PRESENTED BY:

NATIONAL LAW INSTITUTE

Continuing Legal Education

Sponsored by:

Distressed Real Estate and Bankruptcy IV

NATIONAL
LAW INSTITUTE
Continuing Legal Education

- Carlos J. Cuevas, Esq.
- 1250 Central Park Avenue
- Yonkers, New York 10704
- Tel. No. 914.964.7060
- Fax No. 914.964.7064
- Email ccuevas576@aol.com
- Website www.carloscuevaslaw.com

Bankruptcy Code Section 1121: The Filing of a Plan of Reorganization

Copyright 2015 Carlos J. Cuevas

I. *Bankruptcy Code Section 1121 and the Filing of a Plan of Reorganization*

- In a Chapter 11 case a debtor has the right to file a plan of reorganization at any time. 11 U.S.C. § 1121(a). With a few exceptions, only a debtor has the right to file a plan of reorganization during the initial 120 day period of a Chapter 11 case. 11 U.S.C. § 1121(b).

- Any party in interest, including a creditor, may file a plan of reorganization if a Chapter 11 Trustee has been appointed; the debtor has failed to file a plan of reorganization within the initial 120 day period after the order for relief; or the debtor has not filed a plan of reorganization that has been accepted by each class of claims or interests that is impaired by such plan within the initial 180 day period after the order for relief. 11 U.S.C. § 1121(c).

- A party may move to extend the exclusive period to file a plan of reorganization for "cause." 11 U.S.C. § 1121(d)(1). The decision to extend a debtor's exclusive period is a fact specific inquiry. *In re Borders Group,Inc., 460 B.R. 818, 822 (Bankr. S.D.N.Y. 2011). The following are factors that are considered when determining whether an exclusive period should be extended:*

- . . . . (a) the size and complexity of the case; (b) the necessity for sufficient time to permit the debtor to negotiate a plan of reorganization and prepare adequate information; (c) the existence of good faith progress toward reorganization; (d) the fact that the debtor is paying its bills as they become due; (e) whether the debtor has demonstrated reasonable prospects for filing a viable plan; (f) whether the debtor has made progress in negotiations with its creditors; (g) the amount of time which has elapsed in the case; (h) whether the debtor is seeking an extension of exclusivity in order to pressure creditors to submit to the debtor's reorganization demands; and (i) whether an unresolved contingency exists.

- *In re Adelphia Communications Corp., 352 B.R. 578, 587 (Bankr. S.D.N.Y. 2006).*

- In *In re McLean Industries, Inc., 87 B.R. 830 (Bankr. S.D.N.Y. 1987) the court granted an extension of exclusivity because of the complexity of the case. On the other hand, in In re CGM Capital Partners III, LP, 503 B.R. 596 (Bankr. S.D.N.Y. 2014) the Bankruptcy Court denied the motion for the extension of exclusivity because the case was small and uncomplicated. The debtor was not paying its post petition operating expenses. Finally, the debtor was unable to demonstrate that it could propose a viable plan that the major creditor in the case would support.*

- In a single asset real estate case unless a debtor can make adequate protection payments a debtor is under pressure to file a plan of reorganization within the initial ninety day period. A debtor's failure to make adequate protection payments or file a viable plan of reorganization could result in the automatic stay being lifted. *See 11 U.S.C. 362(d)(3).*

- In a large reorganization case a debtor usually seeks at least one extension of exclusivity. The issue of which leases to accept or reject are usually central to a plan of reorganization in a large case. In a supermarket or a department store with multiple locations the analysis of existing leases is a vital issue to restructuring the debtor.

- As will be discussed later, a debtor's exclusive period is also important to satisfying the "new value exception" to the absolute priority rule. If the debtor's exclusive period has expired and there are no competing offers, then the free market has spoken concerning the value of the debtor's enterprise. Under these circumstances, debtor's management can state that the existing offer is the highest and best offer.

Bankruptcy Code Sections 1122 & 1124: Classification of Claims and Impairment

Copyright 2015 Carlos J. Cuevas

I. *Introduction*

- Bankruptcy Code Section 1122 governs the designation of class of claims or interests in a plan of reorganization, and it states:
- (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
- (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.
- 11 U.S.C. § 1122.

- Bankruptcy Code Section 1124 regulates the concept of "impairment", and it states:

- Except as provided in section 1123 (a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—

- (1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or

- (2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—

- (A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365 (b)(2) of this title or of a kind that section 365 (b)(2) expressly does not require to be cured;

- (B) reinstates the maturity of such claim or interest as such maturity existed before such default;
- (C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;
- (D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365 (b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and
- (E) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.
- 11 U.S.C. § 1124.

- The concept of "impairment" is consequential in a corporate reorganization case because of Bankruptcy Code Section 1129(a)(10). If a class of claims is "impaired", then at least one impaired class of claims must accept the plan of reorganization in order for the plan of reorganization to be confirmed. 11U.S.C. § 1129(a)(10).

- The acceptance of one impaired class permits a bankruptcy court to "cram down" a plan of reorganization over a dissenting class of impaired creditors. *See, 11 U.S.C. § 1129(b). In a single asset real estate case the secured creditor with a deficiency claim will control the secured and unsecured classes and make it difficult, if not impossible, to obtain confirmation of a plan of reorganization.*

Bankruptcy Code Section 1123: The Contents of a Plan of Reorganization

Copyright 2015 Carlos J. Cuevas

Bankruptcy Code Section 1123(a) contains the mandatory provisions for a plan of reorganization. 11 U.S.C. § 1123(a).

Bankruptcy Code Section 1123(a)(1) designate classes of claims. 11 U.S.C. § 1123(a)(1) Administrative claims and tax claims need not be classified. 11 U.S.C. § 1123(a)(1). Substantially similar claims should be placed in the same class. 11 U.S.C. §§ 1122 and 1123(a)(1).

•

- Bankruptcy Code Section 1123(a)(2) requires that a plan specify which class of claims or interests is not impaired. 11 U.S.C. § 1123(a)(2).
- Bankruptcy Code Section 1123(a)(3) requires that a plan specify which class of claims or interest is impaired. 11 U.S.C. § 1123(a)(3).
-

- Bankruptcy Code Section 1123(a)(3) requires that a plan specify which class of claims or interest is impaired. 11 U.S.C. § 1123(a)(3).
- Bankruptcy Code Section 1123(a)(4) requires that a plan 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.

- Bankruptcy Code Section 1123(a)(5) requires that a plan provide for adequate implementation of the plan of reorganization. Bankruptcy Code Section 1123(a)(5)(A) provides that a debtor may retain some or all of the property of the estate. 11 U.S.C. § 1123(a)(5)(A). Bankruptcy Code Section 1123(a)(5)(B) provides that a plan proponent transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan. 11 U.S.C. § 1123(a)(5)(B).

- Bankruptcy Code Section 1123(a)(5)(C) provides that a plan can provide for a merger or consolidation. 11 U.S.C. § 1123(a)(5)(C). Bankruptcy Code Section 1123(a)(5)(D) authorizes that a plan of reorganization can provide for the sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate. 11 U.S.C. § 1123(a)(5)(D).

- Bankruptcy Code Section 1123(b) governs discretionary plan provisions. 11 U.S.C. § 1123(b).

- Under Bankruptcy Code Section 1123(b)(1) a plan of reorganization can impair or leave unimpaired any class of claims, secured or unsecured, or of interests. 11 U.S.C. § 1123(b)(1). A plan of reorganization is authorized to provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section. 11 U.S.C. § 1123(b)(2).

- Under Bankruptcy Code Section 1123(b)(3) authorizes the settlement of claims or the assignment of that claim to a representative of the estate. 11 U.S.C. § 1123(b)(3). Bankruptcy Code Section 1123(b)(4) authorizes the filing of a liquidating plan. 11 U.S.C. § 1123(b)(4). Bankruptcy Code Section 1123(b)(5) authorizes a plan to modify the rights of a secured creditor. 11 U.S.C. § 1123(b)(5).

- Pursuant to Bankruptcy Code Section 1123(d) a plan of reorganization may cure existing defaults, such as with executory contracts. 11 U.S.C. § 1123(d). The amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law. 11 U.S.C. § 1123(d).

II. *Bankruptcy Code Section 1124 and Impairment*

- The focus of Bankruptcy Code Section 1124 requires an examination of whether a plan of reorganization alters the legal, equitable or contractual rights of a creditor. *Acequia, Inc. v. Clinton (In re Acequia, Inc.), 787 F.2d 1352, 1363 (9th Cir. 1986). Any alteration of rights constitutes "impairment", even if a creditor's rights are enhanced. Acequia, Inc. v. Clinton (In re Acequia, Inc.), 787 F.2d 1352, 1363 (9th Cir. 1986). Congress defined "impairment" in the broadest possible sense. In re Madison Hotel Associates, 749 F.2d 410, 418 (7th Cir. 1984).*
-

- The United States Court of Appeals for the Ninth Circuit has made the following statements concerning “impairment”:

- In any event, the plain language of section 1124 says that a creditor's claim is "impaired" unless its rights are left "unaltered" by the Plan. There is no suggestion here that only alterations of a particular kind or degree can constitute impairment.

- *L & J Anaheim Associates v. Kawasaki Leasing International, Inc. (In re L & J Anaheim Associates), 995 F.2d 940, 943 (9th Cir. 1993).*

- An important case involving "impairment" is *L & J Anaheim Associates v. Kawasaki Leasing International, Inc. (In re L & J Anaheim Associates), 995 F.2d 940 (9th Cir. 1993). There, the secured creditor proposed a plan of reorganization. The secured creditor's vote in favor of its plan brought into plan the "cram down" provisions of Bankruptcy Code Section 1129(b). The bankruptcy court confirmed the plan of reorganization. The Ninth Circuit Court of Appeals affirmed the confirmation of the plan of reorganization.*

- The Court of Appeals ruled that the secured creditor was impaired, and it stated:

- Under the loan agreements executed by the parties, Kawasaki was privileged to exercise "all rights and remedies" available to a secured party under the California Uniform Commercial Code once L & J defaulted on its repayment obligations. This was a contractual right for which Kawasaki bargained in exchange for extending financing to L & J. The Plan did away with this right--it left Kawasaki no opportunity to invoke the substantive remedies or procedural mechanisms available to it at state law. Instead, the Plan required that Kawasaki's collateral (the hotel and the lawsuit) be sold at public auction under procedures mandated by federal bankruptcy law. The Plan thus altered Kawasaki's prepetition contract rights, leaving it impaired within the meaning of the Code. See *In re Distrigas Corp., 66 B.R. 382, 384 (Bankr.D.Mass.1986) (claim deemed impaired under plan providing for rejection of contract and resolution of damages under provisions of Bankruptcy Code because it deprived creditor of contractually guaranteed right to arbitrate all contract disputes). As our analysis above makes clear, we have no occasion to ask whether Kawasaki's rights were effectively enhanced or diminished under the Plan; our inquiry ends with the conclusion that those rights were changed.*

- *Id. at 943.*

- Another pertinent case is *In re Atlantic Terrace Apartment Corp., 226 B.R. 535 (Bankr.* E.D.N.Y. 1998). There, the secured creditor filed a plan of reorganization under which it was impaired. The debtor objected, and it contended that the secured creditor was not impaired. An auction sale was conducted under which the secured creditor was the successful bidder.
- The court stated:

- We disagree with Debtor and find that Flatiron is impaired. Flatiron's claim has been altered as it will not be receiving the value of its claim. Its claim arose from an investment transaction-cash for a mortgage note. Now, Flatiron is receiving a deed for its claim. If Flatiron received the cash value of its claim it would be in a position to turn around and invest again. Now, when Flatiron turns around, it will be a landowner. To find that Flatiron is not impaired would send a message that all secured creditors who receive anything other than their bargained for investment, could be elevated to a better position than they were before the bankruptcy filing.

- *Id. at 538.*

- The United States Court of Appeals for the Eighth Circuit has ruled that for purposes of Bankruptcy Code Section 1129(a)(10) a claim is not impaired if the alteration of rights arises solely from a debtor's exercise of discretion. *Windsor on the River Associates, Ltd. v. Balcor Real Estate Finance, Inc. (In re Windsor on the River Associates, Ltd.), 7 F.3d 127, 132-33 (8th Cir. 1993).*

- The United States Court of Appeals for the Fifth Circuit has adopted the Ninth Circuit Court of Appeals strict interpretation of "impairment", and it has rejected the Eighth Circuit Court of Appeals discretionary interpretation of "impairment." The Fifth Circuit has stated:

- Today, we expressly reject Windsor and join the Ninth Circuit in holding that § 1129(a)(10) does not distinguish between discretionary and economically driven impairment. As the Windsor court itself acknowledged, § 1124 provides that " any alteration of a creditor's rights, no matter how minor, constitutes ' impairment.' " By shoehorning a motive inquiry and materiality requirement into § 1129(a)(10), Windsor warps the text of the Code, requiring a court to " deem" a claim unimpaired for purposes of § 1129(a)(10) even though it plainly qualifies as impaired under § 1124. Windsor 's motive inquiry is also inconsistent with § 1123(b)(1), which provides that a plan proponent " may impair or leave unimpaired any class of claims," and does not contain any indication that impairment must be driven by economic motives. (Footnotes omitted).

- *Id. at 245-46.*

- The Fifth and Ninth Circuit's interpretation of the concept of impairment is correct. The concept of impairment is focused on the alteration of rights. If the improvement or dissipation of rights that constitutes impairment.

III. *Artificial Impairment*

- Artificial impairment occurs when a plan imposes an insignificant or *de minimis impairment on a class of claims to qualify those claims as impaired pursuant to Bankruptcy Code Section 1124. In re Combustion Eng'g, Inc., 391 F.3d 190, 243 (3d Cir.2004). When a debtor can demonstrate a legitimate business purpose for impairing a class, then the class is not deemed artificially impaired. In re RAMZ Real Estate Co., LLC, 510 B.R. 712, 717 (Bankr. S.D.N.Y. 2014).*

- One court has made the following comments concerning artificial impairment:

- Artificial impairment usually refers to " [t]he manipulation of classes of claims in order to artificially create an accepting class of impaired claims." In some cases, " artificial impairment" is used to describe a debtor's proposal to separate classes of claims/ creditors who otherwise could have been grouped into one class, purely for the purpose of creating an accepting class to support the Chapter 11 plan. The Sixth Circuit has actually referred to this scenario as " artificial classification" and ruled that it is not permissible under the Code. (Footnote omitted).

- *Federal National Mortgage Association v. Village Green I, GP, 483 B.R. 807, 814-15 (Bankr.*W.D.Tenn. 2012).

- The majority position is that artificial impairment is antithetical to the Bankruptcy Code Section 1129(a)(10). E.g., *Windsor on the River Associates, Ltd. v. Balcor Real Estate Finance, Inc. (In re Windsor on the River Associates, Ltd.), 7 F.3d 127, 132 (8th Cir. 1993); Federal National Mortgage Association v. Village Green I, GP, 483 B.R. 807, 814-15 (Bankr. W.D.Tenn. 2012); In re RYYZ, LLC, 490 B.R. 29, 43 (Bankr. E.D.N.Y. 2013).*

- In *In re All Land Investments, LLC, 468 B.R. 676 (Bankr. D. Del. 2012) was a single asset real estate case. The debtor attempted to "cram down" the plan of reorganization over the objection of the secured creditor. The bankruptcy court denied confirmation of the debtor's plan because of "artificial impairment." The court stated:*

- The Debtor has not provided any evidence of a valid business purpose for " impairing" the Class 1 and Class 3 claims. Together, the circumstances indicate that Classes 1 and 3 are impaired solely to obtain the requisite vote to permit confirmation by cram down.

- 468 B.R. 691.

- The other position is that "artificial impairment" is not expressly prohibited by the Bankruptcy Code. *See, In re Swartville, LLC, Case No. 11-08676 (SWH) (Bankr. E.D.N.C. August 17, 2012). Rather, the issue of "artificial impairment" calls into direct question the issue of good faith and Bankruptcy Code Section 1129(a)(3). Connecticut General Life Ins. Co. v. Hotel Associates of Tuscon (In re Hotel Associates of Tucson), 165 B.R. 470, 475 (Bankr. 9th Cir. 1994); In re Quigley Co., Inc., 437 B.R. 102, 125-26 (Bankr. S.D.N.Y. 2010).*

- The Ninth Circuit Court of Appeals has stated:

- L & J, citing no authority, contends that the general rule should not apply where it is used abusively, as where the plan proponent enhances its own position, then attempts to use this fact to show impairment and so cram down the rest of the creditors. We believe, however, that abuses on the part of a plan proponent ought not affect the application of Congress's definition of impairment. The bankruptcy court can and should address such abuses by denying confirmation on the grounds that the plan has not been "proposed in good faith." 11 U.S.C. § 1129(a)(3).

- *L & J Anaheim Associates v. Kawasaki Leasing International, Inc. (In re L & J Anaheim Associates), 995 F.2d 940, 943 n. 2 (9th Cir. 1993).*

- In *In re Swartville, LLC, Case No. 11-08676 (SWH) (Bankr. E.D.N.C. August 17, 2012) was a single asset real estate case. The secured creditor had a secured claim and an undefined deficiency claim. The secured creditor had a secured claim of $1,624,530. The unsecured creditor class was small and was not to be paid within sixty days after the effective date of the plan. There was only one unsecured creditor that voted for the plan, and it had a claim of $1,170.00. The court denied confirmation because the creditor class designation violated the good faith provision of Bankruptcy Code Section 1129(a)(3). Swartville is reflective of the problems that a debtor can have in confirming a single asset real estate case when a secured creditor has a large deficiency claim.*

III. *Gerrymandering and Bankruptcy Code Section 1122*

- A debtor in a single asset real estate case might find it difficult to confirm a plan of reorganization because it could be impossible to obtain one impaired class of creditors voting in favor of the plan of reorganization. This is because the secured creditor's unsecured deficiency claim dominates the unsecured creditors. Under these circumstances, a debtor might attempt to gerrymander the classes of unsecured creditors to obtain one class of impaired creditors that approves of the plan of reorganization.

- Gerrymandering of creditor classes is with a few exceptions is disapproved of practice. *Barakat v. The Life Insurance Co. of Virginia (In re Barakat), 99 F.3d 1520, 1524-26 (9th Cir. 1996); Boston Post Road Ltd. Partnership v. Federal Deposit Insurance Corp. (Boston Post Road Ltd. Partnership), 21 F.3d 477 (2nd Cir. 1994); Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture), 995 F.2d 1274, 1278-82 (5th Cir. 1991); Creditors Committee v. Route 37 Business Park Associates, 987 F.2d 154, 159-61 (3rd Cir. 1993); Lumber Exchange Building Ltd. Partnership v. The Mutual Life Insurance Co. of New York (In re Lumber Exchange Building Ltd. Partnership), 968 F.2d 647, 649-50 (8th Cir. 1992); Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Porperties, XVIII), 961 F.2d 496, 502 (4th Cir. 1992); Olympia & York Florida Equity Corp. v. The Bank of New York (In re Holywell Corp.), 913 F.2d 873, 880 (11th Cir. 1990); In re U.S. Truck Co., 800 F2d 581, 586 (6th Cir. 1986).*

- The United States Court of Appeals for the Fifth Circuit has made the following comments concerning gerrymandering:

- Those courts did not, however, adhere to the one clear rule that emerges from otherwise muddled caselaw on § 1122 claims classification: thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan.

- *Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture), 995 F.2d 1274, 1279 (5th Cir. 1991).*

- The United States Court of Appeals for the Sixth Circuit has the following statements concerning the need for the anti-gerrymandering rule:

- Unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out of a few impaired creditors (or even one such creditor) who eill vote for the plan and placing them in their own class.

- *In re U.S. Truck Co., 800 F.2d 581, 586 (6th Cir. 1986).*

- A pertinent case that involves a single asset real estate case is *Lumber Exchange Building Ltd. Partnership v. The Mutual Life Insurance Co. of New York (In re Lumber Exchange Building Ltd. Partnership), 968 F.2d 647 (8th Cir. 1992). There, the secured creditor was owed more than $20,000,000.00. The debtor valued the real property at $7,000,000.00. The secured creditor had an unsecured deficiency claim of $13,877,504.64. Other unsecured claims against the debtor totaled $1,000,000.00. The debtor proposed to place the secured creditor's unsecured deficiency claim in a separate class.*

- The Eighth Circuit Court of Appeals reasoned that the debtor's proposed plan was a blatant attempt to gerrymander approval of its plan, which is a violation of Bankruptcy Code Section 1122. The manner in which the undersecured creditor and the trade creditor obtain their claims does not provide a basis for separate classification of the claims. There was no practical reason justifying the separate classification because the amount of trade debt was minimal compared to the unsecured deficiency. There was no valid reason as to why all the unsecured claims could not be classified together and provided the same treatment.

- A case in which separate classification was permitted was *In re Woodbrook Associates, 19 F.3d 312 (7th Cir. 1994). There, the debtor, a partnership, proposed a plan of reorganization under which HUD's deficiency claim was separately classified from the other unsecured claims.* The bankruptcy court denied confirmation and dismissed the Chapter 11 case. The district court affirmed the bankruptcy court. The Seventh Circuit affirmed the dismissal of the Chapter 11 case. In its opinion the Seventh Circuit Court of Appeals held that because of Bankruptcy Code Section 1111(b) that separate classification of a deficiency claim was permissible. The court stated:
-

- The drafters of the Bankruptcy Code did not intend these results. We find that, at least where the debtor is a partnership comprised of a fully encumbered single asset, the legal rights of a Sec. 1111(b) claimant are substantially different from those of a general unsecured claimant. Accordingly, we hold that Secs. 1111(b) and 1122(a) not only permit but require separate classification of HUD's Sec. 1111(b) unsecured deficiency claim in Class 4. Woodbrook's separate classification of HUD's Sec. 1111(b) claim neither prevents confirmation of Woodbrook's plan nor serves as conclusive evidence in this case that Woodbrook manipulated the plan to obtain an affirmative vote.
- *Id. at 319.*

- It should be noted that separate treatment because of Bankruptcy Code Section 1111(b) has been rejected by various Courts of Appeal. *E.g., Barakat v. The Life Insurance Co. of Virginia (In re Barakat), 99 F.3d 1520, 1524-26 (9th Cir. 1996); Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture), 995 F.2d 1274, 1279-80 (5th Cir. 1991); Lumber Exchange Building Ltd. Partnership v. The Mutual Life Insurance Co. of New York (In re Lumber Exchange Building Ltd. Partnership), 968 F.2d 647, 649 (8th Cir. 1992).*

- In rejecting the argument that Bankruptcy Code Section 1111(b) does not provide a basis for separate classification the Fifth Circuit Court of Appeals ha stated:

- The purpose of § 1111(b) is to provide an undersecured creditor an election with respect to the treatment of its deficiency claim. Generally, the creditor may elect recourse status and obtain the right to vote in the unsecured class, or it may elect to forego recourse to gain an allowed secured claim for the entire amount of the debt. If separate classification of unsecured deficiency claims arising from non-recourse debt were permitted solely on the ground that the claim is non-recourse under state law, the right to vote in the unsecured class would be meaningless. Plan proponents could effectively disenfranchise the holders of such claims by placing them in a separate class and confirming the plan over their objection by cramdown. With its unsecured voting rights effectively eliminated, the electing creditor's ability to negotiate a satisfactory settlement of either its secured or unsecured claims would be seriously undercut. It seems likely that the creditor would often have to "elect" to take an allowed secured claim under § 1111(b)(2) in the hope that the value of the collateral would increase after the case is closed. Thus, the election under § 1111(b) would be essentially meaningless. We believe Congress did not intend this result. (Footnote omitted).

- *Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture), 995 F.2d 1274, 1279-80 (5th Cir. 1991).*

- Another pertinent case is *Steelcase, Inc. v. Johnston (In re Johnston), 21 F.3d 323 (9th Cir. 1994). There, the Ninth Circuit Court of Appeals held that a creditor could be placed in a separate class because of the nature of its claim was different. The creditor was partially secured and involved in pending litigation with the debtor. The court stated:*
-

- Steelcase does not dispute that its claim, unlike all others, is partially secured by collateral of COS, the primary obligor. Steelcase must also concede that it, unlike all other unsecured creditors, is embroiled in litigation with Johnston, and that its claim thus may be offset or exceeded by Johnston's own claim against Steelcase. Steelcase cannot deny the possibility, if not necessarily the probability, that, if successful in the litigation, it could be paid in full before all other unsecured creditors. Under these circumstances, the bankruptcy court was not clearly erroneous in concluding that Steelcase's claim is distinguishable from Class 19, Class 20, and Class 22 claims.

- *Id. at 328.*

- In *Wells Fargo Bank, N.A. v. Loop 76, LLC (In re Loop 76, LLC), 465 B.R. 525 (Bankr. 9th Cir. 2012) the Bankruptcy Appellate Panel for the Ninth Circuit extended the Ninth Circuit's holding in Johnston, and it ruled that a bankruptcy court could consider the existence of a personal guarantee in determining whether to separately classify a claim. The Bankruptcy Appellate Panel stated:*
-

- Here, we have an undersecured creditor who has a third-party source of recovery for its deficiency claim, the guarantors, whom it has already sued. Even if Loop 76 makes the 10% payment on the claim, Wells Fargo can still proceed to collect its entire debt from the guarantors. This is clearly a " special circumstance" that does not apply to any other unsecured claimants and accords Wells Fargo a different status. *In re Barakat, 99 F.3d at 1526; In re Johnston, 21 F.3d at 328. Contrary to Wells Fargo's argument, we see no legal distinction between whether the claimant can recover against collateral held by a third party, or whether the claimant can recover from a third-party guarantor, when determining the similarity of the claims. See Principal Mutual Life Ins. Co. v. Baldwin Park Towne Ctr., Ltd. (In re Baldwin Park Towne Ctr., Ltd.), 171 B.R. 374, 377 (Bankr.C.D.Cal. 1994) (citing In re Johnston and finding that an unsecured deficiency claim was not of the same " species" and dissimilar to the unsecured trade claims because, inter alia, the trade claimants could pursue the general partner for recovery).*

- *Id. at 541.*

- It should be noted that the majority position that the existence of a personal guarantee does not warrant the separate classification of a creditor's claim. *In re 18 RVC, LLC, 485 B.R.* 492, 497 (Bankr. E.D.N.Y. 2012). Judge Grossman has stated:

- The majority of courts that have considered this issue have held that the existence of a personal guarantee, alone, is not a sufficient basis to find that an unsecured deficiency claim is not substantially similar to other unsecured creditors. *See, e.g., In re AOV Indus., Inc., 792 F.2d 1140, 1150-51 (D.C.Cir.1986) (" The existence of a third-party guarantor does not change the nature of a claim vis-a-vis the bankrupt estate and, therefore, is irrelevant to a determination of whether claims are ' substantially similar' for classification purposes."); In re 4th Street East Investors, Inc., 2012 WL 1745500 at *4-5 (Bankr.C.D.Cal. May 15, 2012) (declining to follow Loop and finding non-debtor guarantor to be an insufficient basis to separately classify unsecured claims); In re 500 Fifth Ave. Assocs., 148 B.R. 1010, 1019 (Bankr.S.D.N.Y.1993), aff'd, 1993 WL 316183 (S.D.N.Y. May 21, 1993) (a right of recourse against the debtor's general partners did not justify separate classification); In re Thornwood Associates, 161 B.R. 367, 372 (Bankr.M.D.Pa.1993) (" The fact that [a creditor] holds a personal guarantee outside of bankruptcy is not relevant to the claim classification inquiry in the Chapter 11 context.").*

- *In re 18 RVC, LLC, 485 B.R. 492, 497 (Bankr. E.D.N.Y. 2012).*

Bankruptcy Code Section 1125 and the Solicitation of Acceptances in a Chapter 11 Case

Copyright 2015 Carlos J. Cuevas

- Bankruptcy Code Section 1125(b) regulates when a party in interest may solicit acceptances concerning a plan of reorganization. 11 U.S.C. § 1125(b). Bankruptcy Code Section 1125(b) states:

- An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information. The court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets.

- 11 U.S.C. § 1125(b).

- Prior to disseminating a disclosure statement a party in interest must obtain approval from the Bankruptcy Court. 11 U.S.C. § 1125(b).

- Adequate information is defined in Bankruptcy Code Section 1125(a)(1), and it states:

- "adequate information" means 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, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to

- make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan and in determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information;

- 11 U.S.C. § 1125(a). The issue of adequate information is adjudicated on a case by case basis. *In re Applegate Property, Ltd., 133 B.R. 827, 829 (Bankr. W.D.Tex. 1991).*

- In order to ascertain whether a disclosure statement contains "adequate information" a Bankruptcy Court uses the *Metrocraft factors. In re Metrocraft Pub. Services, Inc., 39 B.R. 567, 568 (Bankr.N.D.Ga. 1984). The following are the Metrocraft factors:*

- Relevant factors for evaluating the adequacy of a disclosure statement may include: (1) the events which led to the filing of a bankruptcy petition; (2) a description of the available assets and their value; (3) the anticipated future of the company; (4) the source of information stated in the disclosure statement; (5) a disclaimer; (6) the present condition of the debtor while in Chapter 11; (7) the scheduled claims; (8) the estimated return to creditors under a Chapter 7 liquidation; (9) the accounting method utilized to produce financial information and the name of the accountants responsible for such information; (10) the future management of the debtor; (11) the Chapter 11 plan

- or a summary thereof; (12) the estimated administrative expenses, including attorneys' and accountants' fees; (13) the collectibility of accounts receivable; (14) financial information, data, valuations or projections relevant to the creditors' decision to accept or reject the Chapter 11 plan; (15) information relevant to the risks posed to creditors under the plan; (16) the actual or projected realizable value from recovery of preferential or otherwise voidable transfers; (17) litigation likely to arise in a nonbankruptcy context; (18) tax attributes of the debtor; and (19) the relationship of the debtor with affiliates.

- *In re Metrocraft Pub. Services, Inc., 39 B.R. 567, 568 (Bankr.N.D.Ga. 1984).*

- The first *Metrocraft factor is intended to give the Bankruptcy Court and the parties in interest background as to why it was necessary for the debtor to file for Chapter 11. Understanding the problem that caused the filing will enable the Bankruptcy Judge and the parties to determine whether the debtor has been rehabilitated.*

- The second *Metrocraft factor is intended to provide the Bankruptcy Court and the parties in interest information to enable them to determine whether the debtor should be liquidated or whether there is a going concern value that should be preserved for the creditors.*

- The third *Metrocraft factor is intended to provide the Bankruptcy Court and parties in interest information concerning the future of the debtor. Is this a viable business plan? In this current economic environment does the debtor's future business make sense?*

- The fourth *Metrocraft factor is intended to provide the Bankruptcy Court and parties in interest information concerning the source of the information for the disclosure statement. Is the source of the information a convicted felon?*

- The fifth *Metrocraft factor is a disclaimer stating that the Bankruptcy Court does not take a position on the merits of the plan of reorganization.*

- The sixth *Metrocraft factor is a description of the debtor's performance while in Chapter 11. This is a financial analysis of the debtor's profitability. Has the debtor earned a profit in Chapter 11? Also pertinent is the restructuring that the debtor has conducted in Chapter 11. Has the debtor downsized? Has the debtor rejected burdensome leases?*

- The seventh *Metrocrafti factor is a listing of the scheduled claims. How much does the debtor owe to its creditors? Based on the scheduled debt is a plan of reorganization confirmable?*
-

- The eighth *Metrocraft factor is a liquidation analysis. In order to obtain confirmation of a plan of reorganization a debtor must demonstrate that the unsecured creditors will receive more under the plan than in a Chapter 7 liquidation. If the creditors will receive a greater distribution in a Chapter 7 case, then they should reject the plan of reorganization.*

- The ninth *Metrocrafti factor is the accounting method used in the disclosure statement. What is the true cash performance of this debtor in Chapter 11?*
- The tenth *Metrocrafti factor is the future management of the company. Has the debtor purged itself of incompetent or fraudulent management? Is the management team competent to lead this debtor?*

- The eleventh *Metrocrafti factor is a summary of the plan of reorganization. What are the distributions to creditors? How is the plan of reorganization going to be effectuated?*
-

- The twelfth *Metrocraft factor is the administrative debt in the case. Can the debtor pay its administrative creditors on confirmation? If the debtor has huge administrative debt it might not be able to confirm its plan of reorganization. Has the debtor performed poorly and accumulated unpaid post-petition taxes?*

- The thirteenth *Metrocraft factor is the "the collectibility of accounts receivable." Are the debtor's accounts receivable an illusion? How old are the accounts?
-

- The fourteenth *Metrocraft factor is the financial information, data, valuations or projections relevant to the creditors' decision to accept or reject the Chapter 11 plan. In order to assess a debtor's performance in Chapter 11 it is vital to have accurate financial data of the debtor's performance in Chapter 11. If the plan of reorganization envisions a payment plan over a few or several years it is critical to have projections. The financial information is important to assess the feasibility of a debtor's plan of reorganization.*

- The fifteenth *Metrocraft factor is the risks associated with the plan of reorganization. What are the risks associated with the plan of reorganization? Is the plan of reorganization speculative? Is the plan of reorganization feasible?*

- The sixteenth *Metrocraft factor requires the plan proponent to discuss the recovery of preferences, fraudulent conveyances, and other possible causes of action. If there is the potential recovery of a major fraudulent conveyance, then, under the absolute priority rule, the unsecured creditors are entitled to receive the proceeds of this type of litigation.*

- The seventeenth *Metrocraft factor is litigation in a nonbankruptcy context. Are there any post-petition claims against the debtor? Does the debtor have any claims that it can pursue against its former management?*
- The eighteenth *Metrocraft factor is the tax attribute of the debtor. Does the debtor have any loss carry forwards? Having loss carry forwards will reduce a debtor's tax liability and make it more profitable in the future.*

- The nineteenth *Metrocraft factor is the debtor's relationship with its affiliates. Has the debtor down streamed money to its affiliates such that the debtor has major claims against affiliates? A debtor's claims against its affiliates has to be disclosed.*

- The *Metrocraft factors are applied by bankruptcy courts to determine the adequacy of disclosure statements. E.g., In re Coastal Realty Investments, Inc., Case No. 12-20564 (Bankr. S.D.Ga. January 17, 2013); In re Pacific Shores Development, Inc., Case No. 10-11351MM-11*(Bankr. S.D.Cal. Feb. 25, 2011); *In re Scioto Valley Mortg. Co., 88 B.R. 168 (Bankr. S.D.Ohio 1988).*

- In *In re Pacific Shores Development, Inc., Case No. 10-11351MM-11 (Bankr. S.D. Cal.* Feb. 25, 2011) the court denied approval of a disclosure statement. The bankruptcy court ruled debtor's disclosure statement inadequate in that it contained inaccurate and misleading statements regarding the securities exemptions, and provided insufficient detail regarding the tax consequences of, and claims to be paid under debtor's plan of reorganization.

- In *In re Scioto Valley Mortg. Co., 88 B.R. 168 (Bankr. S.D.Ohio 1988) the court denied*
- approval of the debtor's disclosure because of various deficiencies. The Bankruptcy Court stated:

- Obviously, it would be impossible for the Court to instruct any plan proponent as to the entire spectrum of information which should properly be included in a disclosure statement. As a starting point, however, the Court directs the Debtor to the aforementioned types of information which numerous courts have noted are most often included in a disclosure statement. The Court also refers the Debtor to the various objections filed by the parties since, for the most part, they contain valid complaints about the adequacy of the information contained in the Disclosure Statement. The use of such guideposts would appear to mandate, at a minimum, the disclosure of the following information: (1) matters pertaining to an Agreement and Note entered into by and between the Debtor

- and an entity known as Quail Marsh Partnership, including the status of the parties' relationship and the existence and collectibility of a possible account receivable from Quail Marsh Partnership; (2) a more-detailed liquidation analysis, including the potential impact upon claimholders in the event of a hypothetical Chapter 7 liquidation (particularly if the sale of partnership property were treated as an event of dissolution under the particular partnership agreements); (3) additional information concerning the status of various partnerships in which the Debtor may

- have an interest, including the nature and extent of any such interest or relationship; (4) the status of negotiations with KinderCare regarding future business opportunities of the Debtor; (5) information regarding the future ownership and management of the Debtor, including compensation to be paid to any insiders, directors, and/or officers of the Debtor; (6) all significant assets of the Debtor, including payments--whether they are periodic, lump-sum, or "balloon" payments--which the Debtor is

- entitled to receive in the future pursuant to any agreements with corporations, partnerships, individuals and other entities; (7) more detailed information concerning the Debtor's ability to make the payments proposed in the plan; (8) all accounting and valuation methods used in the preparation of the Disclosure Statement; (9) whether the Debtor can sell or alienate its interest in various partnerships, as proposed by the plan; and (10) whether the Debtor has any executory contracts it intends to assume under the plan.

- *Id. at 171-72.*

- An important case involving the interpretation of Bankruptcy Code Section 1125(b) and the concept of solicitation of acceptances for a plan of reorganization is *Century Glove, Inc. First American Bank of New York, 860 F.2d 94 (3rd 1988). There, First American Bank contacted attorneys representing other creditors and urge them to vote against the debtor's plan of reorganization. First American Bank also circulated a document that was labeled draft and was a plan of reorganization. First American Bank's document did not satisfy the requirements for a disclosure statement.*

- The bankruptcy court held that First American Bank had violated Bankruptcy Code Section 1125(b) by circulating its draft plan of reorganization, and it imposed sanctions. The district court reversed the bankruptcy court.
- The Third Circuit Court of Appeals affirmed the district court. The Third Circuit thought that the bankruptcy court had interpreted the concept of "solicitation" too broadly. The Court of Appeals stated:
-

- As the district court pointed out, allowing a bankruptcy court to regulate communications between creditors conflicts with the language of the statute. A creditor may receive information from sources other than the disclosure statement. Section 1125 itself defines "typical investor" of a particular class

- in part, as one having "such ability to obtain such information from sources other than the disclosure required by this section...." 11 U.S.C. Sec. 1125(a)(2)(C). In enacting the bankruptcy code, Congress contemplated that the creditors would be in active negotiations with the debtor over the plan. See infra, part V. The necessity of "adequate information"

- was intended to help creditors in their negotiations. See *In re Gulph Woods, 83 B.R. 339 (Bankr.E.D.Pa. 1988). Allowing the bankruptcy court to regulate communications between creditors under the guise of "adequate information" undercuts the very purpose of the statutory requirement.*
-
- *Id. at 100-01.*

- The debtor's proposed interpretation is burdensome. Every time a party sought to communicate with another party it would have to seek prior court permission. This would impede plan negotiations. The concept of "solicitation" must be read narrowly:

- We agree with the district court that "solicitation" must be read narrowly. A broad reading of Sec. 1125 can seriously inhibit free creditor negotiations. All parties agree that FAB is not barred from honestly negotiating with other creditors about its unfiled plan. "Solicitations with respect to a plan do not involve mere requests for opinions." Senate Report, 1978 U.S.C.C.A.A.N. at 5907. The purpose of negotiations between creditors is to reach a

- compromise over the terms of a tentative plan. The purpose of compromise is to win acceptance for the plan. We find no principled, predictable difference between negotiation and solicitation of future acceptances. We therefore reject any definition of solicitation which might cause creditors to limit their negotiations. (Footnote omitted).
- *Id. at 101-02.*

- Finally, the narrow interpretation of "solicitation" does not offend Bankruptcy Code Section 1121(b). If a debtor's plan is the only plan that can be discussed, then this will grant a debtor too much power in the plan negotiations.

- Another pertinent case is *In re The Heritage Organization, LLC, 376 B,R, 783 (Bankr. N.D.Tex. 2007). There, a trustee was able to negotiate a comprehensive settlement. A liquidating plan term sheet was executed under which the creditors pledged to vote the plan.* The court ruled that the pre-disclosure solicitation prohibition was inapplicable. The court noted that all of the signatories to the term sheet, except one party, are co-proponents of the plan of reorganization. The court stated:

- In other words, if a creditor believes that it has sufficient information about the case and the available alternatives to jointly propose a Chapter 11 plan with another entity (whether that co-proponent is another creditor, the debtor, or a trustee (who also believes that it has sufficient information)), it is absurd to think that the signing of a term sheet by those parties (that contains the material terms of their to-be-filed joint plan and states that the co-proponent creditor(s) will vote for their agreed upon joint plan) is an improper solicitation of votes in accordance with § 1125(b).

- *Id. at 791.*

- Another pertinent case is *In re Indianapolis Downs, LLC, 486 B.R. 286 (Bankr. D. Del. 2013). There, the debtors, a hedge fund, an ad hoc committee reached an agreement entitled the Restructuring Support Agreement ("RSA"). The RSA required the debtors to propose a plan by a specific time; required that the parties to the RSA not support a competing plan; and that the parties to the RSA vote yes for a plan that complies with the terms of the RSA. A party contended that the RSA constituted a wrongful post-petition solicitation prior to court approval of a disclosure statement.*

- The court overruled the objection. The bankruptcy court stated:

- The Court finds the analysis and reasoning in Heritage dispositive. Congress intended that creditors have the opportunity to negotiate with debtors and amongst each other; to the extent that those negotiations bear fruit, a narrow construction of " solicitation" affords these parties the opportunity to memorialize their agreements in a way that allows a Chapter 11 case to move forward.

- Designation of votes in this case would be demonstrably inconsistent with the purposes of the Bankruptcy Code for at least two reasons. First, creditor suffrage is a bedrock component of Chapter 11; it would indeed be anomalous, in the absence of a showing of bad faith or wrongful conduct, to discount or ignore the votes of the overwhelming majority of the creditors and stakeholders, and thereby deny confirmation of a Plan that has been laboriously (and expensively) developed and has won broad support.

- Second, and perhaps more to the point, the interests that § 1125 and the disclosure requirements are intended to protect are not at material risk in this case. The Code's robust disclosure requirements were designed to end the " undesirable practice ... of soliciting acceptance or rejection at a time when creditors and stockholders were too ill-informed to act capably in their own interests."

- *Id. at 295.*

- A case in which a bankruptcy court found violations of both Bankruptcy Code Sections 1121(b) and 1125(b) is *In re Clamp-All Corp., 233 B.R. 198 (Bankr. D. Mass. 1999). In Clamp-All Corp., two creditors had circulated a plan of reorganization to all of the creditors that had not been approved by the bankruptcy court during the debtor's exclusive period. The court ruled that the creditors had violated Bankruptcy Code Section 1121(b) had been violated. The court stated:*
-

- Section 1121 provides the debtor with a clear advantage early in the case. "It was intended that at the outset of a Chapter 11 case a debtor should be given the unqualified opportunity to negotiate a settlement and propose a plan of reorganization without interference from creditors and other interests." *In re Texaco, Inc., 81 B.R. 806, 809 (Bankr.S.D.N.Y.1988) (citing H.R.Rep. No. 595, 95th Cong., 2d Sess. 221-22, reprinted in 1978 U.S.C.C.A.N. 5787). The*

- *exclusivity period gives the debtor the ability to stabilize its operations and the opportunity to retain control over the reorganization process. The adoption of a limited period of exclusivity also assures speed by motivating the debtor to be more fair and reasonable in its negotiations with creditors, because the debtor knows that the bargaining leverage of exclusivity will soon end.*

- *Id. at 207.*

- The creditors also violated Bankruptcy Code Section 1125(b). Bankruptcy Code Section 1125(b) requires court approval of a disclosure statement to ensure that there is "adequate information." The creditors also violated Federal Rule of Bankruptcy Procedure 3017:

- The rule forbids sending copies of a plan and disclosure statements to any party other than those explicitly mentioned. "The Bankruptcy Code's requirement of court approval of a disclosure statement, combined with Rule 3017's restrictions on dissemination of an unapproved disclosure statement, clearly contemplates some creditors need to be protected against misinformation."

- *Id. at 208.*
-

- The court sanctioned the creditors by equitably subordinated the creditors’ claims to the claims of all the other creditors.

Bankruptcy Code Section 1126 and the Acceptance of a Plan of Reorganization

Copyright 2015

Carlos J. Cuevas

NATIONAL LAW INSTITUTE
Continuing Legal Education

I. *Acceptance of a Plan of Reorganization*

- The holder of an allowed claim is permitted to vote for a plan of reorganization. 11 U.S.C. § 1126(a). A class of claims is deemed to have accepted a plan of reorganization if at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by such creditors has voted to accept the plan of reorganization. 11 U.S.C. § 1126(c).

- A class of interests has accepted a plan if such plan has been accepted by holders of such interests if at least two-thirds in amount and more than one-half in number of the allowed interests of such class held by such interest holders has voted to accept the plan of reorganization. 11 U.S.C. § 1126(c).

- A number of courts that have considered this issue have concluded that § 1126 does not automatically exclude insider votes in determining class acceptance as long as there is one class of impaired creditors that does not contain an insider. *In re United Marine, Inc., 197 B.R. 942, 946 (Bankr. S.D.Fla. 1996)*

- *Mere insider status does not automatically disqualify a creditor from determining whether a class of claims has accepted a plan of reorganization. In re United Marine, Inc., 197 B.R. 942, 946 (Bankr. S.D.Fla. 1996); In re Gilbert, 104 B.R. 206, 212-13 (Bankr. W.D.Mo. 1989).*

- A class that is not impaired is conclusively presumed to have accepted the plan of reorganization. 11 U.S.C. § 1126(f). A class that does not receive or retain any property under the plan of reorganization is deemed to have rejected the plan of reorganization. 11 U.S.C. § 1126(g).

II. *Bankruptcy Code Section 1126(e) and Bad Faith Rejection of a Plan of Reorganization*

A. *Introduction*

- Bankruptcy Code Section 1126(e) authorizes a bankruptcy court to disregard a creditor's vote if the creditor has acted in bad faith. 11 U.S.C. § 1126(e). Bankruptcy Code Section 1126(e) states:

- On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title.

- 11 U.S.C. § 1126(e).

- Bankruptcy Code Section 1126(e) is to be used sparingly. *DISH Network Corp. v. DBSD*
- *North America, Inc. (In re DBSD North America, Inc.), 634 F.3d 79, 101-02 (2nd Cir. 2011).*
- Bankruptcy Code Section 1126(e) does not define what constitutes "good faith." *In re*
- *Bataa/Kierland, LLC, 476 B.R. 558, 564 (Bankr. D. Ariz. 2012). Bankruptcy Code Section*
- 1126(e)'s good faith test delegates to the courts the task of determining when a creditor has
- violated the boundaries of good faith. *DISH Network Corp. v. DBSD North America, Inc. (In re*
- *DBSD North America, Inc.), 634 F.3d 79, 101 (2nd Cir. 2011).*

- Bankruptcy courts are reluctant to recast a creditor's vote because a creditor is entitled to employ "enlightened self-interest" when voting on a plan of reorganization. *E.g., In re Greenwod Point, LP, 445 B.R. 885, 898-99* (Bankr. S.D.Ind. 2011). Bankruptcy Code Section 1126(e) is concerned with whether a creditor cast its vote for an ulterior motive for the purpose of securing an advantage that it was not otherwise entitled to receive. *In re Lloyd McKee Motors, Inc., 157 B.R. 487, 489 (Bankr.* D.N.M. 1993). The consequence of redesignation is that the creditor's vote is not counted to determine whether the class has accepted the plan. *In re Monticello Realty Investments, LLC, 526* B.R. 902, 909 (Bankr. M.D.Fla. 2015).

- The United States Court of Appeals for the Fourth Circuit has made the following comments concerning Bankruptcy Code Section 1126(e):

- When a plan of reorganization is submitted to the creditors of a bankrupt for approval or disapproval, votes that are not cast in "good faith" are not to be counted. Congress intentionally left "good faith" undefined. 5 *Collier on Bankruptcy paragraph 1126.05 (1988). It is well settled, however, that good faith in casting a vote does not require of the creditor a selfless disinterest. Each creditor is expected to cast his vote in accordance with his perception of his own self-interest, but he may not act with an ulterior or coercive purpose.*

- One who casts his vote with a purpose of coercing payment to him of more than he might reasonably perceive as his fair share of the debtor's estate, does not cast his vote in good faith. See, e.g., *Young v. Higbee Co., 324 U.S. 204, 211 & n. 10, 65 S.Ct. 594, 598 & N. 10, 89 L.Ed. 890 (1945); In re Featherworks Corp., 36 B.R. 460, 463 (E.D.N.Y. 1984); In re P-R Holding Corp., 147 F.2d 895, 897-98 (2d Cir.1945); 5 Collier on Bankruptcy paragraph 1126.05 (1988); see also H.R.Rep. No. 595, 95th Cong., 1st Sess. 411, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5963, 6367.*

- *Insinger Machine Co. v. Federal Support Co. (In re Federal Support Co.), 859 F.2d 17, 19*(4th Cir. 1988).

- Judge Bernstein has made the following comments concerning the "badges" of bad faith:

- Over the years, Courts have developed several badges of bad faith which may justify disqualification. They include creditor votes designed to (1) assume control of the debtor, *In re Landing Associates Ltd., 157 B.R. 791, 807-08 (Bankr.W.D.Tex.1993); In re Allegheny Int'l., Inc., 118 B.R. 282, 290 (Bankr.W.D.Pa.1990), (2) put the debtor out of business or otherwise gain a competitive advantage, In re Landing Associates Ltd., 157 B.R. at 808; In re MacLeod Co., 63 B.R. at 655-56; see In re Pine Hill Colleries, 46 F.Supp. at 672 (dictum); but cf. In re Lloyd McKee Motors, Inc., 157 B.R. at 489 (the court refused to disqualify creditors' votes against the plan, even though the creditors were defendants in a lawsuit whose success would provide the sole basis for funding the plan, and the creditors voted against the plan to frustrate the litigation), (3) destroy the debtor out of pure malice, In re*

- *Landing Associates Ltd., 157 B.R. at 808; cf. In re Marin Town Center, 142 B.R. at 379 ("Section 1126(e) does not require a creditor to have an interest in seeing the debtor reorganize"); In re Kovalchick, 175 B.R. at 875 (bad faith does not necessarily exist because the creditor has no desire to see the debtor reorganize or refuses to cooperate in the debtor's efforts to reorganize); In re Pleasant Hill Partners, L.P., 163 B.R. at 395 (subjective ill will between the debtor and its secured creditor is insufficient to establish bad faith under Section 1126(e)), or (4) obtain benefits available under a private agreement with a third party which depends on the debtor's failure to reorganize. See In re Landing Associates, 157 B.R. at 809. In addition, the Code's legislative history makes clear that the Court can designate the vote of a creditor who has a conflict of interest with the class in which it votes. (Footnote omitted).*

- *In re Dune Deck Owners Corp., 175 B.R. 839, 844-45 (Bankr. S.D.N.Y. 1995).*

- Courts have found bad faith under the following circumstances:

- (1) if the claimant is using obstructive tactics and hold-up techniques to extract better treatment for its claim compared to the treatment afforded similarly situated claimholders in the same class; or

- (2) if the holder of the claim casts its vote for the ulterior purpose of securing some advantage to which it would not otherwise be entitled; or

- (3) when the motivation behind its vote is not consistent with a creditor's protection of its own self-interest. (Footnote omitted).

- *In re Adelphia Communications Corp., 359 B.R. 54, 60 (Bankr. S.D.N.Y. 2006).*

- B. *Cases Denying 1126(e) Motions*
- A pertinent case involving Bankruptcy Code Section 1126(e) is *Figter Ltd. v. Teachers Ins. and Annuity Association of America (In re Figter Ltd), 118 F.3d 635 (9th Cir. 1997). There, the secured creditor in the case purchased twenty-one unsecured claims so that it vote each claim separately and block the debtor's plan of reorganization. The debtor had proposed a plan of reorganization under which its apartment building would be converted into condominiums. The secured creditor opposed the debtor's plan of reorganization, and the secured creditor proposed its own plan of reorganization.*

- The Ninth Circuit Court of Appeals held that the secured creditor acted in good faith. The court stated:

- Thus, if Teachers acted out of enlightened self interest, it is not to be condemned simply because it frustrated Figter's desires. That is true, even if Teachers purchased Class 3 claims for the very purpose of blocking confirmation of Figter's proposed plan. See *255 Park Plaza Assocs. Ltd. Partnership v. Connecticut General Life Ins. Co. (In re 255 Park Plaza Assocs. Ltd. Partnership), 100 F.3d 1214, 1218-19 (6th Cir.1996). That self interest can extend even further without being an ulterior motive. It has been held that a creditor commits no wrong when he votes against a plan of a debtor who has a lawsuit pending against the creditor, for that will not, by itself, show bad*

- *faith. See Federal Support Co., 859 F.2d at 20; see also In re A.D.W., Inc., 90 B.R. 645, 651 (Bankr.D.N.J.1988); In re Landau Boat Co., 8 B.R. 432, 436 (Bankr.W.D.Mo.1981). It has also been held that no bad faith is shown when a creditor chooses to benefit his interest as a creditor as opposed to some unrelated interest. See In re Landing Assocs., Ltd., 157 B.R. 791, 803 (Bankr.W.D.Tex.1993); In re Peter Thompson Assocs., Inc., 155 B.R. 20, 22 (Bankr.D.N.H.1993). And the mere fact that a creditor has purchased additional claims for the purpose of protecting his own existing claim does not demonstrate bad faith or an ulterior motive. "As long as a creditor acts to preserve what he reasonably perceives as his fair share of the debtor's estate, bad faith will not be attributed to his purchase of claims to control a class vote." In re Gilbert, 104 B.R. 206, 217 (Bankr.W.D.Mo.1989).*

- *Id. at 639.*

- Another pertinent case is *255 Park Plaza Associates Ltd. Partnership v. Connecticut General Life Insurance Co. (In re 255 Park Plaza Associates Ltd. Partnership), 100 F.3d 1214 (6th Cir. 1996). There, the court dismissed the appeal for lack of appellate jurisdiction. Nonetheless, the Sixth Circuit Court of Appeals discussed Bankruptcy Code Section 1126(e) as applied to the facts of the case. The debtor filed a plan of reorganization.*

- *The secured creditor filed a liquidating plan of reorganization that contemplated the sale of the debtor's real property. In the process the secured creditor purchased all but one of the non-insider unsecured claims. The bankruptcy court confirmed the secured creditor's plan of reorganization.*

- In its opinion the Sixth Circuit Court of Appeals stated that the secured creditor did not violate Bankruptcy Code Section 1126(e). The court stated:

- Appellants' first argument, that a plan proponent cannot also purchase claims of creditors, is meritless. Nothing in the Bankruptcy Code or the case law suggests such a rule. While a plan-proponent's purchase of votes may shed light on that proponent's motive, whether bad faith exists can only be decided after an analysis of the facts of each case. In this case, Connecticut General's actions do not fall within any of the above-mentioned bad-faith definitions. Connecticut General certainly did not take advantage of other creditors, since it offered to purchase for full value the claims of all non-insider unsecured creditors. Furthermore, there is no indication that it received more than its fair share from the sale of the property. In fact, while other creditors were paid the full value of their claims, Connecticut General was not.

- Presumably forced to concede the non-applicability of the cases that focus on the unfair treatment of creditors, appellants instead argue that Connecticut General possessed an ulterior motive, either to take over Debtor, or simply to destroy Debtor at any cost. While Connecticut General did purchase the property in question at an auction, there is absolutely no indication that Connecticut General plans to enter the real-estate rental market in Birmingham, Michigan. There is also little merit to appellants' argument that Connecticut General wanted to destroy Debtor at any cost. Connecticut General did not contest the minute details of Debtor's plan in an attempt to prolong the bankruptcy process. Rather, it acquired the claims of Debtor's creditors and voted those claims against Debtor's plan, while proposing a plan of its own. Simply put, Connecticut General's actions in this case did not amount to bad faith.

- *Id. at 1219.*

C. *Cases Finding Bad Faith*

- In *DISH Network Corp. v. DBSD North America, Inc. (In re DBSD North America, Inc.),* 634 F.3d 79 (2nd Cir. 2011) the Second Circuit affirmed the redesignation of the appellant's vote. The Second Circuit thought that record supported the findings of bad faith. The court stated:

- Although we express no view on the correctness of the specific findings of bad faith of the parties in those specific cases, we think that this case fits in the general constellation they form. As the bankruptcy court found, DISH, as an indirect competitor of DBSD and part-owner of a direct competitor, bought a blocking position in (and in fact the entirety of) a class of claims, after a plan had been proposed, with the intention not to maximize its return on the debt but to enter a strategic transaction with DBSD and " to use status as a creditor to provide advantages over proposing a plan as an outsider, or making a traditional bid for the company or its assets." DBSD II, 421 B.R. at 139-40. In effect, DISH purchased the claims as votes it could use as levers to bend the bankruptcy process toward its own strategic objective of acquiring DBSD's spectrum rights, not toward protecting its claim.

- We conclude that the bankruptcy court permissibly designated DISH's vote based on the facts above. This case echoes the Waco case that motivated Congress to impose the good faith requirement in the first place. In that case, a competitor bought claims with the intent of voting against any plan that did not give it a lease in or management of the debtor's property. 87 F.2d at 397-99. In this case, a competitor bought claims with the intent of voting against any plan that did not give it a strategic interest in the reorganized company. The purchasing party in both cases was less interested in maximizing the return on its claim than in diverting the progress of the proceedings to achieve an outside benefit. In 1936, no authority allowed disregarding votes in such a situation, but Congress created that authority two years later with cases like Waco in mind. We therefore hold that a court may designate a creditor's vote in these circumstances.

- We also find that, just as the law supports the bankruptcy court's legal conclusion, so the evidence supports its relevant factual findings. DISH's motive — the most controversial finding— is evinced by DISH's own admissions in court, by its position as a competitor to DBSD, by its willingness to overpay for the claims it bought, by its attempt to propose its own plan, and especially by its internal communications, which, although addressing the Second Lien Debt rather than the First Lien Debt at issue here, nevertheless showed a desire to " to obtain a blocking position" and " control the bankruptcy process for this potentially strategic asset." (Footnotes omitted).

- *Id. at 104-05.*

- In In *In re Allegheny Intern., Inc., 118 B.R. 282 (Bankr. W.D.Pa. 1990) the bankruptcy court held that Japonica Partners had acted in bad faith, and its claims should be redesignated. Japonica Partners purchased claims in order to block the debtor's plan of reorganization and to takeover the debtor's business.*

- The court stated:
- Under chapter 11, creditors and interest holders vote for or against a plan of reorganization, after adequate disclosure, if such vote is in their best economic interests. If, as in the instant case, an outsider to the process can purchase a blocking position, those creditors and interest holders are disenfranchised. If competing plans of reorganization are pending, the court must consider the preferences of the creditors and interest holders. If a plan proponent, such as Japonica, can purchase a blocking position, the votes of the other creditors and interest holders are rendered meaningless. Moreover, Japonica, who chose to become a creditor, should not have veto control over the reorganization process. The court does not believe that such a result was intended by Congress. Therefore, for all of the reasons stated above, the court designates the votes of Japonica pursuant to 11 U.S.C. § 1126(e) in Class 2.AI.2 and Class 4.AI.2.
- *Id. at 290.*

Bankruptcy Code Section 1127 and Modification of a Plan of Reorganization

Carlos J. Cuevas Copyright 2015

I. *Bankruptcy Code Section 1127(a)*

- Bankruptcy Code Section 1127(a) permits a proponent of a plan of reorganization to modify a plan of reorganization at any time before confirmation, but may not modify such plan of reorganization so that such plan as modified fails to meet the requirements of sections 1122 and 1123 of this title. 11 U.S.C. § 1127(a). The proponent of a modification has to comply with Bankruptcy Code Section 1125. 11 U.S.C. § 1127(c).

II. *Bankruptcy Code Section 1127(b) and Substantial Consummation*

A. *Introduction*

- Bankruptcy Code Section 1127(b) authorizes a proponent of a plan or the reorganized debtor to modify such plan of reorganization at any time after confirmation of such plan and before substantial consummation of such plan, but may not modify such plan so that such plan as modified fails to meet the requirements of sections 1122 and 1123 of this title. 11 U.S.C. § 1127(b).

- Bankruptcy Code Section 1101(2) defines substantial consummation as the following:
- (2) "substantial consummation" means-
- (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 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.
- 11 U.S.C. § 1101(2).

- All three requirements of Bankruptcy Code Section 1102 must be met for there to be

  a finding of substantial consummation. *In re H & L Developers, Inc., 178 B.R. 77, 80 (Bankr. E.D.Pa. 1994). The burden is on the plan proponent to demonstrate that substantial modification has not occurred. In re H & L Developers, Inc., 178 B.R. 77, 80 (Bankr. E.D.Pa. 1994).*

- The following statements have been made as to what constitutes a “modification”:

- The Bankruptcy Code does not define the term " modification." Instead, " courts determine what constitutes a ‘ modification’ on a case-by-case basis." *In re Boylan Int'l, Ltd., 452 B.R. 43, 47 (Bankr.S.D.N.Y. 2011) (citing 7 Collier on Bankruptcy ¶ 1127.03 (16th ed. rev. 2011)). Some find modifications when changes to a plan alter " the legal relationships among the debtor and its creditors." In re Ionosphere Clubs, Inc., 208 B.R. 812, 816 (S.D.N.Y.1997). Others see modifications only where provisions of a plan are violated or removed. See Hawkins v. Chapter 11 Trustee, No. 6:07-cv-0766 (LEK), 2009 WL 701115, at *3 (N.D.N.Y. Mar. 13, 2009) (reversing as an impermissible modification the bankruptcy court's approval of a lump sum payment instead of conveyance of a percentage of the bankruptcy estate as provided by the confirmed plan); see also In re U.S. Brass Corp., 301 F.3d 296, 307 (5th Cir.2002) (finding substitution of arbitration of claims in place of litigation to be a modification). Still others look instead to whether the change is major or minor, and whether it is one of substance or procedure. See In re Joint E. & S. Dist. Asbestos Litig., 982 F.2d 721, 747-48 (2d Cir.1992) (finding that " significant changes of substance" as opposed to " minor changes of procedure" constitute modifications).*

- *McCray v. Barnett (In re Sea Island Co.), 486 B.R. 559, 570 (S.D.Ga. 2013).*

- Under Bankruptcy Code Section 1127(b) prohibits a plan proponent or the reorganized debtor from modifying a plan of reorganization once substantial consummation has occurred.
- *In re AT of Maine, Inc., 56 B.R. 55, 57 (Bankr. D. Me. 1985). Once a distribution has occurred pursuant to a plan of reorganization, then a court will find that substantial consummation has occurred. In re United States Brass Corp., 255 B.R. 189, 194 (Bankr. E.D.Tex. 2000).*

- The policy underlying Bankruptcy Code Section 1127(b) has been stated as follows:
- Section 1127(b)'s prohibition of modification after substantial consummation provides both the debtor and creditors with finality as to confirmation orders. To allow the continual modification of substantially consummated plans, by a new chapter 11 case or otherwise, would create uncertainty among creditors. Why would a creditor consent to the treatment of its claim as part of a plan of reorganization if it thought that treatment could later be modified and its claim further impaired? *See Carter v. Peoples Bank and Trust Co. (In re BNW, Inc.), 201 B.R. 838, 846 (Bankr.S.D.Ala.1996). To allow a debtor to continuously file plans of reorganization which modified the prior confirmed and consummated plan would render § 1127(b) meaningless.*
- *In re Northtown Real Co., L.P., 215 B.R. 906, 911 (Bankr. E.D.N.Y. 1998).*

B. *Serial Chapter 11 Cases are Violative of Bankruptcy Code Section 1127(b)*

- Some serial Chapter 11 cases are deemed a bad faith violation of Bankruptcy Code Section 1127(b). *Elmwood Development Co. v. General Electric Pension Trust (In re Elmwood Development Co.), 964 F.2d 508 (5th Cir. 1992); In re Northtown Real Co., L.P., 215 B.R. 906 (Bankr. E.D.N.Y. 1998); In re Delray Associates Limited Partnership, 212 B.R. 511 (Bankr. D.Md. 1997)*

- In *Elmwood Development Co. v. General Electric Pension Trust (In re Elmwood Development Co.), 964 F.2d 508 (5th Cir. 1992) the debtor had confirmed a plan of reorganization. The debtor subsequently defaulted on the plan of reorganization. The debtor attempted to modify the first confirmed plan of reorganization. The bankruptcy court denied the debtor's attempt to modify the first plan of reorganization because it had been substantially consummated.*

- The Fifth Circuit Court of Appeals ruled that the debtor's second Chapter 11 case was filed in bad faith. The court stated:

- Even prior to Johnson, the national consensus permitted serial filings in Chapter 11 cases provided the second petition was filed in good faith. Where a debtor requests Chapter 11 relief for a second time, the good faith inquiry must focus on whether the second petition was filed to contradict the initial bankruptcy proceedings. Because the Elmwood I bankruptcy court had found that the confirmed plan in that case was substantially consummated, we must consider whether the Elmwood II petition was an attempt to evade the Code's prohibition against modification of substantially consummated confirmed plans. We are impelled to the conclusion that Elmwood II would only accomplish this impermissible purpose. In 1987 Elmwood bargained for three years in which to sell or refinance its property, granting an absolute deadline after which GEPT could proceed undisturbed with a foreclosure of Elmwood Towers. After reaping the benefit of its bargain Elmwood sought to avoid its solemn obligation by filing Elmwood II. (Footnotes omitted).

- *Id. at 511.*

- Similarly, in *In re Northtown Real Co., L.P., 215 B.R. 906 (Bankr. E.D.N.Y. 1998) the late Chief Judge Duberstein ruled that a second Chapter 11 case was an impermissible attempt to modify a substantially consummated plan of reorganization. The court ruled that there is a limited exception for unforseen circumstances. Chief Judge Duberstein wrote:*

- Certain courts have also permitted serial chapter 11 filings where the debtor has shown that unforeseeable changed circumstances have occurred since confirmation of the prior reorganization. But such serial chapter 11 cases have been permitted only in very unusual, almost extraordinary, factual situations. "Unanticipated changed circumstances" sufficient to justify a serial chapter 11 filing have been defined as "a legitimately varied and previously unknown factual scenario" which requires "a different plan to accomplish the goals of bankruptcy relief."

- *Id. at 913. Tenant default was not an unforseen circumstance warranting modification of a* plan of reorganization.

C. *Exceptions to the Substantial Consummation Rule*

- There is an unanticipated changed circumstances exception to the substantial consummation rule. One court has made the following statements concerning the unanticipated changed circumstances exception:

- Courts have allowed a limited exception where there are " unanticipated changed circumstances" which were " unknown at the time of the substantial consummation of the prior plan and must have substantially affected the debtor's ability to perform that plan." Id. (citing *In re Casa Loma Assocs., 122 B.R. 814, 818-19 (Bankr.N.D.Ga.1991)). Where unanticipated changed circumstances exist, Chapter 11 relief may be justified even when obligations created*

- *under a previously confirmed, substantially consummated plan will be modified. In re Elmwood Dev. Co., 964 F.2d at 512. The rationale is that, " [i]n that instance, a second petition would not necessarily contradict the original proceedings because a legitimately varied and previously unknown factual scenario might require a different plan to accomplish the goals of bankruptcy relief." Id. at 511.*

- *In re Triumph Christian Center, Inc., 493 B.R. 479, 487 (Bankr. S.D.Tex. 2013).*

- In *CFC 78 Partnership B v. Casa Loma Associates (In re Casa Loma Associates), 122 B.R. 814 (Bankr. S.D.Ga. 1991) the bankruptcy court found that there were unanticipated changed circumstances warranting a second reorganization case.*

- The court stated:

- In the instant case, if Debtor relied merely on changed market conditions to support the second Chapter 11 filing, however, Debtor would have failed to show sufficiently changed circumstances to warrant a second filing. Debtor, however, has shown an unanticipated change in federal law and the discovery of fire damage and structural defects, which were unknown at the time of substantial consummation of the plan in Casa Loma I, which substantially affected Debtor's

- ability to perform under the Casa Loma I plan. Additionally, other factors which would support dismissal of Debtor's petition as having been filed in bad faith have not been shown. Debtor appears to have a reasonable prospect of successful reorganization. Therefore, dismissal of Debtor's second Chapter 11 petition will be denied.

- *Id. at 818-19.*

- Another exception that to the substantial consummation rule is if the second reorganization case is filed with the sole intent of reorganizing the debtor. *Fruehauf Corp. v. Jartran, Inc. (In re Jartran, Inc.), 886 F.2d 859 (7th Cir. 1989).*

- *In Jartran, the Court of Appeals for the Seventh Circuit ruled that the debtor's second Chapter 11 case did not violate Bankruptcy Code Section 1127(b) because the debtor's second reorganization case was intended solely to liquidate the debtor and not modify the debtor's plan of reorganization.*

Sanctions in Bankruptcy Cases

Copyright 2015 Carlos J. Cuevas, Esq.

I. Introduction

- A bankruptcy court may impose sanctions under Federal Rule of Bankruptcy Procedure 9011; Judicial Code Section 1927; and Bankruptcy Code Section 105(a). It is important to understand the substantive and procedural requirements for the imposition of sanctions.

II. Federal Rule of Bankruptcy Procedure 9011

- A. Introduction

Federal Rule of Bankruptcy Procedure 9011 is the primary rule under which a bankruptcy court may impose sanctions against an attorney. Fed. R. Bankr. P. 9011. Federal Rule of Bankruptcy Procedure 9011 is the bankruptcy equivalent of Federal Rule of Civil Procedure 11. *Gromchociski v. Spehar Capital, LLC (In re Spehar Capital, LLC), 458 B.R. 473, 483 (Bankr. N.D.Ill. 2011).*

- The jurisprudence of Federal Rule of Civil Procedure 11 is relevant in the determination of cases under Federal Rule of Bankruptcy Procedure 9011. *In re Obasi, 2011 WL 6336153 at 4 (Bankr. S.D.N.Y. 2011). The central role of Federal Rule of Bankruptcy Procedure 9011 is to deter abusive litigation practices. Gromchociski v. Spehar Capital, LLC (In re Spehar Capital, LLC), 458 B.R. 473, 483 (Bankr. N.D.Ill. 2011).*

- Federal Rule of Bankruptcy Procedure 9011 is not intended to be a fee shifting statute that requires the losing litigant to pay legal fees and costs. *State Bank of India v. Kaliana (In re Kaliana), 207 B.R. 597, 601 (Bankr. N.D. Ill. 1997). A bankruptcy court may independently consider the imposition of sanction under Federal Rule of Bankruptcy Procedure 9011. In re Smith, 462 B.R. 783, 792 (Bankr. D. Nev. 2011).*

- Absent exceptional circumstances a law firm shall be held jointly liable for violations committed by its partners, associates, and employees. Fed. R. Bankr. P. 9011(c). An attorney that has signed a document must review it prior to its filing. *In re Obasi, 2011 WL 6336153 at 5 (Bankr. S.D.N.Y. 2011).*

- The person signing, filing, submitting or advocating has a nondelegable duty to the court. *In re Obasi, 2011 WL 6336153 at 5 (Bankr. S.D.N.Y. 2011). Sanctions under Federal Rule of Bankruptcy Procedure 9011 are to be issued sparingly and not imposed lightly. Gromchociski v. Spehar Capital, LLC (In re Spehar Capital, LLC), 458 B.R. 473, 483 (Bankr. N.D.Ill. 2011).*

B. Federal Rule of Bankruptcy Procedure 9011(b)

- Federal Rule of Bankruptcy Procedure 9011(b) contains the substantive standards that
- (b) Representations to the court
- By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,--

- (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
- (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

- **(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and**
- **(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.**
- Fed. R. Bankr. P. 9011(b).

- An attorney's conduct is sanctionable if such document is not presented (1) for any improper purpose, (2) based upon frivolous legal arguments, (3) without adequate evidentiary support for its allegations, and (4) without a basis for denials of fact. *In re Outboard Marine Corp., 2011 WL 2632115, 4 (Bankr. N.D.Ill. 2011).*

- The conduct prohibited by Federal Rule of Bankruptcy Procedure 9011(b) falls into two categories: frivolous claims and improper purpose. *In re American Telecom Corp., 319 B.R. 857, 867 (Bankr. N.D.Ill. 2004). The frivolous component is intended to be the objective test, and the improper purpose is intended to be the subjective test. In re Outboard Marine Corp., 2011 WL 2632115, at 4 (Bankr. N.D.Ill. 2011).*

- Under Federal Rule of Bankruptcy Procedure 9011(b) a court measures an attorney's conduct "objectively" against a reasonableness standard. *In re Smith, 462 B.R. 783, 792 (Bankr. D. Nev. 2011). The reasonableness standard consists of a competent attorney admitted to practice before the particular court. In re Smith, 462 B.R. 783, 792 (Bankr. D. Nev. 2011).*

- A reasonable attorney in like circumstances could not have believed this implausible argument to be factually or legally justified. *In re W.A.R. LLC, 2012 WL 1576002 at 16 (Bankr. D.D.C. 2012). A finding of subjective bad faith is unnecessary; rather, all that is necessary is that he attorney failed to satisfy the objective standard. In re Schivo, 462 B.R. 765, 777 (Bankr. D. Nev. 2011).*

- One court has made the following comments as to what constitutes a frivolous claim:

- According to the Bankruptcy Appellate Panel of the Ninth Circuit, "[t]he word 'frivolous,' when used in connection with sanctions denotes a filing that is both baseless—lacks factual foundation—and made without reasonable competent inquiry." *Id. (citing Townsend v. Holman Consulting Corp., 929 F.2d 1358, 1362 (9th Cir.1990)). An attorney, then, "has a duty to conduct a*

- *reasonable factual investigation as well as to perform adequate legal research that confirms that his position is warranted by existing law (or by a good faith argument for a modification or extension of existing law) ." Id. (citing Christian v. Mattel, Inc., 286 F.3d 1118, 1127 (9th Cir.2002)). "Thus, a finding that there was no reasonable inquiry into either the facts or the law is tantamount to a finding of frivolousness." Id. (citing Townsend, 929 F.2d at 1362).*

- *In re Spickelmier, 2012 WL 1190295 (Bankr. D. Nev. 2012).*

- A legal argument is not warranted by existing law if it is based on legal theories that are plainly precluded by well-established legal principles and authoritative precedent, unless the pleading plainly argues for a reversal or change of law and presents a nonfrivolous argument to support that position. *White v. Burdick (In re CK Liquidation Corp.), 321 B.R. 355, 362 (Bankr. 1st Cir. 2005). Nevertheless, a legal argument need not ultimately previal in order to be warranted by existing law. White v. Burdick (In re CK Liquidation Corp.), 321 B.R. 355, 363 (Bankr. 1st Cir. 2005).*

- Courts usually do not conclude that an unsuccessful argument is not warranted by existing law where the argument involves unsettled or highly complex law. *Hermosilla v. Hermosilla (In re Hermosilla), 450 B.R. 276, 291 (Bankr. D. Mass. 2011) aff'd,*
- 2011 WL 60344 (Bankr. 1st Cir. 2011)

- Another court has made the following statement concerning a reasonable inquiry into the facts of the case:

- In making the determination of whether a reasonable inquiry was made with respect to the facts of a case, courts must consider five factors: (1) whether the signer of the document had sufficient time for investigation; (2) the extent to which the attorney had to rely on the client for the factual foundation underlying the pleading; (3) whether the case was accepted from another attorney; (4) the complexity of the facts and the attorney's ability to perform a sufficient profiling investigation; and (5) whether discovery would have been beneficial to the development of the underlying facts.

- *In re Outboard Marine Corp., 2011 WL 2632115, 5 (Bankr. N.D.Ill. 2011).*

- Under Federal Rule of Bankruptcy Procedure 9011 the attorney must have conducted an adequate inquiry into the law and facts. *Hermosilla v. Hermosilla (In re Hermosilla), 450 B.R.* 276, 290 (Bankr. D. Mass. 2011) *aff'd, 2011 WL 60344 (Bankr. 1st Cir. 2011). "'Put simply, a* pure heart no longer excuses an empty head.'" *Hermosilla v. Hermosilla (In re Hermosilla), 450* B.R. 276, 290-91 (Bankr. D. Mass. 2011) *aff'd, 2011 WL 60344 (Bankr. 1st Cir. 2011).*

- In *Orton v. Hoffman (In re Kayne), 453 B.R. 372 (Bankr. 9th Cir. 2011) the Bankruptcy Appellate Panel for the Ninth Circuit affirmed the issuance of sanctions against the attorney. The schedules and statement of financial affairs contained at least thirteen patently false statements. The attorney knew that these statements were false when he prepared the documents.*

- *The schedules had omitted a $61,000.00 promissory note due to the debtor. Under the 2005 amendments the schedules and statement of financial affairs were within the purview of Federal Rule of Bankruptcy Procedure 9011. The attorney violated Federal Rule of Bankruptcy 9011 by signing the petition.*

- In *In re Michael's Enterprises of Virginia, Inc., Case No. 14-30611-KRH (Bankr. E.D.Va. Nov. 6, 2014) the court, pursuant to Federal Rule of Bankruptcy Procedure 9011, sanctioned a debtor's attorney. The Chapter 11 case was filed subsequent to a foreclosure sale. A bankruptcy case filed to circumvent and collaterally attack a state court judgment qualifies as an improper purpose and warrants the imposition of sanctions.*

- In *In re Letourneau, 422 B.R. 132 (Bankr. N.D. Ill. 2010) an alleged debtor violated Federal Rule of Bankruptcy Procedure 9011 by filing an involuntary petition to block a foreclosure proceeding. The three petitioning creditors did not hold claims against the alleged debtor, and they did not sign the involuntary petition. There were no circumstances in which the filing of an involuntary petition by an alleged debtor against himself could be proper.*

- In *In re Obasi, 2011 WL 6336153 (Bankr. S.D.N.Y. 2011) the court ruled that an attorney violated Federal Rule of Bankruptcy Procedure 9011. The attorney had submitted a proof of claim which he failed to review before his signature was affixed, and failed to contain the assignment to the current holder of the mortgage.*

- In *Hermosilla v. Hermosilla (In re Hermosilla), 2011 WL 60344 (Bankr. 1st Cir. 2011)(per curiam) the court affirmed the finding that the debtor's attorney had violated Federal Rule of Bankruptcy Procedure 9011 by advancing arguments that were frivolous. The statute of limitations argument was barred by Bankruptcy Code Section 108.*

- *The debtor's attorney also advanced a jurisdictional argument of the Massachusetts Probate Court that was contrary to existing precedent. The debtor's attorney also advanced arguments that were precluded by the pre-trial order and pre-trial statement.*

C. Federal Rule of Bankruptcy Procedure 9011(c)(1): The Initiation of Sanctions

- Federal Rule of Bankruptcy Procedure 9011(c)(1) governs the initiation of a motion for sanctions. Fed. R. Bankr. P. 9011(c)(1).

- When sanctions are requested by a party's motion there are two requirements that must be
- satisfied: the motion must be made separately and specifically describe the conduct that has violated subsection (b) and the motion may not be presented to the court unless, twenty-one days after service, the opposing party has not withdrawn or corrected the challenged document. *Gromchociski v. Spehar Capital, LLC (In re Spehar Capital, LLC), 458 B.R. 473, 486 (Bankr. N.D.Ill. 2011).*

- A motion for sanctions must be made separately. *In re Outboard Marine Corp., 2011 WL 2632115, at 6 (Bankr. N.D.Ill. 2011). A party seeking sanctions must serve the motion on the other party twenty-one days before filing the motion with the court. Lehrer v. Flaherty (In re Flaherty), 432 B.R. 742, 758 (Bankr. N.D. Ill. 2010).*

- This is the safe harbor provision under which the offending party has twenty-one days to withdraw or correct the pleading. *Hoffman v. Barbara (In re Barbara), 403 B.R. 237, 243 (Bankr. E.D.N.Y. 2009). The safe harbor provision is a mandatory procedural prerequisite. Claudio v. LVNV Funding, LLC (In re Claudio), 463 B.R. 190, 196 (Bankr. D. Mass. 2012).*

- *The failure to comply with the safe harbor motion requires the denial of a sanctions motion. In re Taub, 439 B.R. 276, 283 (Bankr. E.D.N.Y. 2010); Lehrer v. Flaherty (In re Flaherty), 432 B.R. 742, 758 (Bankr. N.D. Ill. 2010).*

- Sanctions under Federal Rule of Bankruptcy Procedure 9011 are intended to be deterrent in nature. *In re Schivo, 462 B.R. 765, 781 (Bankr. D. Nev. 2011). Sanctions should be limited to deter repetition of such conduct or comparable conduct by other attorneys that are similarly situated. In re Schivo, 462 B.R. 765, 781 (Bankr. D. Nev. 2011).*

- The following are criteria that a bankruptcy court should examine when imposing sanctions:

- Whether the improper conduct was willful, or negligent; whether it was part of a pattern of activity, or an isolated event; whether it infected the entire pleading, or only one particular count or defense; whether the person has engaged in similar conduct in other litigation; whether it was intended to injure; what effect it had on the litigation process in time or expense; whether the responsible person is trained in the law; what amount, given the financial resources of the responsible person, is needed to deter that person from repetition in the same case; [and] what amount is needed to deter similar activity by other litigants.

- *Ameriquest Mortgage Co. v. Nosek (In re Nosek), 609 F.3d 6, 9 (1st Cir. 2010).*

- The Bankruptcy Appellate Panel for the Ninth Circuit has made the following observations concerning aggravating and mitigating factors:

- To determine an appropriate sanction, the bankruptcy court should consider: (1) whether the duty violated was to a client, the public, the legal system or the profession; (2) whether the lawyer acted intentionally, knowingly or negligently; (3) whether the lawyer's misconduct caused a serious or potentially serious injury; and (4) whether aggravating factors or mitigating circumstances exist. *Crayton, 192 B.R. at 980.*

- Aggravating factors include considerations that justify an increase in the degree of discipline imposed, such as a prior disciplinary offense, multiple offenses, a pattern of misconduct, and refusal to acknowledge the wrongful nature of the conduct. *Id. at 981. Mitigating circumstances include considerations which justify a reduction in the degree of discipline, such as the absence of a prior disciplinary record, personal or emotional problems, inexperience in the practice of law, or a timely good faith effort to make restitution or to rectify the consequences of the misconduct. Id.*

- *In re Brooks-Hamilton, 400 B.R. 238,252-53 (Bankr. 9th Cir. 2009).*

- In *Nosek, the First Circuit Court of Appeals reduced the sanction from $250,000.00 to $5,000.00 because it thought that the sanction was excessive.*

- In *In re Brent, 458 B.R. 444 (Bankr. N.D. Ill. 2011) the court found that an attorney violated Federal Rule of Bankruptcy Procedure 9011 when he filed fee applications that stated he had entered into model retention agreements with his clients, but attached an addendum to each fee application that allowed him to charge higher fees beyond the district's standard flat fees for Chapter 13 cases. The court imposed a $10,000.00 sanction; directed the attorney to complete a legal ethics course; and contacted the disciplinary committee for possible disciplinary action.*

- In *Hermosilla v. Hermosilla (In re Hermosilla), 2011 WL 60344 (Bankr. 1st Cir. 2011). the Bankruptcy Appellate Panel for the First Circuit affirmed a sanctions award. The court stated:

- In the context of this case, several of these factors weigh in favor of a sanction that is not just a slap on the wrist but carries instead some lasting sting. First, this is not the first time Attorney Baker has been sanctioned for violating Bankruptcy Rule 9011 in connection with this bankruptcy case. As the bankruptcy court pointed out, it had previously imposed sanctions of $1,585.70 against Attorney Baker in the Debtor's main case for filing a motion for sanctions that

- wholly without merit.” *See In re Hermosilla, 375 B.R. 20 (Bankr.D.Mass. 2007), aff'd, Baker v. Keller (In re Hermosilla), 2008 U.S. Dist. LEXIS 123130 (D.Mass. Sept. 30, 2008). Additionally, Attorney Baker's disregard for the binding nature of stipulated facts forced the bankruptcy court to expend considerable resources needlessly on an otherwise stipulated case. His actions transformed a simple nondischargeability proceeding into a protracted, five-year litigation. Under the circumstances, the $9,000 sanction the court imposed was not “grossly excessive” and was consistent with controlling authority. (Footnote omitted).*

- 2011 WL 60344 at 10.

- In *Orton v. Hoffman (In re Kayne), 453 B.R. 372 (Bankr. 9th Cir. 2011) the Bankruptcy Appellate Panel for the Ninth Circuit affirmed a sanction of $20,000.00. The award was appropriate because of the damage to the estate and the costs incurred to rectify the error.*

III. Judicial Code Section 1927

- A. Introduction
- Judicial Code Section 1927 authorizes the imposition sanctions against an attorney who engages in vexatious litigation. 28 U.S.C. § 1927. Judicial Code Section 1927 states:
- Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.
- 28 U.S.C. § 1927.

- *In re Cohoes Indus. Terminal Inc., 931 F.2d 222 (2d Cir. 1991) the Second Circuit stated that a bankruptcy court may impose sanction. However, the court never addressed the Judicial Code Section 451 issue.*

C. Bad Faith is Required to Impose Sanctions

In order to impose sanctions under Judicial Code Section1927 the court must find that the attorney's conduct was motivated by an improper purpose. *In re Cohoes Indus. Terminal Inc.; 931 F. 2d 222, 230 (2d Cir. 1991).*

- The late Chief Bankruptcy Judge Tina Brozman (S.D.N.Y.) wrote:
- Imposition of sanctions under this section requires a clear showing of bad faith. The court must find both that an attorney's conduct was motivated by an improper purpose, such as harassment or delay, and is entirely without color. (Citation omitted).
- *In re French Bourekas Inc., 175 B.R. 517, 523-24 (Bankr. S.D.N.Y. 1994) aff'd, 195 B.R. 19* (S.D.N.Y. 1996)(citation omitted).

- Judge Dorothy Eisenberg made the following observations concerning bad faith:

- Bad faith may be inferred "when the attorney's actions are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose such as delay. By its terms, §1927 looks to unreasonable and vexatious multiplications of proceedings, and it imposes on attorneys through the entire litigation to avoid dilatory tactics." (Citations omitted).

- *Estate of Perlbinder v. Dubrowsky (In re Dubrowsky), 206 B.R. 30, 36 (Bankr. E.D.N.Y. 1997).*

- The purpose of Judicial Code Section1927 is to protect the judicial process from abuse, to punish those who have offended the judicial process, and to provide relief for the party who has had to contend with vexatious litigation practices. *In re LJAK Associates Inc., 165 B.R. 9, 12 (Bankr. E.D.N.Y. 1994). A court may only use Judicial Code Section1927 to sanction counsel; it is inapplicable to litigants. Wood v. Brosse U.S.A. Inc., 149 F.R.D. 44, 49 (S.D.N.Y. 1993).*

Bankruptcy courts have utilized Judicial Code Section 1927 to sanction counsel who have engaged in bad faith litigation practices. *E.g., In re Brown, 444 B.R. 691 (Bankr. E.D. Tex. 2009); In re Bauman, 201 B.R. 202 (Bankr. W.D. Tenn. 1996); In re Spectee Group Inc., 185 B.R. 146 (S.D.N.Y. 1995); In re Eatman, 182 B.R. 386 (Bankr. S.D.N.Y. 1995); In re French Bourekas Inc., 175 B.R. 517 (Bankr. S.D.N.Y. 1994) aff'd, 195 B.R. 19 (S.D.N.Y. 1996).*

- In *In re St. Stephen's 350 East 116th St., 313 B.R. 161 (Bankr. S.D.N.Y. 2004) the Bankruptcy Court, pursuant to Judicial Code Section 1927, sanctioned an attorney for a bad faith filing. The court stated:*
-

- In any event, the same factors that led to the dismissal of these cases also clearly support the imposition of sanctions, even on the higher standard. Indeed, the actions and inaction of Mr. Hancock were particularly telling factors in persuading the Court that there was never any reasonable likelihood that these Debtors intended to reorganize and that there was no reasonable probability that they ever would successfully emerge from chapter 11. *See In re Cohoes Indus. Terminal, 931 F.2d at 227; In re Intercorp Intern., 309 B.R. at 694; In re 68 West 127 Street, 285 B.R.*

- *at 846-47; In re Spectee Group, 185 B.R. at 155-56 (stating criteria for bad faith filing). Mr. Hancock's only actions as counsel were to sign the chapter 11 petitions and to sign his Affirmation in opposition to the Dismissal Motion. A proper review of the petitions and only a cursory examination of Mr. Blanchard would have revealed, however, that the Debtors lacked the assets, ownership structure and fundamental business purpose to reorganize; that is, Mr. Hancock should have seen that he did not really*

- *have a client, but, rather, that he was furthering the interests of Mr. Blanchard as a real estate professional, not a shareholder, over the interests of M & T to get its debts paid. Moreover, Mr. Hancock's Affirmation merely attempted to relitigate issues that already had been decided in M & T's favor on the merits in the state court, which is sanctionable in a bad faith filing context. In re Cohoes Indus. Terminal, 931 F.2d at 230-31; In re Intercorp Intern., 309 B.R. at 695.*
- *Id. at 171.*

- In *Chaudhry v. Usoskin (In re Usoskin), 56 B.R. 805 (Bankr. E.D.N.Y. 1985). the plaintiffs filed a complaint objecting to the debtor's chapter 7 discharge. The complaint was filed solely to hinder the debtor. The court held that the plaintiffs' attorney should be sanctioned pursuant Judicial Code Section 1927. The court declared:*

- Plaintiffs' complaint was not brought in good faith, but solely to hinder and delay the discharge to which Usoskin is entitled. The complaint and other documents signed by plaintiffs' attorney were not well grounded in fact which was necessarily known to plaintiffs' attorney when he signed them. Judgment will f

- be entered in favor oUsoskin, overruling plaintiffs' objections to her discharge. Sanctions are hereby imposed on plaintiffs and their attorney pursuant to Bankruptcy Rule 9011, 28 U.S.C. §1927 and the general equitable powers of the court, including but not limited to an award of reasonable attorneys' fees, payable by plaintiffs and their attorney who are jointly and severally liable therefore.
- *Id. at 819.*

- Another case in which a court imposed sanctions pursuant to §1927 is *In re Eatman. 182 B.R. 386 (Bankr. S.D.N.Y. 1995). There, the debtor and his wife had filed several chapter 13 cases in an attempt to forestall a foreclosure proceeding by the condominium in which they occupied a unit. The debtor had failed to pay the common area charges for several years. The court held that the case was filed with sole intent of thwarting the foreclosure, and therefore, it was filed in bad faith. The court, pursuant to Judicial Code Section1927, imposed sanctions against debtor's counsel.*

- The court stated:

- The findings of bad faith justifying sanctions against the debtor under Rule 9011 also justify the imposition of sanctions against the debtor's attorney. Although the debtor's present counsel did not file the prior cases, he never stated, in response to the motion, that he was not familiar with the history of Eatman's' cases. In any event, he participated in the preparation and drafting of

- bankruptcy papers which listed the condominium's foreclosure proceeding-- thereby conceding the existence of a secured claim--but failed to schedule the secured claim or deal with it under the plan. Mr. Rolle therefore knew or should have known that he was participating with the debtor in filing a case designed to forestall the condominium but that could not be confirmed under the proposed plan or any other plan.
- *Id. at 396.*

IV. Bankruptcy Code Section 105(a)

A. Introduction

- Bankruptcy Code Section 105(a) is another basis for awarding sanctions, and the statute states:
- (a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.
- 11 U.S.C. § 105(a).

- The United States Supreme Court has made the following statements concerning a court's inherent powers:

- It has long been understood that "[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution," powers "which cannot be dispensed with in a Court, because they are necessary to the exercise of all others." *United States v. Hudson, 7 Cranch 32, 34, 3 L.Ed. 259 (1812); see also Roadway Express, Inc. v. Piper, 447 U.S. 752, 764, 100 S.Ct. 2455, 2463, 65 L.Ed.2d 488 (1980) (citing Hudson). For this reason, "Courts of justice are universally acknowledged to be vested, by their very creation, with power to impose silence, respect, and decorum, in their presence, and submission to their lawful mandates." Anderson v. Dunn, 6 Wheat. 204, 227, 5 L.Ed. 242 (1821); see also Ex parte Robinson, 19 Wall. 505, 510, 22 L.Ed. 205 (1874). These powers are "governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases." Link v. Wabash R. Co., 370 U.S. 626, 630–631, 82 S.Ct. 1386, 1388–1389, 8 L.Ed.2d 734 (1962).*

- Prior cases have outlined the scope of the inherent power of the federal courts. For example, the Court has held that a federal court has the power to control admission to its bar and to discipline attorneys who appear before it. See *Ex parte Burr, 9 Wheat. 529, 531, 6 L.Ed. 152 (1824). While this power "ought to be exercised with great caution," it is nevertheless "incidental to all Courts." Ibid.*

- *Chambers v. NASCO, Inc., 501 U.S. 32 (1991).*

- Under Bankruptcy Code Section 105(a) a bankruptcy court has the authority to issue sanctions. *In re Volpert, 110 F.3d 494, 501 (7th Cir. 1997); Caldwell v. United Capital Corp. (In re Rainbow Magazine), 77 F.3d 278, 283-84 (9th Cir. 1996); Jones v. Bank of Santa Fe (In re Courtesy Inns, Ltd), 40 F.3d 1084, 1089-90 (10th Cir. 1994). Bankruptcy Code Section 105(a) furnishes a bankruptcy court with authority to sanction conduct that abuses the judicial process, including conduct that unreasonably and vexatiously multiplies bankruptcy proceedings. In re Volpert, 110 F.3d 494, 501 (7th Cir. 1997).*

B. Bad Faith is Required to Impose Sanctions Under Bankruptcy Code Section 105(a)

- In order to impose sanctions there must be particularized showing of bad faith conduct. *680 Fifth Avenue Associates v. EGI Co. Services, Inc. (In re 680 Fifth Avenue Associates),* 218 B.R. 305, 324 (Bankr. S.D.N.Y. 1998). The court must impose the least onerous sanction that addresses the situation. *In re Schuessler, 386 B.R. 458, 492 (Bankr. S.D.N.Y. 2008). Pursuant to Bankruptcy Code Section 105(a) a court may sanction an attorney or litigant. 680 Fifth Avenue Associates v. EGI Co. Services, Inc. (In re 680 Fifth Avenue Associates),* 218 B.R. 305, 323 (Bankr. S.D.N.Y. 1998).

- In *In re Aston-Nevada Ltd. Partnership, 391 B.R. 84 (Bankr. D. Nev. 2006) the court, pursuant to Bankruptcy Code Section 105(a), sanctioned a law firm for a Chapter 11 filing and its conduct throughout the Chapter 11. The court ordered that the law firm disgorge its fees. The court found that the law firm had filed the Chapter 11 case for an improper purpose. The debtor had a single asset: a 911 Porsche.*

- *The case was filed solely to thwart the secured creditor from foreclosing on its collateral. The law firm lacked the experience to prosecute a Chapter 11 case. The law firm had engaged in bad faith litigation tactics, including trying to thwart a Federal Rule of Bankruptcy Procedure 2004 examination.*

- In *Elmasri v. Rupp (In re Elmasri), 2011 WL 1544420 (Bankr. E.D.N.Y. 2011) the court imposed sanctions against the debtor–plaintiff for a frivolous adversary proceeding. The debtor engaged in vexatious multiplication of proceedings.*

- In *In re Schuessler, 386 B.R. 458 (Bankr. S.D.N.Y. 2008) the court imposed sanctions against Chase Home Mortgage for abusive lift stay motion.*

- In *In re Campora, Case No. 14-70330(AST)(Bankr. E.D.N.Y. October 6, 2014) the Bankruptcy Court, pursuant to its inherent powers, sanctioned a debtor a total of $13,635.00. The court found that the debtor had raised baseless claims and had engaged in bad faith and vexatious litigation tactics.*

Distressed Real Estate and Bankruptcy IV

NATIONAL
LAW INSTITUTE
Continuing Legal Education