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From the Bankruptcy Courts

Benjamin Weintraub* and Alan N. Resnick**

THE RUTI-SWEETWATER WARNING TO CREDITORS—A POWERFUL LESSON

Secured creditors are often placed in separate one-member classes in a chapter 11 reorganization plan because they are rarely similarly situated. Collateral types and values differ, and the debtor often proposes to treat each secured creditor differently. It is common, therefore, for a mortgagee, judicial lienor, or other creditor with a secured claim to find itself in a class by itself.

Qualifications for Confirmation

There are two ways in which a reorganization plan may qualify for confirmation so as to render the plan binding. The first road to confirmation is by satisfying the requirements listed in Section 1129(a) of the Bankruptcy Code, including the need to obtain the acceptances of every class that is impaired by the plan. A class of creditors "accepts" the plan if the members of the class who hold at least two thirds in amount and one half in number of the total allowed claims of the class who vote accept. Only those members of the class who actually vote to accept or reject the plan are counted as class members for this purpose.

The second road to confirmation is the "cramdown" approach pursuant to Section 1129(b), which is used if the proponent of the plan is unable to satisfy the requirement in Section 1129(a)(8) that all impaired classes accept the plan. In essence, as long as at least one impaired class of noninsiders accepts the plan, the plan may be "crammed down" nonaccepting classes if the plan does not

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1 See 11 U.S.C. § 1122(a), which provides that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class."


4 See 11 U.S.C. § 1126(c).
"discriminate unfairly" and is "fair and equitable," as that term of art is defined in Section 1129(b)(2), with respect to each impaired class that has not accepted the plan.

The court must hold a confirmation hearing and is compelled to confirm a plan if all the requirements of Section 1129(a) are met.5 If the requirements of Section 1129(a) are met, including acceptance by every impaired class, the proponent need not present any evidence showing that the plan does not "unfairly discriminate" and is "fair and equitable." But what happens if every member of a particular impaired class of creditors fails to submit a ballot and, accordingly, neither accepts nor rejects the plan? Suppose that the class does not object or even appear at the confirmation hearing. Should the court confirm the plan, even though it is not fair and equitable under Section 1129(b)? Did such a class accept the plan or did it reject it?

These questions are especially important for the secured creditor that finds itself in a class by itself. If it does not vote at all and does not object to confirmation of the plan—in other words, the secured creditor does absolutely nothing in the case—is it proper for the court to confirm the plan without satisfying the "fair and equitable" standard?

The Tenth Circuit's recent opinion in In re Ruti-Sweetwater, Inc.6 is the only court of appeals decision on the issue of whether a class has accepted or rejected a plan when no member votes or objects to confirmation. Although improperly decided, Ruti-Sweetwater is a powerful lesson for creditors who, secure in the protection of the "fair and equitable" doctrine, think that they are guaranteed absolute priority of their claims while ignoring the case by not voting or objecting to confirmation.

The Ruti-Sweetwater Case

Ruti-Sweetwater, Inc., and seven related companies filed chapter 11 petitions resulting in the consolidation of the eight cases for the purpose of administration. The debtors were actively engaged in the vacation timeshare business, and their complex 120-page reorganization plan included eighty-three separate classes of secured creditors and forty separate classes of timeshare owners. A separate class was created for three related individuals, the Heins, who held a judgment lien on a specific parcel of real property to secure payment of $30,000 plus $8,000 interest. The reorganization plan

5 See 11 U.S.C. §§ 1128(a), 1129(a) ("The court shall confirm a plan only if all of the following requirements are met: . . . ").

6 836 F.2d 1263 (10th Cir. 1988).
treated the Heins as a separate class and provided that the Heins' lien was to be transferred to unsold time-share intervals so that the Heins would realize a small portion of their claim upon the sale of each interval. The plan also provided that the Heins would receive the entire amount of their claim, with interest, within forty-eight months after confirmation. Clearly, the Heins' claim was "impaired" under the plan. 7

The Heins did not exercise their right to vote on the plan and did not file any written objections to confirmation. Nineteen other classes of secured claims also failed to vote. Moreover, the Heins did not appear at the confirmation hearing at which the bankruptcy court ruled in the absence of objection that the non-voting creditors were deemed to have accepted the plan, for the purpose of relieving the plan proponent of the need to satisfy the cramdown requirements of Section 1129(b). Therefore, there was no need to show that the plan was "fair and equitable."

Only four days after the court entered an order confirming the plan, the court held a hearing on the distribution of the proceeds from the sale of the parcel of land in which the Heins had their lien. The court previously approved

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the sale of the property free and clear of all liens, including the Heins lien, pursuant to Section 363(f) of the Bankruptcy Code. The Heins appeared with counsel for the first time at the hearing on distribution of the sales proceeds and they challenged the reorganization plan. In particular, they challenged the provisions of the plan under which the lien was removed from the property and transferred to the unsold time-share intervals. The bankruptcy court ruled that the Heins were bound by the provisions of the confirmed plan that removed their lien from the real property that was sold free and clear of liens prior to the confirmation date.

The Issue on Appeal

The Heins appealed the order confirming the plan to the district court, which viewed the appeal as raising a single issue: "whether a non-voting, non-objecting creditor who is the only member of a class is deemed to have accepted the plan for purposes of 11 U.S.C. § 1129." 8

The district court correctly observed that Section 1126(a) of the Code does not require a creditor to vote; it provides only that a creditor may accept or reject a plan.

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7 See 11 U.S.C. § 1124 on impairment of claims.
However, the Code does not indicate whether a failure to vote is deemed to be an acceptance. It is undisputed that under the former Bankruptcy Act a failure to vote was considered a rejection of the plan. . . . The presumption under the prior law that non-voting creditors rejected the plan has been removed. Non-voting creditors are deemed neither to have accepted the plan nor rejected it; they are simply bound by the result produced by those who vote. The necessity of deeming a failure to vote as either an acceptance or a rejection of a plan arises only when no members of a class cast a vote.9

The district court then stretched the absence of any congressional intent on this issue to reach its conclusion that a class that does not vote at all is deemed to have accepted the plan:

Congress, when it eliminated the presumption of rejection, apparently overlooked the possibility that all the members of a class might fail to vote. This court finds it difficult to believe that Congress intended on the one hand to deny a non-voting creditor the benefits of section 1129(b) whenever other, more concerned, members of the class voted to accept a plan; but, on the other hand, to reward a non-voting creditor's apathy or carelessness with those benefits whenever the other members of the class also fail to vote.10

It is important to note that the district court did not merely rule that the Heins did not have standing to challenge the order of confirmation on appeal because they did not object below. Such a holding would not have been unnecessarily far-reaching. Instead, the district court went a considerable step further and, creating new substantive law on confirmation requirements, held that it is not necessary for a plan proponent to show, or for the court to be concerned with, the “fair and equitable” and “unfair discrimination” aspects of cramdown under Section 1129(b) with respect to an impaired class when no member of the class votes or objects to confirmation:

Accordingly, the court concludes as a matter of law that a non-voting, non-objecting creditor who is a member of a class that casts no votes is deemed to have accepted the plan of reorganization for the purposes of section 1129(a)(8) and 1129(b). Because the Heins, the only members of the class, did not vote, they are deemed to have accepted the plan. It was not necessary for the part of the plan that affected the Heins to meet the standards imposed by section 1129(b).11

The Court of Appeals Affirms

The court of appeals affirmed the district court decision after

9 Id. at 749-750.
10 Id. at 750.
11 Id.
reviewing the issue de novo as a mixed question of law and fact. The holding, which was that the Heins' failure to either vote or object constituted acceptance of the plan, was the same as that of the district court:

To hold otherwise would be to endorse the proposition that a creditor may sit idly by, not participate in any manner in the formulation and adoption of a plan in reorganization and thereafter, subsequent to the adoption of the plan, raise a challenge to the plan for the first time. Adoption of the Heins' approach would effectively place all reorganization plans at risk in terms of reliance and finality. 12

The court of appeals also agreed with the district court's finding that "creditors are obligated to take an active role in protecting their claims." 13

The problem with the court's reasoning is that these concerns regarding finality and the prevention of a nonobjecting party from attacking a confirmation order for the first time after the hearing is concluded could have been dealt with by merely holding that the Heins do not have standing to appeal the confirmation order because of their failure to object below. Such a narrow holding would not have had the improper effect of permitting bankruptcy courts in future cases to confirm plans under Section 1129 without making an independent inquiry as to whether they are "fair and equitable" regarding impaired classes whose members did not vote on a plan or formally object to confirmation.

The most troubling rationale found in the court's opinion is that the Bankruptcy Code, unlike the former Bankruptcy Act, "does not indicate whether a failure to vote, such as here, is deemed to be an acceptance or rejection of the plan." 14 The court seems to ignore the fact that Section 1126(c) of the Code provides that a class of claims has accepted a plan if it "has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan." 15 Also, Bankruptcy Rule 3018(c) requires that "an acceptance or rejection shall be in writing . . . be signed by the creditor . . . and conform to Official Form No. 30." Therefore, it is clear from the Bankruptcy Code and the Bankruptcy Rules that "acceptance" means actual acceptance and that acceptance may not be implied by silence alone when dealing with an impaired class.

The court of appeals found comfort in the fact that the Bank-

12 836 F.2d at 1266-1267.
13 Id. at 1267.
14 Id.
15 11 U.S.C. § 1126(c) (emphasis added).
Bankruptcy Code contains certain presumptions regarding acceptance and rejection, even though these presumptions clearly had no relevance to the issue before it. Section 1126(f) provides that an unimpaired class is conclusively presumed to have accepted the plan. Section 1126(g) provides that a class is deemed to have rejected a plan if the plan does not entitle class members to receive or retain anything. After mentioning such presumptions in the Bankruptcy Code, the court of appeals slipped comfortably to its conclusion by creating a new presumption:

Since the Heins did not object to the Plan at any time prior to its confirmation and because the Heins unilaterally opted not to vote on the confirmation of the Plan, the bankruptcy court did not err in presuming their acceptance of the Plan for purposes of § 1129(b).

Once acceptance was properly presumed, the court was not obligated to inquire as to whether the Plan discriminated unfairly or was not fair and equitable to the Heins under § 1129(b)(1). When the Heins failed to object to the Plan, they waived their right to challenge the Plan or to assert, after the fact, that the Plan discriminated unfairly and was not fair and equitable.17

We question whether the court of appeals gave proper consideration to the difference between (1) holding that the Heins waived their right to challenge the confirmation order on appeal because they failed to timely object to confirmation in the bankruptcy court and (2) holding that their failure to vote or object is deemed acceptance for Section 1129(a)(8) purposes. The former holding would not relieve the bankruptcy court in future cases from requiring the proponent of a plan to prove by competent evidence that the requirements for cramdown found in Section 1129(b) are satisfied regarding nonvoting, nonobjecting classes. It would also be consistent with numerous cases holding that the bankruptcy court should not confirm a plan without being satisfied that the confirmation requirements set forth in Section 1129 are met, despite the absence of objections.18 On the other hand, the latter holding means that bankruptcy courts may disregard entirely all cramdown requirements designed to protect nonaccepting impaired classes when the classes fail to vote or object to confirmation.

Although the reach of Ruti-Sweetwater goes beyond the treatment of secured creditors and

16 See 11 U.S.C. § 1124 on impairment of claims.
17 836 F.2d at 1267-1268.
may be applied to unsecured creditors and equity interest holders, secured creditors are the most vulnerable because of the common practice of placing each secured creditor in a separate class. Thus, if a one-member secured creditor class fails to vote or object, the creditor may no longer rely on the expectation that the bankruptcy court will refuse to confirm the plan unless and until it is satisfied by the evidence that the plan is fair and equitable as to that creditor.

A Better Approach: *Townco Realty*

A better approach to the issue presented in *Ruti-Sweetwater* was illustrated in *In re Townco Realty, Inc.* The debtor in *Townco* had six creditors, with one creditor holding 99.9 percent of the total debt and a mortgage on the debtor’s only asset, a shopping mall. None of the members of the class of unsecured creditors voted on the plan. The bankruptcy court stated:

The debtor assumes . . . that the failure to vote constitutes acceptance of the plan. That is not the case. There is no predicate in the statute or the rules for this conclusion.20

The bankruptcy court in *Townco* properly relied on Section 1126(c) of the Bankruptcy Code and Bankruptcy Rule 3018(c) in concluding that mere failure to vote for a plan does not constitute acceptance of the plan for Section 1129 purposes. However, when faced with a choice of following the holding of *Ruti-Sweetwater* or the holding of *Townco*, the bankruptcy court in *In re Campbell*21 concurred with the reasoning of *Ruti-Sweetwater*:

A single creditor or class of creditors should not, by their total inaction, be able to force a debtor to have to resort to the cramdown process to obtain confirmation of a plan when all of the other confirmation requirements, including the affirmative acceptance of the plan by at least one impaired class, have been met.22

Conclusion

A clear reading of the Bankruptcy Code and Bankruptcy Rules should have led all of these courts to the conclusion that a nonvoting, nonobjecting class is entitled to “fair and equitable” protection under the cramdown provisions of Section 1129(b) and that the bankruptcy court should require the proponent of the plan to show that such cramdown standards are met. However, with *Ruti-Sweetwater* and *Campbell* as authority, creditors in a particular

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20 Id. at 708.
22 Id. at 188.
class should be certain to have at least one member of the class actually vote to reject a plan if they want to rely on the cramdown protection of Section 1129(b). In fact, every creditor who wants Section 1129(b) cramdown protection should vote because of an even more outrageous suggestion contained in a footnote in the district court’s decision in Rutis-Sweetwater: “The court expresses no opinion on whether a non-voting creditor whose class votes against a plan will be able to ride the coat tails of the class and have the benefits of section 1129(b).”

23 57 BR at 750 n.3.