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06-BK-C

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Subject Suggestion for bankruptcy rules change

I recently had to decide whether a post-solicitation chapter 11 plan modification required additional disclosure and solicitation of creditors' acceptances. It seems to me that current rule 3019 could be read to conflict with sections 1125 and 1127(c) of the Bankruptcy Code. I am attaching the opinion that I wrote which explains my analysis and proposed solution. I submit these comments for the consideration of the Advisory Committee on Bankruptcy Rules.

Wes Steen

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	
	§	CASE NO. 05-41279-H2-11
ADRIAN D. MOSLEY	§	
ANISSA F. MOSLEY	§	

ORDER DENYING MOTION TO ALLOW MODIFICATION OF CHAPTER 11 PLAN WITHOUT FURTHER DISCLOSURE AND SOLICITATION (doc # 194)

In docket # 194, Debtors ask the Court to confirm their Third Amended chapter 11 plan without any disclosure or solicitation of votes supplementary to what has already been provided for the Second Amended Plan. The Third Amended Plan was filed after the conclusion of the hearing on confirmation of the Second Amended Plan and just a few hours prior to the time that the Court had set for announcement of its decision. Even though the changes in the Third Amended plan do not reduce the amount that Debtors propose to pay on any specific claim, the Court concludes that additional disclosure and solicitation are necessary to comply with Bankruptcy Code § 1125. Therefore, Debtors' motion to allow modification without additional disclosure and solicitation is denied and the Court has issued a separate order for further disclosure and solicitation and for case management and conclusion of this case.

BACKGROUND

Debtors' chapter 11 plan, filed on February 17, 2006, was set for confirmation hearing on April 18. A number of creditors objected to confirmation. On April 11, Debtors filed a modified plan. When the case was called for the confirmation hearing on April 18, Debtors announced settlement with several creditors and represented that the settlements would require further plan modification. Debtors filed their Second Amended Plan and Disclosure Statement on May 10; The disclosure statement was approved and the disclosure statement and plan were distributed to creditors for them to vote on the plan. The Court set June 6 for the confirmation hearing on the Second Amended Plan.

When the case was called for hearing on June 6, not all objections had been resolved. The Court commenced the confirmation hearing. During a recess, Debtors reached agreement with World Bank. At the conclusion of the confirmation hearing, Debtors announced that they were close to agreement with the sole remaining objecting creditor ("McIngvale"), a creditor holding a disputed, unsecured, allegedly nondischargeable claim. Debtors asked for a continuance of the confirmation hearing to continue settlement negotiations. Because the case had already been pending for almost a year without confirmation of a plan, the Court denied that request, closed evidence on the Second Amended Plan, but deferred announcement of its decision on plan confirmation to June 19. When the case was called

on June 19, Debtors announced that they had reached an agreement with McIngvale. The agreement was reflected in the Third Amended Plan that had been filed a few hours before the hearing.

The settlement purports to affect only McIngvale. Prior to the settlement, Debtors had objected to McIngvale's claim, McIngvale had filed an adversary proceeding alleging that the claim was valid and nondischargeable, and the Second Amended Plan provided for inclusion of the McIngvale claim (if allowed) as a general unsecured claim in class 5.1. In general, claims in class 5.1 are paid pro rata from a sum that is (i) 25% of the amount of unsecured claims in class 5.1, plus (ii) 50% of net recovery, if any, from a lawsuit that Debtors might file and prosecute against another creditor. The settlement between Debtors and McIngvale would withdraw the objection to the McIngvale claim, would separately classify the McIngvale claim from the claims of other unsecured creditors, and would pay 100% of the McIngvale claim, with most of the payments being made prior to payments to class 5.1.

DOCKET # 194–MOTION TO ALLOW MODIFICATION

In docket # 194 Debtors request that the Court allow them " ... to modify their chapter 11 plan pursuant to § 1127 with no further disclosure or solicitation..." Debtors allege that the Third Amended Plan does not adversely affect the treatment of any creditor's claim. Debtors contend that the amount payable to general unsecured creditors might increase by separate classification of McIngvale's claim because then McIngvale would not participate in distributions from the fund available for class 5.1 creditors.

COURT PERMISSION TO MODIFY THE PLAN IS NOT NECESSARY

Debtors do not need Court permission to modify their plan prior to confirmation, and therefore the Court need not give permission for the modification.

Bankruptcy Code § 1127(c) provides:

> The proponent of a plan may modify such plan at any time before confirmation.

The issue that the Court must decide is whether additional disclosure and solicitation of creditors' votes is required.

STATUTORY STRUCTURE–DISCLOSURE AND SOLICITATION

In chapter 11, after a party in interest proposes a plan[1] the plan proponent must provide "adequate information" about the plan before votes are solicited,[2] creditors and interest holders who are impaired[3] are allowed to vote on the plan,[4] and the court confirms the plan if it is accepted by creditors and if it otherwise complies with the statutory requirements.[5] Disclosure of adequate information is central and crucial to the voting process.[6]

AUTHORITY CONCERNING DISCLOSURE AFTER MODIFICATION

Bankruptcy Code § 1127, which allows a plan proponent to modify a plan prior to confirmation, provides:

> The proponent of a modification shall comply with section 1125 of this title with respect to the plan as modified.

"Adequate information" is an important, defined term. Bankruptcy Code § 1125(a) provides:

> "[A]dequate information" means information of a kind, and in sufficient detail, as far as is reasonably practicable ... that would enable a hypothetical investor ... of the relevant class to make an informed judgment about the plan ...
>
> An acceptance or rejection of a plan may not be solicited ... 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.

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[1] Bankruptcy Code § 1121.

[2] Bankruptcy Code § 1125.

[3] Bankruptcy Code § 1124.

[4] Bankruptcy Code § 1126.

[5] Bankruptcy Code § 1129.

[6] Bankruptcy Code §§ 1125(b), 1126(b), 1127(c), 1129(a)(2).

But Federal Rules of Bankruptcy Procedure (FRBP) 3019 provides:

> ...[A]fter a plan has been accepted and before its confirmation, the proponent may file a modification of the plan. If the court finds ... that the proposed modification does not adversely change the treatment of the claim of any creditor ... who has not accepted in writing the modification, it shall be deemed accepted by all creditors and equity security holders who have previously accepted the plan.

Rule 3019 is designed for the salutary purpose of avoiding unnecessary expense and delay of solicitation and disclosure when there is a plan amendment that is immaterial and does not adversely affect a creditor who has already received disclosure and has voted to accept the plan. The rule further promotes efficiency by indicating that a creditor who is adversely affected may accept the modification in writing. But the rule is problematic because it does not explicitly require a creditor who is adversely affected to have received "adequate information" before the creditor accepts the modification in writing. The rule seems to assume that the disclosure statement provided prior to the modification is adequate information for the modification, but that may or may not be correct. Bankruptcy Code § 1125 requires a proponent of a plan modification to provide adequate information before soliciting votes to accept the plan; presumably the statute requires adequate information before written acceptance of a modification, which would be equivalent to a vote. Bankruptcy Code § 1127(c) requires compliance with § 1125, nothing less.

The language of the rule is also problematic because it uses the phrase "adversely change the <u>treatment of the claim</u>." [Emphasis supplied.] The meaning of "treatment" is not entirely clear; would it include the relative treatment of similar classes or is it narrowly limited to the proposal for payment of claims in a single class.[7] And the phrase "treatment of the claim" is not entirely clear; would it include a massive change in the plan that would affect the feasibility of the plan or would it be narrowly limited to refer only to the amount that the plan proposes to pay the claimant?[8] The rule might be interpreted to imply that a creditor is not entitled to adequate information about a plan modification and is not entitled to change its vote on the plan unless the modification calls for a reduced payment on that creditor's claim. Such an interpretation would ignore the fact that a creditor might be seriously adversely affected by a plan modification even though the amount that the plan proposes to pay to the creditor is not reduced. Or, the creditor might want to change its vote merely because the bargain it struck when it voted for the plan depended on the relative treatment of its claim with the treatment of other claims. If the language were narrowly interpreted, then the rule would conflict with § 1127(c), which requires

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[7] For example, if two classes have similar rights, would enhanced "treatment" of one class be considered adverse treatment of another class because their relative treatment is affected?

[8] Although the Court has an independent and particular duty not to confirm a plan if the plan is not feasible, *see Collier on Bankruptcy, 15th Ed.* ¶ 1129.02[5], creditors nevertheless have the right to consider feasibility in determining how they vote on the plan.

compliance with § 1125, which in turn requires disclosure of "adequate information" to allow creditors to make an "informed judgment" about the plan.

Chapter 11 plans are intended to be agreements reached after negotiation. There are any number of factors that a creditor might consider in voting for or against a plan. Those factors are set out in the multitude of cases that attempt to define what information a disclosure statement must include. Reasonable creditors in this case might consider whether they still want to vote for the plan in light of the special treatment given the McIngvale claim and might also consider whether the payments to McIngvale affect the feasibility of the plan, and thus their vote.[9]

There are other factors that a reasonable creditor might consider in this case. The point is that § 1125 requires disclosure of "adequate information" about the plan, not just information about the treatment of their claim, as FRBP 3019 might be interpreted to suggest. To read §§ 1125, 1127, and FRBP 3019 in harmony, one must read the language of the rule to require additional disclosure whenever the Court concludes that the modification is sufficiently material that disclosure of the change and its potential consequences might reasonably affect votes on the plan. To that end, it might be useful for the rules committee to consider revision of the language of the rule to read something like this:

> ... after a plan has been accepted and before its confirmation, the proponent may file a modification of the plan. If the court finds ... that disclosure made under § 1125 prior to the modification provided adequate information about the plan as modified, then no further disclosure and solicitation is necessary and acceptances received prior to the modification shall be effective notwithstanding the modification. If the Court finds that the modification is sufficiently material that prior disclosure under § 1125 does not provide adequate information about the modified plan, then the court may require additional disclosure and solicitation to creditors and interest holders whom the court concludes are entitled to it.

The Court finds that the Third Amended Plan materially changes the Second Amended Plan in this case and that all parties entitled to vote on the plan are entitled to adequate information about the settlement(s) reached after the prior disclosure,[10] about the separate classifications of claims and modified payment requirements that are the consequences of those settlements, and about the effects of those changes on plan feasibility. The Court concludes that to comply with Bankruptcy

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[9] In the docket # 194, Debtors acknowledge that financial information provided in support of plan confirmation leaves substantial doubt about whether Debtors can make payments to McIngvale. Debtors allege that they may have to obtain loans or other financial assistance from relatives post confirmation to make those payments.

[10] Both World Bank and McIngvale are settlement reached after the dissemination of the Second Amended Disclosure Statement.

Code §§ 1127(c) and 1125, the proponent of the modification (Debtors) must provide this information to creditors and that the creditors who might be affected cannot be "deemed" by FRBP 3019 to have accepted the modification unless they have received adequate information about the plan as modified and unless they have had an opportunity to exercise their right to accept or to reject the plan based on their evaluation of that adequate information.

FRBP 3019 requires adversely affected creditors to accept the modification in writing. But as noted, it is difficult to determine from the rule which creditors are adversely affected, within the meaning of the rule. Therefore, since the plan has been materially modified, the Court will simply require reballoting based on the material modification of the plan. Neither prior acceptances nor prior rejections will be deemed to carry over.

Therefore, the motion to allow modification without additional disclosure and solicitation is denied. The Court has this date issued an order setting deadlines and otherwise providing for case management.

SIGNED June 23, 2006

/s/
WESLEY W. STEEN
UNITED STATES BANKRUPTCY JUDGE