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2020 Volume XII No. 15

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Cite as: *Circuit Courts Interpret the Section 1123(a)(4) Equal Treatment Rule*, 12 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 15 (2020)

INTRODUCTION

Under section 1123(a)(4) of title 11 of the United States Code (the "Bankruptcy Code"), a plan of reorganization must "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." The Supreme Court has never interpreted this provision, nor has the Bankruptcy Code defined the standard of equal treatment. As a result, the circuit courts have created a standard for what exactly the equal treatment rule requires.[1]

The first part of this memorandum discusses what the section 1123(a)(4) equal treatment rule actually requires, and the second part analyzes how four circuit courts have interpreted this rule to find that a plan of reorganization can, in fact, treat class members differently, as long as certain criteria are met.

I. The section 1123(a)(4) Equal Treatment Standard Does Not Require that all Claimants Receive the Same Amount of Money.

[1] *See Ahuja v. LightSquared Inc.*, 644 F. App'x 24 (2d Cir. 2016); *Mabey v. Sw. Elec. Power Co.* (*In re* Cajun Elec. Power Coop., Inc.), 150 F.3d 503 (5th Cir. 1998); *Acequia, Inc. v. Clinton* (*In re* Acequia, Inc.), 787 F.2d 1352 (9th Cir. 1986).

Under section 1123(a)(4) of the Bankruptcy Code, when confirming a plan of reorganization, it is well established that all claimants are required to receive equality of treatment, meaning that "all class members receive equal value and pay the same consideration in exchange for their distributions."[2] Yet, multiple courts have held that this does not mean that all claimants are required to receive equality of result.[3] Section 1123(a)(4) is satisfied "if claimants in the same class have the same opportunity to recover."[4] This means that if a plan subjects all members of the same class to the same means of claim determination, it is sufficient to satisfy the requirements of section 1123(a)(4).[5]

"The key inquiry under § 1123(a)(4) is not whether all of the claimants in a class obtain the same thing, but whether they have the same opportunity."[6] In *In re Dana Corp.*, a portion of the claimant's in a particular class reached settlement agreements with the debtor, and as a result, they received far less than their full claims, while those who did not settle did receive their full claims.[7] Yet, the court held that the chapter 11 plan did not violate section 1123(a)(4) even though the claimants did not agree to less favorable treatment, because all the claimants in the same class had the same opportunity to settle their claims.[8]

Additionally, a reorganization plan that implemented a lottery system that would divide all of the creditors into seven classes and established "a mandatory redemption schedule under

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[2] *In re* Breitburn Energy Partners LP, 582 B.R. 321, 358 (S.D.N.Y. 2018).
[3] *See id; In re* W.R. Grace & Co., 729 F.3d 311, 327 (3d Cir. 2013) ("[C]ourts have interpreted the 'same treatment' requirement to mean that all claimants in a class must have 'the same opportunity' for recovery."); *In re* Central Med. Ctr., Inc., 122 B.R. 568, 574 (Bankr. E.D. Mo. 1990).
[4] *See In re* Breitburn, 582 B.R. at 358.
[5] *See In re* Central Med., 122 B.R. at 575.
[6] *See Ad Hoc Committee of Personal Injury Asbestos Claimants v. Dana Corp.*, (*In re* Dana Corp.), 412 B.R. 53, 62 (S.D.N.Y. 2008).
[7] *See id.*
[8] *See id*; *In re* Joint Eastern and Southern Dist. Asbestos Litigation, 982 F.2d 721, 749 (2d Cir.1992) ("the 'same treatment' standard of section 1123(a)(4) does not require that all claimants within a class receive the same amount of money.").

which a given number of bonds are randomly selected by the trustee to be redeemed each year" has also been found to satisfy the requirements of Section 1123(a)(4).[9] To elaborate, under this lottery system the creditors who were chosen first would receive a more favorable interest rate than those bondholders chosen to be paid later and therefore they would receive different amounts of money.[10] However, the court found that section1123(a)(4) simply requires that a plan subject class members to the same process for claim satisfaction, not that the process must yield the same pecuniary result for each class member.[11]

Accordingly, while it is well established that members of a certain class do not have to receive the same compensation under a reorganization plan, they must be subject to the same process in determining that compensation.

II. Circuit Courts find that Reorganization Plan may Treat Certain Creditors More Favorable Without Violating Section 1123(a)(4).

An issue of interpretation arises when certain class members are treated better than others because they have provided some new form of consideration in exchange for that better treatment. Because the Supreme Court has never defined what exactly equal treatment requires under the Bankruptcy Code, and because the Bankruptcy Code itself has never provided a standard for equal treatment, this is the question that the circuit courts are beginning to address and create a standard for.[12] Under this interpretation, a reorganization plan does not violate section 1123(a)(4) if it treats creditors within the same class differently if that favorable treatment is in exchange for a "valuable new commitment" by the creditor.[13] The Second, Fifth,

[9] *In re* Central Med., 122 B.R. at 574.
[10] *See id.*
[11] *See id.* at 575 ("[T]he Plan affords all bondholders the opportunity to participate in the same random lottery system. The fact that some may ultimately receive more money than others is merely a consequence of a system that was applied equally to all members of that class.").

[12] *In re* Peabody Energy Corporation, 933 F.3d 918, 925 (8th Cir. 2019); *Ahuja*, 644 F. App'x at 24; *In re* Cajun, 150 F.3d at 503; *In re* Acequia, 787 F.2d at 1352.
[13] *See In re* Peabody, 933 F.3d at 925.

Eighth, and Ninth Circuits have found that it is in fact possible for a plan to treat certain creditors more favorable without violating the equal treatment rule.

One way a creditor may provide "valuable new commitment" to satisfy this standard is if it had a secured claim separate from its equity interest.[14] For example, in the Second Circuit, the court addressed the question of whether a plan of reorganization violated the equal treatment standard where senior creditors were paid more than their claims were worth and found that the plan was permissible. The Court held that there was no violation because the senior creditors that were treated more favorably had not received that extra value in the reorganization for its common equity interests, "but rather for its secured claim against LightSquared Inc. and the causes of action against third parties that it agreed to attribute to reorganized LightSquared."[15] So, because the equity holder had a secured claim separate from its equity interest and had agreed to attribute to the reorganized debtor "certain causes of action against third parties," it was permissible that they were treated more favorably than other equity holders within their class.[16]

The Fifth and Ninth Circuit have both held similarly in cases going as far back as 1986.[17] The Ninth Circuit established that if a claimant in a particular class is receiving preferential treatment over other claimants in the class, the inequality is permissible as long as the treatment is the result of something other than her ownership interest as a shareholder.[18] In *In re* Acequia, Inc., the reorganization plan classified two separate shareholders in the same class but denied only one of those shareholders the right to "participate in management of the Debtor as an officer or director."[19] The less favored shareholder argued that this restriction on his shares violated the

[14] *See Ahuja*, 644 F. App'x at 24.
[15] *See id.* at 29.
[16] *See id.*
[17] *See In re* Cajun, 150 F.3d 503; *In re* Acequia, 787 F.2d 1352.
[18] *See In re* Acequia, 787 F.2d at 1363.
[19] *Id.* at 1362.

equal treatment rule, but the Ninth Circuit found otherwise. The Court found that because the shareholder's "position as director and officer of the Debtor is separate from her position as an equity security holder" and the preferential treatment was tied to her service to the debtor as a director and officer of the debtor, rather than to her ownership interest as a shareholder, the preferential treatment was permissible.[20]

Additionally, the Fifth Circuit has found reimbursement of expenses incurred in a bankruptcy case to the claimants is enough to permit favorable treatment of certain claimants.[21] In *In re Cajun*, the court found that even though the debtor made additional payments to one claimant resulting in a more favorable treatment, "the payments were not made in satisfaction of the … members' claims against Cajun, but rather as reimbursement for plan and litigation expenses incurred in the bankruptcy case."[22] So, because the payments were made for a purpose other than to satisfy the claimants claims against the debtor, the favorable treatment was permissible.

The Eighth Circuit is the most recent circuit court to adopt this interpretation of the equal treatment rule. In *In re Peabody,* the Eighth Circuit seemed to summarize the fellow circuits interpretations and create a more clear-cut rule, in holding that "a reorganization plan may treat one set of claim holders more favorably than another so long as the treatment is not for the claim but for distinct, legitimate rights or contributions from the favored group separate from the claim."[23] In doing so, the Eighth Circuit distinguished *In re Peabody* from *Lasalle*, where the Supreme Court "rejected a reorganization plan that gave a debtor's prebankruptcy equity holders the exclusive opportunity to receive ownership interests in the reorganized debtor if the equity

[20] *See id*. at 1363.
[21] *See In re* Cajun, 150 F.3d at 518.
[22] *See id.*
[23] *In re* Peabody, 933 F.3d at 925.

holders would invest new money in the *reorganized debtor*."[24] In distinguishing *LaSalle*, the Eighth Circuit seemingly laid out three essential criteria that must be met in order to satisfy § 1123(a)(4).[25] First, the claimant that is treated less favorably must not be excluded from any opportunity that is afforded to the claimant that receive preferential treatment. Second, the creditors that receive preferential treatment must give up something of value in exchange for said preferential treatment. Finally, the debtor must consider alternative ways to raise capital other than through providing preferential treatment.[26] For these reasons, the Eighth Circuit found that *Lasalle* does not imply that there are no circumstances under which a plan may treat claimants differently within the same class.

CONCLUSION

Notwithstanding that under section 1123(a)(4) of the Bankruptcy Code, a plan of reorganization must "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," the circuit courts are beginning to carve out a way for debtors to provide certain creditors with special treatment. The Eighth Circuit has laid out the three requirements that are needed to satisfy the requirement under this developing interpretation: (1) the claimant that is treated less favorably must not be excluded from any opportunity that is afforded to the claimant that receive preferential treatment; (2) the creditors that receive preferential treatment must give up something of value in exchange for said preferential treatment; and (3) the debtor must consider alternative ways to raise capital other than through providing preferential treatment.[27]

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[24] *See id.*; *Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 456 (1999).
[25] *See In re* Peabody, 933 F.3d at 926.
[26] *See id.*
[27] *See id.*