By James Bailey, Jay Bender and Aaron Johnson

Eleventh Circuit Strictly Applies Bankruptcy Rule 3019(a)

James Bailey
Bradley Arant Boult Cummings LLP
Birmingham, Ala.

Jay Bender
Bradley Arant Boult Cummings LLP
Charlotte, N.C.

Aaron Johnson
Bradley Arant Boult Cummings LLP
Nashville, Tenn.

James Bailey is a partner with Bradley Arant Boult Cummings LLP in Birmingham, Ala. Jay Bender is a partner in the firm's Charlotte, N.C., office. Aaron Johnson is an associate in the firm's Nashville, Tenn., office.

The chapter 11 plan-confirmation process requires both the flexibility to quickly incorporate negotiated compromises up to the confirmation hearing and procedural safeguards to protect interested parties. As the Eleventh Circuit addressed in *In re America-CV Station Group Inc.*, notwithstanding other courts' contrary decisions, the practical balancing of these interests when considering pre-confirmation plan modifications cannot be used to deny interested parties who have voted to reject (or are deemed to have rejected) a proposed plan the procedural safeguards of receiving an additional disclosure statement, and a new opportunity to vote, when the requirements of Rule 3019(a) of the Federal Rules of Bankruptcy Procedure are otherwise satisfied.[1]

Background

In *America-CV Station Group Inc.*, the Eleventh Circuit disagreed with both the bankruptcy and district courts' decisions that proposed modifications to the debtors' chapter 11 reorganization plans did not require the distribution of a new disclosure statement and the re-solicitation of votes on the plans. The debtors were holding companies for Spanish-language television networks and their operating subsidiaries. Their voluntary petitions were filed to restructure the companies' debt obligations while continuing operations.[2]

Under the plans, the financing for the reorganized debtors would come from additional capital contributions and a new line of credit, all provided by the debtors' existing equityholders. The existing equity interests would be extinguished and the equityholders would receive equity interests in the reorganized debtors. All of the equity interest-holders were classified in the same class of interest-holders, but one of the equity interest-holders was an entity owned by the debtors' chief executive officer (the "CEO's company"). The CEO's company had operational control of the debtors.[3]

Plan confirmation proceeded, parties raised minor objections, and the debtors submitted an amended disclosure statement and subsequently solicited votes on the plans. The plans originally called for the equityholders to fund the additional capital investment after the confirmation order became final. However, two weeks before the confirmation hearing, the debtors informed the equityholders that the debtors would require the capital contributions three days before the confirmation hearing. The equityholders provided the financing before the confirmation hearing but missed the deadline set by the debtors.[4]

After the equityholders other than the CEO's company (the "other equityholders") missed the deadline, the CEO's company funded the entire capital amount.[5] The debtors then filed an emergency motion to modify the plans to provide all of the equity in the reorganized debtors to solely the CEO's company. The other equityholders were not served with the motion, there was no evidence the other equityholders knew the motion was filed, and the debtors assured the other equityholders that they would try to resolve the issue with respect to the other equityholders' capital contribution disagreement over any proposed modification.[6] The debtors also continued to work with the other equityholders to coordinate the other equityholders' portion of the financing after the CEO's company funded the entire amount.

The debtors received the other equityholders' wire transfer for the financing before the confirmation hearing, but the hearing on the emergency motion to modify the plans went forward.[7] At the modification hearing, the debtors informed the bankruptcy court that they intended to return the contributions by the other equityholders and move forward with the modified plans. Without requiring a new disclosure statement or a re-solicitation of votes, the bankruptcy court approved the modifications.

The bankruptcy court next considered confirmation of the plans as modified. No members of the class of equityholders voted on the plans prior to the modification, but the court reasoned that the plans extinguished the existing equity without providing anything in return. Therefore, the other equityholders were deemed to have rejected the plans under § 1126(g), and the plans were confirmed as cramdown plans over the other equityholders' deemed dissent.[8]

1 56 F.4th 1302 (11th Cir. 2023).
2 *Id.* at 1306.
3 *Id.*
4 *Id.*
5 *Id.*
6 *Id.* at 1306-07.
7 *Id.* at 1307.
8 *Id.*

Lower Courts Follow Nonbinding Precedent

The other equityholders moved for the bankruptcy court to reconsider the confirmation of the modified plans and argued that they were entitled to disclosure of the modification that gave the CEO's company all the equity in the reorganized debtors. The bankruptcy court denied the motion, quoting the U.S. Bankruptcy Court for the Southern District of Mississippi, which said that "the law is clear that modifications to a plan only require further disclosure and re-solicitation in respect of those parties who previously voted for the Plans."[9]

The bankruptcy court further stated that the other equityholders were not entitled to a new disclosure and vote as a matter of law. On appeal, the district court agreed with the bankruptcy court, stating that "a class of creditors or equity interest-holders who have not accepted a plan have no say in whether the plan can be modified."[10]

Eleventh Circuit Reverses on Multiple Grounds

The Eleventh Circuit began by looking to the Bankruptcy Code's requirements for plan modification. The court acknowledged that § 1127(a) allows for "relatively easy" pre-confirmation modification of a plan by the proponent of the plan, but the modification must comply with the substantive requirements generally applicable to any plan (*e.g.*, § 1122's restrictions on classification of claims) and the procedural limitations implemented by the Code (*e.g.*, § 1125's requirement that claim- and interest-holders receive adequate information about the contents of a plan).[11] A plan modification can trigger a claim- or interest-holder's right to receive a new disclosure statement and can call for a new round of voting if the bankruptcy court finds that the modification "materially and adversely changes the way that claim- or interest-holder is treated."[12]

The court found that each lower court erred in its conclusion that the other equityholders were not entitled to additional disclosure and re-solicitation because they were deemed to have rejected the proposed plans. First, under the proposed plans, the other equityholders received the exclusive opportunity to acquire equity in the reorganized debtors as a result of their existing equity, so they could not be deemed to have rejected the plans under § 1126(g).[13] Second, even assuming that the other equityholders rejected the plans, "holders that previously rejected (or did not vote for) a reorganization plan are still entitled to additional disclosure and voting if the treatment of the interests is materially and adversely affected by a modification."[14]

The first error does not address directly the standard for re-solicitation upon plan modification. Rather, the Eleventh Circuit rejected the lower courts' basis for determining that the other equityholders were deemed to have rejected the plans. Section 1126(g) provides that a class is deemed not to have accepted a plan if the plan does not provide that such class is entitled to receive or retain any property on account of the claims of the class.[15] This condition was not satisfied with respect to the other equityholders because they received the exclusive right to acquire their proportionate share of the equity in the reorganized debtors because of their prior equity interests.[16] Therefore, the class of equityholders as a whole could not be deemed to have rejected the plans.

The second error goes directly to the interpretation of Bankruptcy Rule 3019. The rule authorizes pre-confirmation modifications and provides that if the court finds that "the proposed modification does not adversely change the treatment of the claim of *any* creditor or the interest of *any* equity security-holder 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."[17]

Based on the rule's plain language, if a modification to a plan adversely impacts any creditor or the interest of any equity security-holder (not just those that voted to accept the plan), then the rule requires a new disclosure statement and vote.[18] Therefore, even assuming that the other equityholders could be deemed to have rejected the plans, additional disclosure and another round of voting were required, because the other equityholders were adversely affected by their loss of the right to acquire equity in the reorganized debtors.

How Does the Eleventh Circuit's Reversal Differ from Other Precedent?

In its opinion, the Eleventh Circuit acknowledged that the lower courts cited authority that appeared to support the bankruptcy court's conclusion that creditors who have rejected a plan are not entitled to additional disclosure and re-solicitation of votes. Although the Eleventh Circuit reached a different conclusion than these cases, it did not directly address the underlying decisions in the cited cases to explain why it was reversing the lower courts.

One of the decisions relied on by both lower courts was *National Trucking* from the U.S. Bankruptcy Court for the Southern District of Mississippi. In that case, a creditor objected to the modification of a plan via a plan supplement that altered the treatment of the creditor's collateral under the plan.[19] The court found that the creditor offered no cases supporting its position that a plan modification could be material to a creditor who had already rejected the plan.[20] The court further noted that the contrary view (*i.e.*, a plan modification *cannot* be material to a creditor who has rejected the plan) "enjoys wide support."[21] Thus, "[n]umerous courts have held that further disclosure and re-solicitation of votes on a modified plan is only required when the modification materially and adversely affects parties who previously voted for the plan."[22]

9 *In re Am.-CV Station Grp. Inc.*, No. 19-16355 (Bankr. S.D. Fla. July 16, 2020) (order denying motion to reconsider) (citing *In re Nat'l Truck Funding LLC*, 588 B.R. 175, 178 (Bankr. S.D. Miss. 2018)).
10 56 F.4th at 1308.
11 *Id.*
12 *Id.* at 1309.
13 *Id.*
14 *Id.* at 1311.
15 *Id.* at 1309.
16 *Id.* (citing *Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 456 (1999)).
17 *Id.* (emphasis in original).
18 *Id.*
19 *In re Nat'l Truck Funding LLC*, 588 B.R. 175, 178 (Bankr. S.D. Miss. 2018).
20 *Id.*
21 *Id.* at 179.
22 *Id.* (quoting *In re Art & Architecture Books*, 2016 WL 1118743, at *5).

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The other primary decision relied on in the lower courts was *American Solar King Corp*. from the U.S. Bankruptcy Court for the Western District of Texas. In this case, the court primarily addressed the issue of the need for further disclosure and re-solicitation of votes from classes of creditors who had accepted the plan.[23] However, in stating the condition for such further disclosure, the court noted that this "occurs only when and to the extent that the debtor intends to solicit votes from previously dissenting creditors or when the modification materially and adversely impacts parties who previously voted for the plan."[24] Under this reasoning, dissenting creditors' rights to additional disclosures as a result of a modification of a proposed plan turn on whether the proponent of the plan is seeking to turn the votes of such creditors.

In analyzing the debtors' arguments as to why the failure to provide the other equityholders with a new disclosure statement and a new round of voting was harmless, the Eleventh Circuit acknowledged an analogue of the primary justification for the approach taken in *National Trucking* and *American Solar King*. Whereas these cases found that a plan modification was not material to a creditor because the creditor had already voted to reject the plan, the Eleventh Circuit noted that a creditor who has voted against a plan suffers little substantive harm by not having an opportunity to reject the plan a second time.[25]

As to the *National Trucking* approach of deeming the modification to not be material to a creditor who has already rejected the plan, the Eleventh Circuit found that the bankruptcy court erred in "skipping the review for materiality and adversity."[26] The Eleventh Circuit's analysis of the material and adverse impact of the modification to the other equityholders focused on the economic terms of the plans (*i.e.*, the loss of the ability to receive equity in the reorganized debtors) and ignored the benefit (or lack thereof) of additional disclosure to the other equityholders.

However, when addressing the harm of failing to provide a new disclosure statement to the other equityholders, the court found that the failure deprived the other equityholders of the procedural protection of having the opportunity to object to the modified plans on substantive grounds. This opportunity was of particular importance because there were grounds for substantive objections.

Most notable of the substantive errors addressed by the court is that the modified plans removed the other equityholders' opportunity to receive equity in the reorganized debtors and gave all such rights to the CEO's company, a member of the same class of equity interestholders.[27] This disparate treatment was improper without the approval of the other equityholders. Such a substantive error is both a justification for why the other equityholders should have received an updated disclosure statement and an independent reason for why the plans should not have been confirmed (even without an objection from the other equityholders).[28]

The Eleventh Circuit's analysis of Bankruptcy Rule 3019(a) departs significantly from the reasoning in the lower court decisions that construed the same rule. The apparent lack of harm to parties who have voted to reject a plan appears to be a practical consideration of the lower courts in not requiring additional disclosure and voting. To the contrary, the Eleventh Circuit's decision makes it clear that the practical approach taken by the lower courts is not contemplated by Rule 3019(a), and that the rule is to be strictly construed to provide a procedural safeguard when pre-confirmation modifications adversely affect a class of creditors or equity security-holders.

It is an interesting question of whether the Eleventh Circuit would have found the failure to provide a new disclosure statement and opportunity to vote harmless if there had not been substantive objections to confirmation of the modified plans. Regardless, the Eleventh Circuit made it clear that "a dissenting vote on a Chapter 11 plan does not give the debtor a free pass to modify the plan to the detriment of that dissenting claim or interest-holder."[29] This hard-and-fast rule requiring further disclosure and voting should apply — even if the modified plan is confirmable under the Bankruptcy Code.

Conclusion

Following the Eleventh Circuit's decision in *In re America-CV Station Group Inc*., it is evident that even creditors who have previously voted to reject a plan are entitled to a new disclosure statement and opportunity to vote when their interests are materially and adversely affected by a pre-confirmation plan modification. Plan proponents seeking to accomplish a last-minute modification will want to take note of Bankruptcy Rule 3019(a)'s procedural safeguards, which could lead to delays in the confirmation process. Fortunately, Rule 3019(a) provides plan proponents a way to avoid such delays by obtaining the adversely affected parties' approval of the modification in writing. abi

23 *In re Am. Solar King Corp*., 90 B.R. 808, 823 (Bankr. W.D. Tex. 1988).
24 *Id.*
25 56 F.4th at 1311.
26 *Id.* at 1309.
27 *Id.* at 1312.
28 *Id.*
29 *Id.*