

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

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|---------------------------|---|---------------------|
| IN THE MATTER OF |) | |
| |) | |
| LERNER JONES PARTNERSHIP, |) | CASE NO. BK93-81554 |
| |) | |
| DEBTOR |) | CH. 11 |
| |) | Fil. 108, 151, 143 |

MEMORANDUM

Hearing was held on May 23, 1994, on Confirmation of Plan. Appearing on behalf of debtor was Steven Woolley of Polack, Woolley & Forrest, P.C., Omaha, Nebraska. Appearing on behalf of Prudential Insurance Company of America was Clifton R. Jessup, Jr., of Dixon & Dixon, Ltd., L.L.P., Omaha, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(L).

Background

The debtor, Lerner Jones Partnership, owns a shopping mall in Omaha, Nebraska. The debtor has no employees, and management of the property is performed by another entity. The debtor filed a petition to reorganize under Chapter 11 of the Bankruptcy Code on September 21, 1993, after defaulting on a mortgage payment to Prudential Insurance Company of America (Prudential).

Prudential is an oversecured claim holder with a first lien on the asset of the debtor. Prudential's claim is for more than \$6,000,000. Stanley J. Howe & Associates, Inc. (Howe), a general unsecured creditor, has a claim for approximately \$350. All remaining claim holders are insiders of the debtor.

On January 6, 1994, the First Amended Debtor's Plan of Reorganization (the Plan) was filed. Administrative claims, which are all claims of insiders, will be paid within 30 days of their allowance, except one, which will be paid in full over several months. These payments will exhaust all of the debtor's current cash reserves.

The remaining claims are set forth in three classes. Class I is Prudential's claim. The debtor proposes to reamortize Prudential's debt and decrease the interest rate it pays to Prudential. Class II consists of two general unsecured claim holders. One is Howe and the other is a company owned by the general partners of the debtor. These claims will be paid in full

on a pro rata basis based upon the cash flow remaining after the administrative claims and all other expenses are paid. Class III consists of the general partners, who will retain their interests in the debtor and who will be entitled to authorize capital withdrawals from the debtor after Class II claims are paid in full.

Prudential objects to the confirmation of the Plan. Prudential takes the position that the debtor's true intent with the Plan is to rewrite its loan agreement with Prudential to lower the interest rate it agreed to pay Prudential in the loan agreement and to otherwise modify the terms of the agreement to favor the debtor's general partners. To support its position, Prudential asserts that this bankruptcy case is a single asset case and that Prudential's claim of over six million dollars represents over 99% of all claims, and the only remaining claim held by a non-insider is Howe's claim for \$350. Prudential alleges that Howe's claim is artificially impaired, and therefore, Prudential is the only truly impaired claim holder under the Plan. For these reasons, the Plan violates 11 U.S.C. § 1129(a)(3) and (a)(10) and cannot be confirmed because Prudential, the only impaired class, voted against the Plan and because the Plan was filed in bad faith.

Decision

The motion to confirm the Plan is denied without prejudice. The clerk is directed to set a hearing to permit the Court to determine if this case should be dismissed because no truly impaired class has approved the plan.

Discussion

This case is similar to the Eighth Circuit case Windsor on the River Assoc., Ltd. v. Balcor Real Estate Finance, Inc. (In re Windsor on the River Assoc., Ltd.), 7 F.3d 127 (8th Cir. 1993). In Windsor, the debtor, a limited partnership that owned an apartment complex, failed to make payments on its mortgage loan to the secured creditor, so the debtor filed for Chapter 11 protection. 7 F.3d at 129. The secured creditor was oversecured. Of the allowed claims, only the secured creditor's claim for over nine million dollars and the general unsecured trade claims of about \$13,000 were impaired claims held by non-insiders. The trade creditors were to be paid within sixty days after the bankruptcy plan's effective date. The secured creditor was to receive an initial payment of \$500,000 on the effective date of the plan, and thereafter, the debtor proposed to extend the term of the claim and make installment payments thereon. Id. at 130.

The secured creditor in Windsor feared that the debtor would meet the technical requirements for confirmation under 11 U.S.C. § 1129(a)(10) because if the class of trade creditors approved the plan, an impaired class would have approved the plan. The secured creditor acted to avoid the "cram down" of its claim by purchasing

a majority of the unsecured trade creditors' claims and attempting to cast or change the votes accompanying those claims. Windsor, 7 F.3d at 130. The district court confirmed the debtor's plan and denied the secured creditor the right to cast the general unsecured trade creditors' votes because the votes were cast before the secured creditor acquired the claims.

The Eighth Circuit reversed the District Court on the confirmation issue and dismissed the bankruptcy case. The Court noted that under 11 U.S.C. § 1124(1), "any alteration of a creditor's rights, no matter how minor, constitutes "impairment."" Windsor, 7 F.3d at 130. The Court declined to read this definition to its broadest interpretation. Instead, the Court decided that the debtor could not artificially manufacture an impairment at will "just to stave off the evil day of liquidation," because such an impairment was contrary to the purpose of the bankruptcy code. Id. at 130-31 (quotations omitted).

The Court opined that the purpose of 11 U.S.C. § 1129(a)(10), by requiring one impaired class to approve a bankruptcy plan, is to give secured creditors more protection from debtors who attempt to "cram down" bankruptcy plans, and not to give debtors the means to rewrite their credit agreements without the creditor's consent. Windsor, 7 F.3d at 131. "Confirmation of a plan where the debtor engineers the impairment of the only approving impaired class 'so distorts the meaning and purpose of [section 1129(a)(10)] that to permit it would reduce (a)(10) to a nullity.'" Id. (quoting In re Lettick Typographic, Inc., 103 B.R. 32, 39 (Bankr. D. Conn. 1989)).

The Eighth Circuit concluded that permitting debtors to artificially impair a class was "unsettling." Windsor, 7 F.3d at 132. First, the Court stated that debtors who were not fiscally promising enough to refinance loans on the open market would turn to 11 U.S.C. § 1129(a)(10) to force existing creditors to refinance loans. Second, the Court found that artificial impairment would encourage "side dealing" between debtors and certain creditors, to the detriment of other creditors. Debtors could artificially impair a small unsecured creditor class and have a plan approved, but still leave the small unsecured creditor's interests only slightly altered. Id. The Court stated "[i]t is exactly such "side dealing" that prompted the adoption of a bankruptcy code, and to allow it would 'defeat the purposes Congress sought to serve.'" Id. (quoting Norfolk Redevelopment & Housing Authority v. Chesapeake & Potomac Tel. Co., 464 U.S. 30, 36, 104 S. Ct. 304, 307, 78 L. Ed. 2d 29 (1983) (quotations omitted)).

The Eighth Circuit rule is that under 11 U.S.C. § 1129(a)(10), courts must consider a threshold issue: "a claim is not impaired if the alteration of the rights in question arises solely from the debtor's exercise of discretion." Windsor, 7 F.3d at 132. This is a question of fact. Id. In Windsor, the Eighth Circuit reviewed the district court's conclusions under the clearly erroneous

standard and found that the court erred, that the debtor did artificially impair the trade creditor's claims, that the secured creditor was the only truly impaired claim holder who was entitled to vote on the plan, that the secured creditor would never likely approve any plan, and therefore, dismissed the case because the debtor would not be able to propose a confirmable plan. Id. at 132-33.

Although this Court, if writing on a clean slate and not faced with a circuit court opinion such as Windsor, might interpret the literal language of the Code and the purpose of the reorganization statute in a manner more favorable to a debtor exercising its discretion regarding classification and impairment, Windsor seems to be a strong, clear statement of the law in this circuit.

In this bankruptcy case, Prudential is an oversecured creditor, whose claim represents over 99% of all claims in this bankruptcy case. The other non-insider impaired claim holder is Howe, who has a claim for \$350. The debtor asserts that the Plan complies with 11 U.S.C. § 1129(a)(10) and is confirmable because Howe has voted to approve the Plan.

There is a strong indication that the debtor has artificially impaired Howe's claim to gain confirmation of the Plan and to rewrite its loan agreement with Prudential. Howe's claim is only \$350, which is a relatively trivial claim. The amount Prudential's claim is oversecured would cover this claim, and the debtor, which had over \$30,000 in cash when the case was filed and has regular cash flow, has the ability to pay this debt off at confirmation, if not before.

The debtor argues that its administrative costs are very high in this case and that it cannot pay off Howe's claim immediately because all of the cash on hand will go to priority claims, and therefore, this claim must be paid, over time, through the Plan. However, at the beginning of this case, Howe's claim was for more than \$1,000, so it appears that the debtor could and did pay most of this claim already. The debtor's argument that all available cash must be used to pay administrative costs, standing alone, is a weak argument. Because the administrative claims are all claims of insiders, and because insiders have agreed to fund the professional fees and other ongoing expenses during this case, it seems obvious that, if they so chose, insiders could advance \$350 to the debtor to pay the Howe claim at confirmation.

The debtor appears to have engaged in the "side dealing" that the Eighth Circuit warned against in Windsor. The debtor appears to have paid down this claim to a negligible amount and set up its Plan so Howe would receive the remainder of its claim relatively soon, but not soon enough to be considered unimpaired. In response, Howe had no reason to vote against the Plan. However, the end result could be that this Court would "cram down" a

refinancing by Prudential to the benefit of no other creditor except for insiders. The Windsor decision rejects such a practice.

Windsor requires an evidentiary hearing must be held to permit the trial court to make factual findings on the issues of artificial impairment of the claim of Howe. If the debtor continues to insist that there is a legitimate reason for impairing Howe's claim, it is entitled to an evidentiary hearing. However, the debtor should proceed with the knowledge that it appears from consideration of all of the circumstances at this point in time that the debtor did artificially impair Howe's claim to secure confirmation of the Plan. The task facing the debtor at an evidentiary hearing will be onerous, because of the holding in Windsor that "a claim is not impaired if the alteration of the rights in question arises solely from the debtor's exercise of discretion." Windsor, 7 F.3d at 132.

Prudential has stated that it would like this case dismissed, so the parties may continue their relationship pursuant to the terms of the loan agreement or pursuant to state law. If the debtor cannot show that it did not artificially impair this claim for confirmation purposes, the case will be dismissed because the debtor will not be capable of submitting a plan that is confirmable. "A bankruptcy court may dismiss a Chapter 11 case or convert it to a case under Chapter 7 'for cause, including ... inability to effectuate a plan.'" Lumber Exch. Bldg., Ltd. v. mutual Life Ins. Co. (In re Lumber Exch. Bldg., Ltd.), 968 F.2d 647, 648 (8th Cir. 1992) (quoting 11 U.S.C. § 1112(b)(2)).

The Clerk shall schedule a hearing concerning whether the debtor artificially impaired the claim of Howe.

Separate journal entry to be entered.

DATED: June 7, 1994.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: Movant, Debtor(s) Atty. and all parties appearing at hearing
[] Chapter 13 Trustee [] Chapter 12 Trustee [] U.S.Trustee
Movant is responsible for giving notice of this journal entry to all other parties
if required by rule or statute.

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| <u>DEBTOR(S)</u> |) | |
| |) | CH. 11 |
| |) | Filing No. 108, 151, 143 |
| Plaintiff(s) |) | |
| vs. |) | <u>JOURNAL ENTRY</u> |
| |) | |
| |) | DATE: June 7, 1994 |
| <u>Defendant(s)</u> |) | HEARING DATE: May 23, |
| |) | 1994 |

Before a United States Bankruptcy Judge for the District of Nebraska regarding Confirmation of Plan.

APPEARANCES

Clifton R. Jessup, Jr., Attorney for Prudential Ins. Co.
Steven Woolley, Attorney for debtor

IT IS ORDERED:

Plan denied confirmation without prejudice. Clerk shall schedule evidentiary hearing for one-half day on dismissal issues. See memorandum this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: Movant, Objector/Resistor (if any), Debtor(s) Atty. and all parties appearing at hearing
[] Chapter 13 Trustee [] Chapter 12 Trustee [] U.S.Trustee

Movant is responsible for giving notice of this journal entry to all other parties if required by rule or statute.