
[25] Gutzeit & Yozzo, 75.
[26] Gutzeit & Yozzo, 74.
[27] Gutzeit & Yozzo, 37, 74.
[28] Gutzeit & Yozz, 36–37, 74–75.
[29] Gutzeit & Yozzo, 75.

### 3. Should we Blame the Judges?

Lynn LoPucki and Sarah Kalin conducted an empirical study of repeat filings, which, they argue, reveals that a lack of oversight by bankruptcy judges in the District of Delaware and the Southern District of New York is the reason that repeat filings are more numerous in these districts than in others.[30] LoPucki and Kalin argue that judges in those courts take a "hands-off" approach to the debtor's management, which leads to companies emerging from the initial bankruptcy with too much debt and a higher chance of a repeat filing.[31] Judges, they argue, are easy on these debtors out of self-interest, in the belief that this "hands-off" approach will attract more large cases to their venue.

LoPucki and Kalin followed one hundred eighty-eight of the large companies that emerged from bankruptcy as going-concerns between 1979 and December 31, 1996.[32] The cutoff date for the study was February 26, 2000.[33] LoPucki and Kalin determined that ten of the thirty-one companies (thirty-two percent) that filed their initial Chapter 11 cases in the District of Delaware had refiled by February 2000.[34] Ten of the thirty-six companies (twenty-eight percent) that filed their initial bankruptcy in the Southern District of New York had refiled by February 2000.[35] Thus, LoPucki and Kalin claimed that there must be something distinct, and wrong, about the way cases were handled in Delaware and the Southern District of New York.[36]

Professor David A. Skeel Jr. claims that while LoPucki and Kalin's study proves that recidivism is more prevalent in Delaware and the Southern District of New York, the

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[30] LoPucki & Kalin, 255.
[31] LoPucki & Kalin, 255.
[32] LoPucki & Kalin, 237.
[33] LoPucki & Kalin, 238.
[34] LoPucki & Kalin, 248.
[35] LoPucki & Kalin, 248.
[36] LoPucki & Kalin, 248.

conclusion that judicial self-interest caused the repeat filings is largely unfounded. [37] Skeel notes that leaving the initial bankruptcy with too much debt certainly increases the chance of a future reorganization,[38] but most likely this debt burden is either a result of (1) Delaware attracting companies with complex structures; or (2) Delaware attracting companies that enter bankruptcy in the most dire financial straits. [39] As Altman mentioned, reorganizing capital structure to eliminate debt is not an easy proposition.

Robert Rasmussen and Randall Thomas question the idea that higher recidivism rates in Delaware are evidence of a failure of the bankruptcy courts to adequately police reorganization plans. [40] Rasmussen and Thomas point out that if thirty percent of reorganized companies emerging from bankruptcy file again, seventy percent do not. [41] This percentage is, in their view, perfectly adequate[42] under the standard imposed by Code § 1129(a)(11), which requires that the court find that "confirmation of the plan is not likely to be followed by liquidation, or the need for further financial reorganization, by the debtor."[43] Thus, they argue, LoPucki and Kalin's study does not prove the failure of the bankruptcy system.

Further, Rasmussen and Thomas point out that Delaware's high repeat filing rate may actually be a good thing. It may just represent a calculated risk worth taking.[44] Bankruptcy courts handle prepackaged bankruptcies quickly.[45] Thus, a company may opt

[37] Skeel, 318–19.
[38] Skeel, 320.
[39] Skeel, 318–19.
[40] Rasmussen & Thomas, 293.
[41] Rasmussen & Thomas, 293–94.
[42] Rasmussen & Thomas, 293–94.
[43] 11 U.S.C. § 1129(a)(11).
[44] Rasmussen & Thomas, 296–97.
[45] Rasmussen & Thomas, 296.

for a prepackaged bankruptcy, which can be confirmed within one month,[46] and knowingly assume the risk of filing a subsequent bankruptcy rather than take on the costs of a long, expensive, traditional bankruptcy that may fail anyway, within the same time period.[47] If Rasmussen and Thomas are correct, recidivism rates are a reflection of a business decision motivated, in part, by a desire to avoid the high costs of a traditional bankruptcy proceeding.[48]

### 5. Should Bankruptcy Courts Use the Z-Score?

According to Altman, however, regardless of causation, the Z-Score could be used as a predictive measure of the likelihood that companies leaving bankruptcy will refile.[49] Altman states at the conclusion of his article that his Z-Score "model could even be used by the bankruptcy court as the independent "adviser," now required by the revised Bankruptcy Code, to assess the viability of the reorganization plan."[50] Should bankruptcy courts adopt Altman's Z-Score when assessing a reorganization plan's feasibility? What would happen if courts did use this predictive device?

[46] Rasmussen & Thomas, 289.
[47] Rasmussen & Thomas, 296–97.
[48] Rasmussen & Thomas, 296–97.
[49] Altman, 63.
[50] Altman, 63.

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***Predicting Success in Chapter 11: Avoiding Chapter 22***

## Raising Feasibility

**Lauren Lipari, Class of 2014**
**Zaretsky Fellow**

A party in interest who opposes confirmation of a plan but has been, or will be, outvoted, may nevertheless be able to interpose various objections either at the hearing on the disclosure statement or at the confirmation hearing.

### 1. Objections to Confirmation

Bankruptcy Code § 1129(a)[51] sets forth more than a dozen requirements that a plan must satisfy. Of these, the "best interests of creditors" test, contained in Code § 1129(a)(7), and the "feasibility" test, in Code § 1129(a)(11), are likely to be relevant if an objector has concerns about overleverage.

The best interests test requires that if any claim holder votes against a plan (and even if a majority of creditors in the same class vote in favor of a plan), the plan cannot be confirmed by the court unless the claim holder will receive under the plan property that is worth at least as much as the claim holder would receive if the debtor were liquidated. Code § 1129(a)(7)(i), (ii). See generally, *Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 442 n. 13 (1999). The plan proponent bears the burden of showing that the standard is met, *In re Adelphia Communications Corp.*, 361 B.R. 337, 364 (S.D.N.Y. 2007), and the plan cannot be confirmed unless the court finds by a "preponderance of the evidence that the plan is in

[51] All references are to the United States Bankruptcy Code, 11 U.S.C. § 101, *et seq.* unless otherwise indicated.

the best interest of the creditors." *Id.* Such a determination is "reviewed under the clearly erroneous standard." *In re Adelphia Communications Corp.*, 361 B.R. 337, 365 (S.D.N.Y. 2007); Fed. R. Bankr. P. 8013.

A best interests objection may, however, not be a viable option for the unsecured creditor where the debtor is proposing a 100% plan and the proposed payments clearly exceed the value that would be realized upon liquidation. The costs associated with raising this objection, including the cost of an expert witness to perform liquidation and going-concern analyses, may be too high, and the likelihood of success too remote for a typical creditor to pursue. This is, at least in part, because the real objection is not to the proposed payment, but instead is to the likelihood that those payments will actually ever be made. The more a plan promises, the greater the likelihood that the debtor will be unable to perform its obligations under the plan. This additional riskiness can be factored into the "value" of the distribution, but the argument is convoluted.

The proposed plan may be objectionable for another, simpler, reason: the likelihood that the plan will fail. A better strategy may be to raise an objection based on feasibility. Section 1129(a)(11) provides that the court cannot confirm a plan if confirmation is "likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor," unless either are proposed in the plan. Satisfying this standard requires that the plan "structure the debtor to insure its viability as a reorganized company" and provide "enough working capital for the continuation of the business." *In re Duplan Corp.*, 9 B.R. 921, 925 (S.D.N.Y. 1980). *See also In re Am. Capital Equip., LLC*, 688 F.3d 145, 156 (3d Cir. 2012) (stating that Section 1129(a)(11) requires the plan to be "reasonably likely to succeed on its own terms without a need for further

reorganization"). The Second Circuit, in *Kane v. Johns-Manville Corporation*, stated that feasibility means that the plan has a "reasonable assurance of success," though such "[s]uccess need not be guaranteed." 843 F.2d 636, 649 (2d Cir. 1988) (citations omitted). The purpose of the feasibility standard is to prevent the confirmation of speculative or visionary plans that promise creditors more than what the debtor will be able to accomplish. *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 762 (Bankr. S.D.N.Y. 1992). When an unsecured creditor is uncertain about the debtor's ability to fulfill its plan objections, a feasibility objection can be a useful tool.

The feasibility determination requires the judge to consider the debtor's capital structure and earning power, the market and economic conditions in which the debtor operates, the ability of management and the probability that the same management will continue, as well as "other related matters which determine the prospects of a sufficiently successful operation to enable performance of the provisions of the plan." *In re Landmark at Plaza Park, Ltd.*, 7 B.R. 653, 659 (Bankr. D.N.J. 1980).

While the debtor has the burden of demonstrating feasibility, an objection as to feasibility, like an objection on best interests grounds, may entail costly expert testimony. Here, the debtor might have an economic advantage. While most courts agree that "expert witnesses are not professionals within the meaning of § 327," if the expert is also an advisor to the debtor and has had a central role in administration of the estate, the court may be more likely to view the expert as a professional within the meaning of § 327. Christopher R. Harris & H. Gregory Baker, *Practice Pointers for Working With Expert Witnesses in Bankruptcy Court*, N.Y. L.J., Apr. 16, 2012, http://www.lw.com/thoughtLeadership/working-with-expert-witnesses-bankruptcy-court.

In such a situation, the expert's fees are administrative expenses that will be paid by the estate. In short, it is unlikely that an individual unsecured creditor will be able to compete in this battle of the experts, since all of its expenses would be out-of-pocket. Even if the court would award fees to the creditor for expenses associated with a feasibility objection that proves successful, this may be too great of a risk for the individual creditor to undertake. Thus, the cost of challenging feasibility may be beyond the means of a lone objecting creditor. As a result, objections that should be made may not be made.

**2. Timing of Objections: The Disclosure Hearing**

The disclosure hearing may provide an earlier, more cost-effective, opportunity to put feasibility on the table. Feasibility issues are ordinarily "reserved for the confirmation hearing, and not addressed at the disclosure statement stage." However, there are a number of ways in which "feasibility" can be raised earlier (if obliquely). First, courts can consider confirmation issues at the disclosure stage if a plan is "inherently or patently unconfirmable." *In re Am. Capital Equip., LLC*, 688 F.3d 145, 153-54 (3d Cir. 2012) (citations omitted). However, this usually applies to facial objections, such as the failure to pay all priority claims on the confirmation date. Most feasibility objections will not fall into this category.

Second, an objector may be able to argue that the disclosure statement fails to provide adequate information with regard to the plan's feasibility. This raises the question, how much information is enough? Code § 1125(b) provides that a plan proponent cannot solicit any votes on a plan until a written disclosure statement and plan or summary of the plan is transmitted to claim and interest holders. The disclosure

statement must be approved by the court as containing "adequate information" before it is distributed. § 1125(b). Adequate information is defined as "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records…that would enable such a hypothetical investor…to make an informed judgment about the plan…." § 1125(a)(1). Whether a disclosure statement meets this standard is a subjective determination that is largely within the discretion of the bankruptcy court. *In re Ionospheres Clubs, Inc.*, 179 B.R. 24, 29 (S.D.N.Y. 1995). Once the standard is satisfied, additional information can go into the disclosure statement so long it is accurate and not misleading. *In re Adelphia Communications Corp.*, 352 B.R. 592, 596-597 (Bankr. S.D.N.Y. 2006).

Objection to the quality of disclosure as to feasibility may bring substantive feasibility issues to the attention of the court and parties in interest and it may call the debtor to defend the feasibility of its plan at an earlier stage. This is especially true in light of the Third Circuit's holding that a bankruptcy court can decide whether a plan is unconfirmable at the disclosure stage. *See* Ryan M. Murphy, *Putting the Cart Before the Horse: Third Circuit Affirms Rejection of Plan at Disclosure Statement Stage as Patently Unconfirmable*, 22 J. Bankr. L. & Prac. 3 Art. 3 (May 2013) ("In the wake of *American Capital*, plan proponents facing legitimate protestations as to a plan's scheme must take special care to develop an evidentiary record in advance of a disclosure hearing or risk being sent back to the 'drawing board.'").

**3. The Z-Score**

At either the disclosure or confirmation stage, Professor Altman's Z-Score might prove to be an extremely valuable tool to evaluate the feasibility of the plan. A plan

opponent can argue that, because a problematic Z-Score is a useful predictor of the likelihood of the need for further reorganization, the plan should not be confirmed. Also, an objector might complain that a disclosure statement is inadequate if it does not include a Z-Score analysis. They might also use a Z-Score calculation as a basis for criticizing the debtor's feasibility related disclosure. The costs of a disclosure statement objection are likely to be far lower than the costs of a full-blown valuation hearing. The objector may argue that disclosure of the debtor's Z-Score is necessary to provide adequate information, and put feasibility at issue without the need for experts. Moreover, the use of Altman's Z-Score to measure feasibility is consistent with the standard set forth in the Code. In *In re Young Broadcasting Inc.*, the court stated that "just as speculative prospects of success cannot sustain feasibility, the mere prospect of financial uncertainty cannot defeat feasibility." 430 B.R. 99, 129 (Bankr. S.D.N.Y. 2010).

In conclusion, a low Z-Score, while not an absolute determination that reorganization will be unsuccessful, can be used effectively (and *cost*-effectively) to alert a court to more than a *mere* prospect of financial uncertainty. *See* Edward I. Altman, "Post-Chapter 11 Bankruptcy Performance: Avoiding Chapter 22," *Journal of Applied Corporate Finance*, Volume 21 (2009) ("[T]he sample of companies that eventually filed a second bankruptcy petition had a significantly worse financial profile…than the companies that remained a going concern….").

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## Finding Feasibility

**Douglas Keeton, Class of 2014**
**Zaretsky Fellow**

### 1. The Feasibility Finding Under 11 U.S.C. § 1129(a)(11)

Code § 1129(a)(11) provides that in order to confirm a plan, a court must find that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."[52] For a plan to be feasible, it must therefore offer a reasonable assurance of success, although it need not guarantee success.[53] A court need not determine whether there is a certainty or even substantial probability of success.[54] Courts have acknowledged that the risk of a future liquidation or reorganization is acceptable and often unavoidable.[55]

To perform this inquiry, courts engage in a "peculiarly fact intensive" inquiry and perform a case by case analysis.[56] The threshold of proof is low, and requires only that the evidence support a finding of feasibility.[57] Courts will consider a variety of probative factors, including (1) the soundness and adequacy of the capital structure and working capital for the business in which the debtor will engage post-confirmation; (2) the prospective availability of credit; (3) whether the reorganized debtor will have the ability

[52] 11 U.S.C. § 1129(a)(11).
[53] *Dish Network, Inc v. DBSD N. Am. Inc. (In re DBSD N. Am.)*, 634 F.3d 79, 106 (2d Cir. 2011).
[54] *In re DBSD N. Am., Inc.*, 419 B.R. 179, 201 (Bankr. S.D.N.Y. 2009).
[55] *Id.*
[56] *Id.* at 202.
[57] *Id. citing In re Brotby*, 303 B.R. 177, 191 (B.A.P. 9th Cir. 2003).

to meet its requirements for capital expenditures; and (4) economic and market conditions.[58] A bankruptcy judge's finding of feasibility is reviewed only for clear error.[59]

As an example of this inquiry, in the case of *In re DBSD*, the court made specific findings of fact as to the feasibility of the plan. First, the court found that the debtors would be "dramatically deleveraged," as their debt would decrease from $800 million to $260 million, as compared to assets worth between $492 million and $692 million.[60] Second, the court noted that the debtors had "commitments for working capital financing for the next two years" and would likely be able to secure financing thereafter.[61] Third, the court found it unlikely that the debtor would default on its secured debt.[62] Finally, the court found it likely that credit markets would continue to improve, increasing the likelihood that the debtors could repay their creditors.[63]

Because of the flexible nature of the inquiry, and because of the wide discretion created by the applicable standard of review, bankruptcy judges are free to examine whatever factors they find relevant. For example, in *In re Landmark at Plaza Park, Ltd.*, the debtor's only asset was a 200-unit garden apartment in Pennsylvania worth $2.26 million and subject to a first mortgage of $2.2 million.[64] The debtor's plan called for waiving payments on the mortgage for the first 15 months after confirmation, paying

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[58] *Id.* Collier suggests additional factors, including (1) the earning power of the debtor's business; (2) the ability of the debtor's management; (3) the probability of the continuation of the same management; and (4) any other related matters that will determine success. 7 Collier On Bankruptcy ¶1129.02[11] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013).
[59] *Dish Network, Inc v. DBSD N. Am. Inc. (In re DBSD N. Am.)*, 634 F.3d 79, 106 (2d Cir. 2011).
[60] *Id.* at 107; *In re DBSD N. Am., Inc.*, 419 B.R. 179, 202-03 (Bankr. S.D.N.Y. 2009).
[61] *In re DBSD N. Am., Inc.*, 419 B.R. 179, 203 (Bankr. S.D.N.Y. 2009).
[62] *Id.*
[63] *Id.*
[64] *In re Landmark Plaza Park, Ltd.*, 7 B.R. 653, 654 (Bankr. D.N.J. 1980).

interest on the mortgage for the next 21 months, and then on the 36th month paying the mortgage in full.[65] The balloon payment would include the missed interest payments from the first 15 months, and would be made through a combination of $2.4 million in new secured financing and approximately $400,000 in secondary mortgage financing, retained earnings, and new equity financing.[66] To assess feasibility, the court prepared pro forma income statements for the debtor for the three years post-confirmation, and assessed the likelihood of such factors as occupancy rates, rental increases, fuel expenses, and maintenance costs.[67] The court found it unlikely that the apartment building would either generate income sufficient to justify the debtor's proposed refinancing or be valuable enough to pay in full the secured creditor through a sale.[68] As a result, the court denied confirmation and granted the mortgagee stay relief.[69]

2. **Options for Judges in Feasibility Analyses**

The judge is required to find feasibility as a condition of confirmation, and must conclude that the disclosure statement contains adequate information with regard to feasibility. However, if there is no objection, the debtor's presentation will not be challenged. Altman has noted that "unless there is convincing opposition by interested parties, the bankruptcy court has little choice but to sanction the plan as presented."[70] Further, he notes such opposition will be rare as "most corporate advisers and relevant stakeholders have a bias toward emerging as soon as possible."[71] Nonetheless, the judge

[65] *Id.* at 659.
[66] *Id.*
[67] *Id.* at 659-61.
[68] *Id.* at 662-63.
[69] *Id.* at 663.
[70] Edward I. Altman, *Post-Chapter 11 Bankruptcy Performance: Avoiding Chapter 22*, Journal of Corp. Fin., Summer 2009, at 53, 53-54 (hereinafter "Altman").
[71] *Id.* at 54.

him or herself may have reservations. This raises the question, what is a judge to do when a chapter 11 plan enjoys the support of all interested parties, no one has objected to confirmation, and yet the judge has hesitations about the plan's feasibility?

**a. Denial of Confirmation and/or Conversion Under 11 U.S.C. § 1112(b)**

The consequences of a finding that the plan is infeasible are quite harsh. 11 U.S.C. § 1112(b) permits a chapter 11 case to be converted or dismissed, and a court may do so *sua sponte*.[72] "Neither the Code nor its predecessor statutes were intended to prolong a hopeless situation and to postpone inevitable liquidation. If the facts indicate that the plan cannot be performed, it is not feasible and cannot be confirmed, notwithstanding the proponent's sincerity, honesty, and willingness to make a best effort attempt to perform according to the terms of the plan."[73] That said, a judge would certainly be loath to liquidate a debtor on his own motion, where the debtor has proposed a plan that enjoys creditor support.

**b. Appointment of an Examiner in Cases With Low Z-Scores**

Another less draconian option for the judge might be to appoint an examiner. A judge may appoint an examiner for cause "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate…"[74] Courts have held that § 1104(a)(1)'s nonexhaustive list of factors justifying the appointment of an examiner, when read in conjunction with § 105(a), allows courts *sua sponte* to appoint

[72] 7 Collier On Bankruptcy ¶1112.04[2] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013).
[73] *In re Great N. Protective Servs., Inc.*, 19 B.R. 802, 803 (W.D. Wa. 1982) *quoting* 6A Collier on Bankruptcy ¶ 11.29-35 (14th ed. 1978).
[74] 11 U.S.C. § 1104(a)(2).

examiners.[75] A court faced with a potentially unfeasible plan, and no record, could appoint an examiner to scrutinize the debtor's projections and determine whether the court's concerns are justified. Even this however, is likely to be expensive and time-consuming. Therefore, such an appointment should not be made lightly. This raises the further question of how a court might determine when its disquiet justifies further inquiry, and when to defer to the parties.

### 3. Incorporating Altman's Z-Score Into the Feasibility and Confirmation Analysis

Altman's Z-Score may provide a mechanism for sorting cases where feasibility is truly a concern from those where it is not. Altman suggests in his article that his Z-Score analysis could be used by bankruptcy judges to assess feasibility under § 1129(a)(11).[76] The metric is not especially difficult for a court to apply, as it simply entails plugging variables available from the debtor's balance sheet and income statement into a simple algebraic formula.[77] Many of these variables will be available in the disclosure statement even where the debtor has not provided a Z-Score. Indeed, a judge might, as a matter of regular practice, require that the debtor provide this calculation as a condition of approving the debtor's disclosure statement.

In his article, *Avoiding Chapter* 22, professor Altman studied a sample of public company filers and calculated their Z-Scores upon exit from bankruptcy. The Z-Score is a measure of the relationship between the debtor's assets and earnings, and the their debt

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[75] *Byrd v. Johnson*, 467 B.R. 832, 842-43 (D. Md. 2012); *First Am. Health Care of Ga., Inc. v. U.S. Dep't of Health & Human Servs.*, 208 B.R. 992, 994-95 (S.D. Ga. 1996); 7 Collier On Bankruptcy ¶1104.03[1] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013).
[76] Altman at 63.
[77] *See* Altman 57-58.

level. He also calibrated the Z-Score so it could be converted to a bond rating equivalent. He found that the group of filers who did not refile had an average of B+, while those who did refile had an average score of CCC.[78] As such, a proposed plan that presented a Z-Score below B might merit further judicial scrutiny. There remains the question of what form that scrutiny should take?

**a. Appointment of an Examiner Solely to Investigate the Debtor's Z-Score**

Thus, where a chapter 11 plan leaves debtor with a low Z-Score, the court could appoint an examiner. The examiner would be charged with providing the court with an explanation as to how the debtor will remain viable post-confirmation notwithstanding a debt level high enough to result in a Z-Score that predicts failure. Parties could be invited to provide the examiner with detailed projections bearing on the feasibility of the plan, such as how the debtor can service its post-confirmation debt. Additionally, because the examiner is entitled to compensation from the estate,[79] he or she can devote sufficient resources, including retaining experienced professional advisors, to arrive at a satisfactory answer.

Armed with a detailed examiner's report, a judge could settle on an amount of debt the reorganized debtor is deemed capable of safely carrying. A judge could then deny confirmation of plans that do not sufficiently deleverage the debtor. Further, the parties may conclude that the cost and delay that the appointment of an examiner creates is greater than the cost of converting some of the claims against the debtor into equity, thus creating a higher Z-Score. They may also foresee a risk that the examiner may come

[78] Altman at 59-60.
[79] 11 U.S.C. § 330(a)(1).

in at a lower number than is necessary to persuade the judge of the feasibility of the plan and that a plan that splits the difference between the creditors' aspirations and the examiner's predictions might be sufficient to appease the judge and foreclose the need for such an inquiry.

In short, the threat of the appointment of an examiner to investigate the issue of the reorganized debtor's Z-Score may provide immediate benefit to the debtor's prospects while preserving the option to effect further debt reduction at a later date.

### c. Deleveraging

If the examiner's investigation confirms the judges concerns, the judge might indicate to the parties that they should take their distribution in the form of equity rather than debt. Under such a situation, the debtor's Z-Score under a proposed plan could be recalculated, and the change in capital structure of debt and equity necessary to achieve a sufficiently higher Z-Score.

## 5. Conclusion

In sum, even where no parties object, the Bankruptcy judge can use the Z-Score metric to determine whether concerns about feasibility are sufficiently great to merit further investigation and/or judicial action.

*Barry L. Zaretsky Roundtable Discussion*
*Predicting Success in Chapter 11: Avoiding Chapter 22*

# Chapter 11 Post-Confirmation Default Remedies

**Kevin Cooper, Class of 2014**
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After a chapter 11 plan is confirmed, the finding of "feasibility" reflects hope that the court's involvement with the debtor's business is at an end. There are many situations, however, where it may be necessary to modify a confirmed plan.[80] The debtor may not have shed enough debt, or an industry downturn may continue longer than expected. The question, therefore, remains as to what can be done when the chapter 11 plan unravels and the debtor defaults, and whether success or failure of the second case should be traced back to the original confirmed plan.

## 1. Jurisdictional Issues:

After a post-confirmation default, a party seeking a remedy is not automatically entitled to a hearing in the originating bankruptcy court that confirmed the bankruptcy plan. Instead, the party must conduct a jurisdictional inquiry pursuant to 28 U.S.C. § 1334.[81] In considering whether to retain jurisdiction for post-confirmation issues, courts are warned against keeping reorganized entities under "indefinite tutelage" and urged

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[80] "Even the most carefully crafted plans of reorganization sometimes encounter circumstances that warrant adjustment. Events that might be out of the control of the reorganized debtor can change circumstances sufficiently to put the plan at risk." Gerber, Business Reorganizations, at 1187 (quoting *Bankruptcy: The Next Twenty Years,* Report of the National Bankruptcy Review Commission at 601 (1997)).

[81] United States Bankruptcy Courts are granted jurisdiction over cases under title 11 of the United States Code, also referred to as the "Bankruptcy Code." 28 U.S.C § 1334 (a) grants the district court exclusive jurisdiction over bankruptcy cases. 28 U.S.C. § 1334 (b) grants the district court "original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." Under 28 U.S.C. § 157(a), the "district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 shall be referred to the bankruptcy judges for the district." *See e.g.*, Standing Order of Reference Re: Title 11, 12 misc. 00032, (S.D.N.Y. Jan. 31, 2012); In the Matter of the Referral of Matters to the Bankruptcy Judges (E.D.N.Y. Dec. 5, 2012).

caution in the exercise of jurisdiction over an entity formerly under court supervision.[82] "Broadly speaking, the proceeding must affect some aspect of the plan—its meaning, its implementation or its consummation—to come within the Court's post-confirmation jurisdiction."[83]

## 2. Applicable Statutory Provisions[84]

Post-confirmation jurisdiction is retained for issues affecting the confirmation plan. Bankruptcy Code § 1142 explicitly guides the implementation of the confirmed plan, with subsection (a) directing the reorganized entity to comply with the plan, and subsection (b) equipping the court with authority to "perform any other act . . . that is necessary for the consummation of the plan." Further, Federal Rule of Bankruptcy Procedure 3020(d) provides: "(d) *Retained Power*. Notwithstanding the entry of an order of confirmation, the court may issue any other orders necessary to administer the estate." In general, the closer in time to plan confirmation that a dispute arises, the more likely the bankruptcy court will hear the issue.[85] Further, if the disputed issue will affect the distribution to creditors, the bankruptcy court would likely aim to resolve the matter, while if the issue solely affects a third-party not critical to the implementation of the plan, the issue is thought best in a nonbankruptcy court.[86]

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[82] 8 Collier on Bankruptcy ¶ 1142.04 (Henry Sommer & Alan Resnick, eds., 16th ed. 2013) (quoting *N. Am. Car Corp. v. Peerless Weighing & Vending Machine Corp.,* 143 F.2d 938 (2d Cir. 1944)).

[83] *In re Gen. Media Inc.,* 335 B.R. 66, 74 (Bankr. S.D.N.Y. 2005).

[84] Unless otherwise indicated, statutory references are to the United States Bankruptcy Code, 11 U.S.C. § 101, *et seq*.

[85] 8 Collier on Bankruptcy ¶ 1142.04 [2] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013); *see also Booth Oil Site Admin. Group v. Safety Kleen Corp.*, 532 F. Supp. 2d 477, 515 (W.D.N.Y. 2007) (finding a party seeking enforcement of a plan under 11 U.S.C. § 1142(b) barred by New York State's 6-year statute of limitations for equitable remedies).

[86] 8 Collier on Bankruptcy ¶ 1142.04 [2]; *see also* Norton Bankruptcy Law & Practice § 114:10 (analyzing jurisdiction under 11 U.SC § 1142 under the pre-confirmation "conceivable impact test" in the Third Circuit and the "significant effect test" of the Second Circuit).

The Bankruptcy Code contains additional provisions applicable in the case of a post-confirmation default. Under the provisions of Bankruptcy Code § 1144, within 180 days of confirmation a party in interest may request the court revoke confirmation, but "if and only if such order was procured by fraud."[87] On the other hand, Bankruptcy Code § 1112(b) authorizes the court on request of a party in interest to convert a chapter 11 case to chapter 7 or dismiss the case in its entirety, whichever is in the best interest of the creditors and the estate, for cause. "Cause," as defined in Section 1112(b)(4)(A)-(P), includes, *inter alia*, (1) "failure to comply with an order of the court;" (2) "revocation of order of confirmation under section 1144;" (3) "inability to effectuate substantial consummation of a confirmed plan;" (4) "material default by the debtor with respect to a confirmed plan;" and (5) "termination of a confirmed plan by reason of the occurrence of a condition specified in the plan[.]"

Bankruptcy Code § 350(b) is the final provision relevant for a post-confirmation default. Under Section 350(b), "[a] case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause." In deciding whether to reopen a case, the court exercises broad discretion. As explained below, a party who moves to reopen a case is required to pay a substantial fee. Moreover, common law principles, such as laches, could bar the reopening of the case.[88]

**3. Creditor Remedies:**

After the jurisdictional issues are resolved, issues such as standing and the nature of remedies available must be resolved. Depending on whether the party is a debtor or

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[87] Even if a creditor seeks a timely revocation, the action may be rendered moot, unless there is a stay of the debtor's plan consummation efforts. *See In re Circle K Corp.*, 242 F.3d 380 (9th Cir. 2000).
[88] 3 Collier on Bankruptcy ¶ 350.03[5]-[7] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013).

creditor, different routes can be taken. As a creditor, there are additional impediments, such as whether there is standing to bring the action,[89] before the creditor is entitled to the statutory remedies.

A creditor can choose to pursue its default claims in either the bankruptcy court or a nonbankruptcy court. For example, a creditor may choose to file in state court and pursue state law contract claims.[90] (The failure to perform a promise under a plan is, after all, a breach of a contract). If a creditor would prefer to have the issue resolved in bankruptcy court but the case was closed after the effective date, the creditor could file a motion to reopen the case pursuant to Bankruptcy Code § 350(b). The creditor would have to bear the high filing fees of reopening the chapter 11 case (currently $1,213 in the Eastern District of New York and varies by district),[91] but would avoid the difficulties encountered in bringing a state court action. Once the case is reopened, the creditor is able to pursue its remedy through either the enforcement of the specific confirmation plan provisions under Bankruptcy Code § 1142, revocation of the plan due to fraud under the specific provisions Bankruptcy Code § 1144, or the conversion of the case to a chapter 7 liquidation under Bankruptcy Code § 1112.

Conversion to chapter 7 pursuant under Bankruptcy Code § 1112 is a drastic remedy for a post-confirmation default. First, the conversion does not recreate the pre-conversion estate and does not revoke the debtor's discharge.[92] The lack of a pre-

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[89] *See e.g., In re Wedgestone Financial*, 152 B.R. 786 (Bankr. D. Mass 1993) (Suggesting that confirmation plans can hinder creditor committee standing for post-confirmation adjudication where the committee is dissolved upon the effective date of the plan.).
[90] *See In re Troutman*, 253 B.R. 8, 11 (B.A.P. 6th Cir. 2000) (citing *In re Xofox, Indus. Ltd.*, 241 B.R. 541, 543 (Bankr. E.D. Mich. 1999) ("If a reorganized debtor defaults under a plan, creditors have several options, including enforcing the plan terms in any court of competent jurisdiction.").
[91] 3 Collier on Bankruptcy ¶ 350.03 [7] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013).
[92] *See In re Curry*, 99 B.R. 409 (Bankr. C.D. Ill. 1989).

conversion estate poses a problem for a creditor, for according to the Bankruptcy Code, "the confirmation of a plan vests all property of the estate in the debtor."[93] As a result, there is an obstacle confronting a creditor attempting to reach the assets of a reorganized (discharged) debtor.

Thus, for example, in *In re T.S.P. Indus. Inc.*, 117 B.R. 375 (Bankr. N.D. Ill. 1990),[94] the debtor defaulted on its payments to unsecured creditors, and the United States Trustee moved to have the case dismissed or converted to a chapter 7 case. The court found a material default and granted the motion to convert but noted that "[o]nce property has vested in the Debtor, conversion will not revest that property in the estate."[95] As such, the creditors were left with no remedy because there was no estate to liquidate.

Other courts have reached a different result. For example, in *In re Midway, Inc.*, 166 B.R. 585 (D.N.J. 1994), the court found that all of the accounts receivable as of the date of the conversion were property of the estate. Borrowing from decisions involving the conversion of chapter 13 cases to chapter 7 cases, the court found that the accounts receivable after the date of the conversion were similar to those of prepetition payments for the liquidation, and belonged to the estate.[96]

The Ninth Circuit has taken this approach even further, and held that conversion may draw back all transferred assets.[97] In *In re Consol. Pioneer Mortgage Entities*, 264 F.3d 803 (9th Cir. 2001), six related entities filed chapter 11 and a liquidating corporation was formed to take title of all the assets, liquidate those assets, and resolve and pay

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[93] 11 U.S.C. § 1141.
[94] Salazar, *supra* n. 11, at 5.
[95] *In re T.S.P.*, 117 B.R. at 375.
[96] *In re Midway, Inc.*, 166 B.R. at 590.
[97] Salazar, *supra* n. 11, at 5. The Second Circuit does not go quite as far as the Ninth Circuit. *See e.g., In re General Media*, 335 B.R. at 74 ("[U]nless the plan says something different, confirmation vests the property of the estate in the reorganized debtor.").

creditor and investor claims. When the liquidating plan failed, the bankruptcy court converted the cases to chapter 7. The Ninth Circuit found that "[a]lthough typically confirmation of a plan 'terminates the existence of the estate[,] . . . reversion of property from the estate to the debtor upon confirmation contained in 11 U.S.C. § 1141(b) is explicitly subject to the provisions of the plan.'"[98]

Under *Consolidated Pioneer*, two plan components determine whether an asset revests in a chapter 7 estate post-conversion: (1) an explicit provision regarding the distribution of future proceeds of an asset to creditors, and (2) the retention of broad powers in the bankruptcy court to oversee implementation of the plan.[99] Applying Section 1141(b) and interpreting the "language and purpose" of the plan there, the Ninth Circuit held that assets which vested in debtor upon confirmation revested in the chapter 7 estate upon conversion.[100] Accordingly, creditors may be left with varying levels of recoverable assets depending on the jurisdiction and the individual plan confirmation in the matter.

Under Bankruptcy Code § 1112, the movant, seeking to convert the case to chapter 7, bears the initial burden of demonstrating: (1) cause; and (2) whether dismissal or conversion to chapter 7 is in the best interests of the creditors and the estate.[101] The burden is upon the movant, and the movant must establish cause by preponderance of the evidence. While the debtor's failure to make a payment may constitute a default, courts

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[98] *Consol. Pioneer*, 264 F.3d at 807 (quoting *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n.*, 997 F.2d 581, 587 (9th Cir. 1993)).
[99] *Consol. Pioneer*, 264 F.3d at 807.
[100] *Id.*
[101] 7 Collier on Bankruptcy ¶ 1112.04 [4] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013).

have shown reluctance to reopen a case simply because the debtor defaulted on payments to its creditors.[102] As Judge Easterbrook put it:

> Once the bankruptcy court confirms a plan of reorganization, the debtor may go about its business without further supervision or approval. The firm also is without the protection of the bankruptcy court. It may not come running to the bankruptcy judge every time something unpleasant happens.[103]

An option of seemingly last resort to recover after a post-confirmation default from a reorganized debtor would be to pursue an involuntary petition under the Bankruptcy Code § 303.[104] Utilizing the confirmation plan as a contract, under the theory espoused in *Troutman*, a group of creditors could conceivably pursue an involuntary petition for liquidation. While creative, the efforts would likely result in diminished returns due to excessive litigation on claims that were likely impaired in the original confirmation plan.[105] Similar to the issues faced with the enforcement of a confirmation plan in a state court, confirmation plans lack common contractual terms making the use of an involuntary petition difficult.[106]

### 3. Debtor Specific Remedies:

Under Bankruptcy Code § 1127(b), the plan may be modified by the proponent of a plan or the reorganized debtor. Some barriers prevent modification, and the first and foremost is whether the plan has been substantially consummated. Section 1101(2) defines "substantial consummation" as: "(A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by the debtor or by the

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[102] 7 Collier on Bankruptcy ¶ 1112.04 [6][n] (Henry Sommer & Alan Resnick, eds., 16th ed. 2013) (citing *In re OORC Leasing, LLC*, 359 B.R. 227, 233 (Bankr. N.D. Ind. 2007)).
[103] *Pettibone v. Easley*, 935 F.2d 120, 122 (7th Cir. 1991).
[104] Salazar, *supra* n. 11, at 6.
[105] *Id.*
[106] Salazar, *supra* n. 11, at 2.

successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (C) commencement of distribution under the plan." Substantial consummation is a fact intensive inquiry with the burden shifting upon within the Circuit which the case is pending.[107] While substantial consummation is not a *per se* barrier to modification, it does factor into the court's analysis of whether modification would be prudent.[108] The inquiry is vitally important as a court may use its prudential forbearance to decide not "whether a court can hear a case, but whether it should refrain from doing so because of the perceived disruption and harm that granting relief would cause."[109] In looking to modify a plan after confirmation, the Third Circuit has enumerated a number of factors used to decide whether it should refrain from modifying the underlying plan:

> (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.[110]

The Second Circuit similarly contains a set of factors that the court weighs in order to rebut the presumption of equitable mootness and to determine the effects of plan modification:

> (1) the court can still order some effective relief"; (2) "such relief will not affect the re-emergence of the debtor as a revitalized corporate entity";(3) "such relief will not unravel intricate transactions so as to

[107] *Compare In re Semcrude L.P.*, 728 F.3d 314, 321 (3d Cir. 2013)(citing *In re Lett*, 632 F.3d 1216, 1226 (11th Cir. 2011); *In re Paige*, 584 F.3d 1327, 1339–40 (10th Cir. 2009); *In re Focus Media, Inc.,* 378 F.3d 916, 923 (9th Cir. 2004))(stating that the burden should be placed on the party seeking dismissal) wdith *In re Charter Commc'ns*, *Inc.*, 691 F.3d 476, 484 (2d Cir. 2012)(stating that appellants bear the burden).
[108] *In re Charter Commc'ns*, *Inc.*, 691 F.3d at 482.
[109] *In re Semcrude L.P.*, 728 F.3d at 317 (citing *Official Comm. of Unsecured Creditors of LTV Aerospace and Defense Co. v. Official Comm. of Unsecured Creditors of LTV Steel Co. (In re Chateaugay Corp.)*, 988 F.2d 322, 325 (2d Cir.1993)).
[110] *In re Semcrude L.P.*, 728 F.3d at 320 (citing *In re Continental Airlines*, 91 F.3d 553, 560 (3d Cir. 1995).

> knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court"; (4) "the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings"; and (5) "the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from."[111]

Both tests reflect the balancing act between the policies of preserving going concerns and maximizing property available to satisfy creditors.

The substantial burden placed on plan modification suggests that while plan modification is available to remedy post-confirmation default, there is a preference from the court for the parties to get the confirmation correct on the first try and avoid the deadweight costs associated with additional litigation down the line.

Finally, and as a last resort, a debtor could seek to reorganize once more under a new chapter 11 filing, or the so-called chapter 22 filing. While there is no *per se* rule barring a subsequent chapter 11 filing after confirmation, courts and creditors may challenge a new filing as an unlawful attempt to modify the previous confirmation plan or that it was filed in bad faith.

In *Northtown Realty Co. L.P.*, 215 B.R. 906 (Bankr. E.D.N.Y. 1998), the debtor had previously filed and confirmed a chapter 11 plan resolving its outstanding liabilities and providing its largest secured creditor with a mortgage on the debtor's retail shopping complex.[112] Four years later, the debtor was again unable to meet its obligations, due to either unforeseen tenant bankruptcies or management incompetence, and the secured

[111] *In re Charter Commc'ns*, *Inc.*, 691 F.3d at 482 (quoting *Frito–Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.),* 10 F.3d 944, 952–53 (2d Cir.1993)).
[112] *Id.* at 908.

creditor started foreclosure proceedings on the retail shopping complex.[113] The debtor attempted to renegotiate its obligations with the secured creditor, but the creditor did not find the proposals feasible.[114] In order to stay the foreclosure proceedings, the reorganized debtor filed a new chapter 11 proceeding which was met with the secured creditor's immediate motion to dismiss stating that: (1) the plan was substantially consummated and could not be modified by the subsequent filing, and (2) the petition was filed in bad faith.[115]

The court agreed with the secured creditor and granted dismissal, finding that (1) "the debtor [was] unable to effectuate a plan of reorganization as it is barred by Bankruptcy Code § 1127(b)'s prohibition of modification of a plan after substantial consummation"; (2) "there have been no unforeseeable change in circumstances which would warrant allowing the debtor a second attempt at reorganization"; and (3) the secured creditor had "amply demonstrated that under the factors enunciated in *C–TC 9th Avenue Partnership,* [debtor's] chapter 11 case was filed in bad faith."[116] In the analysis, the court did note that that "there is no *per se* or blanket prohibition on subsequent chapter 11 filings by corporate debtors."[117] The court elaborated, "[h]owever, while serial chapter 11 petitions may permissibly be filed, such petitions are still subject to all of the Bankruptcy Code's requirements."[118] The court found that the debtor's inability to effectuate a plan of reorganization reason enough for dismissal as "it is impermissible to

[113] *Id.* at 909.
[114] *Id.*
[115] *Id.*
[116] *Id.* at 910.
[117] *Id.* at 911 (citing *Fruehauf Corp. v. Jartran, Inc. (In re Jartran, Inc.)*, 886 F.2d 859, 866–67 (7th Cir. 1989); *In re Jamesway Corp.,* 202 B.R. 697, 706 (Bankr. S.D.N.Y. 1996) (noting that "serial chapter 11 filings are generally allowed").
[118] *Northtown Realty*, 215 B.R. at 911.

use [serial chapter 11] filings to alter or modify obligations which were created and assumed through a substantially consummated prior plan of reorganization, except in the most extraordinary of circumstances[.]"[119] The court notes that if the second chapter 11 filing had sought liquidation instead of reorganization, this would provide an indicia of good faith as the debtor would not be seeking to evade its responsibilities under the previously confirmed plan.[120]

Second, the court noted that the second chapter 11 filing did not fall under the changed circumstances exception, justifying a second reorganization attempt.[121] The court cited two cases illustrating the exception: (1) *CFC 78 P'ship B v. Casa Loma Assocs. (In re Casa Loma Assocs.),* 122 B.R. 814, 818 (Bankr. N.D. Ga. 1991), allowing a second chapter 11 reorganization where debtor operated "adults-only" apartment complex and new federal law prohibited discrimination against children as tenants; and (2) *In re Garsal Realty, Inc.,* 98 B.R. 140, 150 (Bankr. N.D.N.Y. 1989), noting that debtor's second chapter 11 was not an attempt to modify the prior plan due to new debt which did not arise until after substantial consummation of the prior plan.[122] In both circumstances, fundamental changes occurred affecting the debtor that were not present at the time of the original confirmation and were not contemplated by the original plan. This exception is limited to direct effects on the debtor and not extended towards systemic economic events affecting supply and demand.[123]

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[119] *Id.*
[120] *Id.* at 913 (citing *In re Jartan*, 886 F.2d at 868-69) (finding that a sought after chapter 11 liquidation was "entirely distinct" from the previous chapter 11 reorganization).
[121] *Northtown Realty*, 215 B.R. at 913.
[122] *Northtown Realty*, 215 B.R. at 913.
[123] *See In re Caviata Attached Homes, LLC*, 481 B.R. 34, 47 (B.A.P. 9th Cir. 2012) (listing cases holding changed market conditions alone are insufficient for a second chapter 11 filing.).

Finally, the court found that the debtor's second chapter 11 filing was conducted in bad faith.[124] The court notes that to find bad faith, the court should look at the facts and circumstances unique to the individual case, but may be guided by the following indicators: (1) where the debtor does not have a realistic possibility of reorganization;[125] (2) where there is evidence of an intent to delay or frustrate the efforts of secured creditors to enforce their legitimate rights;[126] and (3) where the debtor is conducting a serial filing.[127]

While the filing of a serial chapter 11 petition is not *per se* barred, it is still considered a "hallmark of bad faith,"[128] and subsequently requires the debtor overcome substantial impediments similar to those faced in modifying a previously confirmed plan.

**Conclusion:**

All of the discussed remedies for a post-confirmation default pose difficult challenges to both the creditors and debtors. Many of the barriers represent the underlying policy of not keeping reorganized debtors under the indefinite tutelage of the bankruptcy court and having reorganized debtors emerge bankruptcy strong enough so as to not become recidivist filers. These policies correspond with the goals of chapter 11 to preserve going concerns while maximizing property available to satisfy creditors.

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[124] *Northtown Realty*, 215 B.R. at 914.

[125] *Id.* at 914 (citing *Y.J. Sons & Co., Inc. v. Anemone, Inc. (In re Y.J. Sons & Co., Inc.)*, 212 B.R. 793, 802 (D.N.J. 1997)).

[126] *Northtown Realty*, 215 B.R. at 914 (citing *9281 Shore Road Owners Corp. v. Seminole Realty Co. (In re 9281 Shore Road Owners Corp.)*, 187 B.R. 837, 848 (E.D.N.Y. 1995); *In re Spectee Gp., Inc.*, 185 B.R. 146, 155 (Bankr. S.D.N.Y. 1995)).

[127] *Northtown Realty*, 215 B.R. at 914 (citing *In re McCormick Road Assocs.,* 127 B.R. 410, 414 (N.D. Ill.1991); *In re Spectee Gp., Inc.,*185 B.R. at 156).

[128] *Northtown Realty*, 215 B.R. at 914.