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Ninth Circuit Holds That Joint Plan Covering Multiple Debtors Must Be Approved by Only One Impaired Class Per Plan, Not One Impaired Class Per Debtor

The Court of Appeals for the Ninth Circuit recently held that section 1129(a)(10) of the Bankruptcy Code – a provision which, in effect, prohibits confirmation of a plan unless the plan has been accepted by at least one impaired class of claims – applies on "per plan" rather than a "per debtor" basis, even when the plan at issue covers multiple debtors. *In re Transwest Resort Properties, Inc.*, 2018 WL 615431 (9th Cir. Jan. 25, 2018). The Court is the first circuit court to address the issue. Its ruling may remove a potential hurdle to non-consensual confirmation in multi-debtor cases, at least in the Ninth Circuit. Debtors covered by a joint plan may be able to use the acceptance of an impaired class of creditors holding claims against one debtor to "cram down" creditors holding claims against a different debtor.

Background

In 2007, certain Transwest companies acquired two resorts: the Westin Hilton Head Resort and Spa in Hilton Head Island, South Carolina and the Westin La Paloma Resort and Country Club in Tucson, Arizona. The resorts were owned by two Transwest operating companies (the "OpCo Debtors"). The OpCo Debtors were owned by two different Transwest entities (the "Mezzanine Debtors") which, in turn, were owned by a Transwest holding company.

In 2010, all five Transwest entities filed for bankruptcy. Their cases were jointly administered but not substantively consolidated.[1] The debtors sought to confirm a plan whereby (1) a third-party investor would acquire the OpCo Debtors and (2) the Mezzanine Debtor's ownership interest in the OpCo Debtors would be extinguished. The OpCo Debtors' prepetition lender (the "Lender") acquired the only claim against the Mezzanine Debtors. The Lender – the only class member for the Mezzanine Debtors – voted against the joint plan.

[1] In a jointly administered case, multiple debtors are administered in one bankruptcy case for purely administrative reasons. Joint administration does not impact the claims of any creditors. Substantive consolidation, on the other, effectively merges the estates of two or more distinct debtors (and sometimes, the estate of a debtor and a non-debtor) into one for purposes of distributing assets. This results in the two estates sharing assets and liabilities and the extinguishment of duplicate claims and claims between debtors. By pooling the assets of, and claims against, two or more entities, substantive consolidation eliminates any structural priority between the claimants of the consolidated entities.

The Lender argued among other things, that section 1129(a)(10) applies on a "per debtor" basis and, thus, the plan of reorganization could not be confirmed over its objection.[2] Section 1129(a)(10) provides that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." The Lender relied heavily on *In re Tribune Co.*, 464 B.R. 126 (Bankr. D. Del. 2011), to support its preferred construction of section 1129(a)(10). In *Tribune*, a Delaware bankruptcy court held that section 1129(a)(10) applies "per debtor" because, according to the court, other subsections of 1129 (*e.g.*, sections 1129(a)(1), (3) and (7)) apply on that basis.

Bankruptcy Court and District Court Decisions

The bankruptcy court overruled the Lender's objection, holding that section 1129(a)(10) applies on a "per plan" basis and, as a result, the plan could be confirmed without an impaired accepting class for the Mezzanine Debtors because several other impaired classes had voted to approve the joint plan. On appeal, the district court affirmed the bankruptcy court's decision, finding that the plain language of section 1129(a)(10) was dispositive: if "at least one class of claims that is impaired *under the plan*" votes to accept the plan, the provision is satisfied even if the plan at issue covers multiple debtors.

Ninth Circuit Decision

The Ninth Circuit affirmed the district court's decision, holding that section 1129(a)(10)'s impaired accepting class requirement applies on a "per plan" basis, not a "per debtor" basis. The Court focused on the plain language of section 1129(a)(10), noting that the provision (1) requires "one impaired class 'under the plan' to 'approve the plan'" and (2) does not refer to creditors of different debtors under "the plan'" or "distinguish between single-debtor and multi-debtor plans."

The Court found that the "statutory context of section 1129(a)(10) does not aid the Lender's argument." While the Lender maintained that Bankruptcy Code section 102(7) – a rule of construction that provides that the singular includes the plural – requires that section 1129(a)(10) apply on a "per debtor" basis, the Court was not persuaded. It noted that applying the rule merely changed the language of the statute to read as follows: "at least one class of claims that is impaired under the plans has accepted the plans." This language was, in the Court's view, consistent with a "per plan" approach.

The Court expressly rejected the *Tribune* court's conclusion that section 1129(a)(10) must be applied "per debtor" because other subsections of 1129 apply on that basis. Focusing first on section 1129(a)(3), which requires that "[t]he plan has been proposed in good faith", the Court concluded that nothing in the text of the statute indicates that it actually applies on a "per debtor" basis. Turning next to the broader

[2] The Lender also objected to the plan on other grounds. The bankruptcy court, district court and Ninth Circuit did not find the Lender's other objections compelling and they are not addressed here.

argument, the Court noted that "while a statute must be 'read as a whole,' . . . the Lender provides no support for its position that all subsections must uniformly apply on a "per debtor" basis, especially when the Bankruptcy Code phrases each subsection differently."

The Court noted that the Lender challenged the *Transwest* plan on appeal on the basis that it purported to provide for joint administration of the debtors when it actually provided for *de facto* substantive consolidation. Under the *Transwest* plan, creditors for different debtors drew from the same pool of assets and if the Lender had voted its claims against the Mezzanine Debtors to accept the plan, those claims would have been paid from the assets of the reorganized OpCo Debtors (surplus cash flow from operations) rather than the assets of the Mezzanine Debtors (valueless stock of the insolvent OpCo Debtors). The Court found that the Lender never raised the substantive consolidation issue in the bankruptcy court and, thus, it was not properly before the Court on appeal. In a concurring opinion, one Circuit Court Judge acknowledged that "the distribution scheme adopted by the [p]lan involved a degree of substantive consolidation" but stressed that "if a creditor believes that a reorganization improperly intermingles different estates, the creditor can and should object that the plan – rather than the requirement for confirming a plan – results in de facto substantive consolidation."

Conclusion

There is surprisingly limited decisional law on this important issue. Whether the ruling will lead to an uptick in litigation regarding this issue –and whether courts outside of the Ninth Circuit will follow *Transwest* – remains to be seen.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Jacob A. Adlerstein
+1-212-373-3142
jadlerstein@paulweiss.com

Paul M. Basta
+1-212-373-3023
pbasta@paulweiss.com

Kelley A. Cornish
+1-212-373-3493
kcornish@paulweiss.com

Alice Belisle Eaton
+1-212-373-3125
aeaton@paulweiss.com

Brian S. Hermann
+1-212-373-3545
bhermann@paulweiss.com

Kyle J. Kimpler
+1-212-373-3253
kkimpler@paulweiss.com

Alan W. Kornberg
+1-212-373-3209
akornberg@paulweiss.com

Elizabeth R. McColm
+1-212-373-3524
emccolm@paulweiss.com

Andrew N. Rosenberg
+1-212-373-3158
arosenberg@paulweiss.com

Jeffrey D. Saferstein
+1-212-373-3347
jsaferstein@paulweiss.com

Practice Management Counsel Erica G. Weinberger and associate Raphael L. Stern contributed to this Client Memorandum.