



2014

Plain Language V. Common Sense: Examining The Problematic Decision In *In Re Village At Camp Bowie I, L.P., And The Harm It Will Cause Future Creditors*

Brett D. Young
J.D. Candidate, May 2015, Loyola Law School

Follow this and additional works at: <https://digitalcommons.lmu.edu/llr>



Part of the [Law Commons](#)

Recommended Citation

Brett D. Young, *Plain Language V. Common Sense: Examining The Problematic Decision In In Re Village At Camp Bowie I, L.P., And The Harm It Will Cause Future Creditors*, 47 Loy. L.A. L. Rev. 1087 (2014).
Available at: <https://digitalcommons.lmu.edu/llr/vol47/iss4/11>

This Notes and Comments is brought to you for free and open access by the Law Reviews at Digital Commons @ Loyola Marymount University and Loyola Law School. It has been accepted for inclusion in Loyola of Los Angeles Law Review by an authorized administrator of Digital Commons@Loyola Marymount University and Loyola Law School. For more information, please contact digitalcommons@lmu.edu.

PLAIN LANGUAGE v. COMMON SENSE: EXAMINING THE PROBLEMATIC DECISION IN *IN RE VILLAGE AT CAMP BOWIE I, L.P.*, AND THE HARM IT WILL CAUSE FUTURE CREDITORS

*Brett D. Young**

I. INTRODUCTION

In a Chapter 11 reorganization, a plan of reorganization can be “crammed down” the throats of non-consenting creditors, but only if the propounding party finds at least one class of “impaired” creditors who will consent to the cramdown plan.¹ A problem arises when courts define the word “impairment”: does it mean genuinely “hurt,” or does it mean simply “altered,” even when the alteration is not really detrimental to the allegedly “impaired” class? The latter definition allows parties to cram down reorganization plans using the controversial technique of artificial impairment.² Artificial impairment is the “technique of minimally impairing a class of creditors solely to create an impaired accepting class and to satisfy [sic] prerequisite to cramdown of Chapter 11 plan.”³ Congress and the Supreme Court are silent on whether the Bankruptcy Code allows artificial impairment,⁴ giving lower courts the power to rule on

* J.D. Candidate, May 2015, Loyola Law School; B.A. History and Psychology, University of California, Santa Barbara, June 2012. I am extremely grateful to Professor Dan Schechter for his constant encouragement, guidance, and passion for teaching, all of which made this comment possible. Thank you to the talented and dedicated staff and editors of the *Loyola of Los Angeles Law Review* for their hard work. Finally, I cannot thank my family and friends enough for all their love and support.

1. See Richard M. Cieri et al., “*The Long and Winding Road*”: *The Standards to Confirm a Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (Part II)*, 3 J. BANKR. L. & PRAC. 115, 146 (1994).

2. Peter E. Meltzer, *Disenfranchising the Dissenting Creditor Through Artificial Classification or Artificial Impairment*, 66 AM. BANKR. L.J. 281, 310–12 (1992).

3. 5 BANKR. SERV. LAW. EDITION (West) § 45:103 (Jan. 2014).

4. Dan Schechter, *Artificial Impairment of Small Class of Unsecured Creditors Is Insufficient to Support Cramdown Plan of Reorganization* [Federal National Mortgage

artificial impairment as they see fit.⁵

Artificial impairment is a problematic development in Chapter 11 reorganization plans. The guidelines presented in 11 U.S.C. § 1129 set forth the requirements for approval of a bankruptcy reorganization plan;⁶ all impaired creditors must unanimously approve the reorganization plan.⁷ However, under § 1129(b), an exception allows a single class of creditors to approve a reorganization plan in accordance with § 1129(a)(10).⁸ A plan approved by this method is often known as a “cramdown” reorganization plan because it is approved by a single vote, despite the objection of the other classes.⁹ Thus, a cramdown plan permits a single class of creditors to approve the plan, but only if the consenting class is impaired as defined by § 1124.¹⁰

Recently, the Fifth Circuit Court of Appeals in *In re Village at Camp Bowie I, L.P.*¹¹ elected to follow Ninth Circuit precedent when confronted with a reorganization plan that was confirmed by a potentially artificially impaired class of creditors.¹² As part of its decision, the Fifth Circuit expressly rejected the position taken by the Eighth Circuit, which advocated for a motive-based inquiry into the reasons a class was impaired to prevent plans from being confirmed by artificial impairment.¹³ Thus, in line with the Ninth Circuit,¹⁴ the Fifth Circuit refused to distinguish between artificial and need-based impairments.¹⁵ In choosing to follow the Ninth Circuit, the Fifth Circuit has taken a position that not only damages a creditor’s rights

Association v. Village I, GP (*W.D. Tenn. 2012*).], COM. FIN. NEWSL., Jan. 28, 2013 (“Congress has had numerous opportunities since 1993 to reject ‘artificial impairment’ and has not done so. Arguably, that inaction is an implicit ratification of the Ninth Circuit’s approach. Perhaps the Supreme Court will ultimately resolve the emerging circuit split.”).

5. *See id.*

6. 11 U.S.C. § 1129 (2012).

7. *Id.* § 1129(a)(8).

8. *Id.* § 1129(a)(10) (setting forth the provision that the plan must be confirmed by the court if “at least one class of claims that is impaired under the plan has accepted the plan”).

9. Cieri, *supra* note 1, at 147.

10. 11 U.S.C. § 1129(a)(10). The standard in § 1124 defines impairment simply as the alteration of a creditor’s rights. *Id.* § 1124.

11. *W. Real Estate Equities, L.L.C. v. Vill. at Camp Bowie I, L.P.* (*In re Vill. at Camp Bowie I, L.P.*), 710 F.3d 239 (5th Cir. 2013).

12. *Id.*; *L & J Anaheim Assocs. v. Kawasaki Leasing Int’l, Inc.* (*In re L & J Anaheim Assocs.*), 995 F.2d 940 (9th Cir. 1993).

13. *Windsor on the River Assocs., Ltd. v. Balcors Real Estate Fin., Inc.* (*In re Windsor on the River Assocs., Ltd.*), 7 F.3d 127, 127 (8th Cir. 1993).

14. *In re L & J Anaheim Assocs.*, 995 F.2d at 940.

15. *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 245.

in the case at hand but sets a dangerous precedent for creditors who are forced to accept cramdown reorganization plans on unfair terms.

This Comment addresses the controversial issue of artificial impairment and seeks to establish that courts should refuse to allow artificially impaired classes to approve cramdown reorganization plans. Part II details the Fifth Circuit's decision in *In re Village at Camp Bowie I, L.P.* and its adoption of the Ninth Circuit's rule regarding artificial impairment. Part III explains the split among bankruptcy courts over artificial impairment by analyzing statutes and Eighth and Ninth Circuit precedent.¹⁶ Part IV argues that the correct interpretation of § 1129(a)(10) includes a motive-based inquiry into the reasons for impairment, to satisfy the legislative intent and history of the Bankruptcy Code and to protect future creditors. Finally, Part V concludes that courts should not interpret the Bankruptcy Code using the strict textualist approach used by the Fifth and Ninth Circuits,¹⁷ and that courts facing this problem in the future should adopt the Eighth Circuit's interpretation.

II. STATEMENT OF THE CASE

Village at Camp Bowie I, L.P. ("Village") acquired a parcel of property in 2004, and began investing in improvements to make the property more suitable for office and retail space.¹⁸ To finance the project, Village infused a large sum of its own capital into the project, but it also obtained a loan from a bank in exchange for a promissory note secured by the real property.¹⁹ Through a series of conveyances, Western Real Estate Equities ("Western") came to hold the note.²⁰ After Village defaulted on the loan payment in August 2010, Western decided to hold a non-judicial foreclosure for the sale of the property.²¹ Prior to the foreclosure proceedings, Village filed a Chapter 11 petition staying the foreclosure sale.²²

In November 2010, Village filed its original plan of

16. *Id.*; *In re L & J Anaheim Assocs.*, 995 F.2d at 940; *In re Windsor on the River Assocs.*, Ltd., 7 F.3d at 127.

17. *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 239; *In re L & J Anaheim Assocs.*, 995 F.2d at 940.

18. *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 242.

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

reorganization under Chapter 11, but the court rejected the plan because the insufficient equity infusion could not stabilize the property.²³ After a series of amendments, Village filed its second reorganization plan, which the court approved after a cramdown vote.²⁴ The plan consisted of two classes of impaired creditors: Western and a group of unsecured trade creditors who had performed various jobs at the property.²⁵ As part of the reorganization plan, Western would receive a new five-year note in the amount of its claim, with interest set at 5.84 percent per annum and a balloon payment due at maturity.²⁶ Additionally, the plan proposed to pay the unsecured trade creditors in full within three months of the plan's approval, but the payment would not include interest—an amount totaling approximately \$900.²⁷

Western objected to the plan, arguing that Village only impaired the trade claims minimally, and that it did so to secure the necessary vote to cram down the plan under § 1129(a)(10).²⁸ In other words, Western argued that Village artificially impaired the trade creditors' claim to cram down the plan. The bankruptcy court rejected Western's argument, stating that § 1129(a)(10) did not distinguish between "artificial impairment and economically driven impairment."²⁹ Western appealed the bankruptcy court's decision to the Fifth Circuit Court of Appeals.³⁰

On appeal, Western again asserted its theory that a debtor could not artificially impair a voting class of creditors to secure an approving vote in a reorganization plan.³¹ The appellate court analyzed this argument by assessing the two views of artificial impairment adopted by the Eighth and Ninth Circuits.³² The court rejected the Eighth Circuit's application of § 1129(a)(10), which distinguished between economic and artificial impairment, in favor

23. *Id.*

24. *Id.* at 242–43.

25. *Id.* at 243.

26. *Id.* The amount owed on the promissory note to Western at the time the case was heard was \$32,112,711, compared to the \$59,398 owed to the trade creditors. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.* at 244.

31. *Id.*

32. *Id.* at 244–45.

of the Ninth Circuit's plain reading of the statute.³³ The court declared that "the Bankruptcy Code *must* be read literally, and congressional intent is relevant only when the statutory language is ambiguous."³⁴ In adopting the Ninth Circuit's precedent and reasoning, the court rejected Western's argument, refusing to distinguish between artificial impairment and any other type of impairment.³⁵ Consequently, it upheld confirmation of the plan.³⁶

III. HISTORY OF THE SPLIT BETWEEN THE EIGHTH AND NINTH CIRCUITS

Prior to the Fifth Circuit's decision in *In re Village at Camp Bowie I, L.P.*,³⁷ the Eighth and Ninth Circuits opposed each other on the issue of artificial impairment.³⁸ To fully understand the flaw in the Fifth Circuit's decision³⁹ and the Ninth Circuit's decision,⁴⁰ it is necessary to review the Bankruptcy Code and analyze the Eighth and Ninth Circuits' holdings.

A. Statutes

The problem of artificial impairment arises in Chapter 11 reorganization plans.⁴¹ Once a debtor files for bankruptcy protection and chooses to pursue a reorganization plan, there are two ways to confirm a plan of reorganization: consensually or under a "cramdown" scenario.⁴² In a consensual plan, all of the § 1129(a) requirements must be met.⁴³ This includes § 1129(a)(8), which requires either that every class of creditors accept the plan or that no non-consenting class is impaired.⁴⁴ Thus, if there is an impaired

33. *Id.* at 245.

34. *Id.* at 246.

35. *Id.* at 245–46.

36. *Id.* at 248.

37. *Id.*

38. *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc. (In re L & J Anaheim Assocs.)*, 995 F.2d 940, 942–43 (9th Cir. 1993); *Windsor on the River Assocs., Ltd., v. Balcors Real Estate Fin., Inc. (In re Windsor on the River Assocs., Ltd.)*, 7 F.3d 127, 130–31 (8th Cir. 1993).

39. *See In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 245.

40. *In re L & J Anaheim Assocs.*, 995 F.2d at 942–43.

41. *See Meltzer, supra* note 2, at 310–11.

42. 11 U.S.C. § 1129(a)-(b) (2012).

43. *Id.* § 1129(a).

44. *Id.* § 1129(a)(8).

non-consenting class, the plan cannot be confirmed.⁴⁵

However, if § 1129(a)(8) cannot be satisfied, the propounding party (usually, but not always, the debtor) can fall back on the cramdown provisions of § 1129(b).⁴⁶ Under § 1129(b)(1), a plan can still be confirmed if all of the other elements of § 1129(a), other than subsection (a)(8), are satisfied.⁴⁷ Therefore, the § 1129(a)(10) requirement that there be at least one impaired class vote to approve the plan applies under § 1129(b).⁴⁸ In other words, even if there are some impaired but non-consenting classes of creditors, the plan can still be confirmed under the cramdown provisions as long as there is at least one impaired consenting class.⁴⁹

Section 1124 determines whether the required claim for a cramdown plan is impaired.⁵⁰ This statute provides that a claim will not be considered impaired unless the creditor's rights are left "unaltered" by the reorganization plan.⁵¹ The problem of artificial impairment thus arises from reorganization plans confirmed under § 1129(a)(10), because § 1124's alteration standard provides minimal guidance on the definition of impairment.⁵² Additionally, § 1124 does not discuss artificial impairment, or whether there should be any type of judicial probe into the reasons for impairing a creditor's claim.⁵³

Using a strict textualist interpretation of these reorganization statutes, debtors may strategically alter the claim of a class of creditors to secure an approving vote for their reorganization plan.⁵⁴ If, for example, a debtor delayed payment under a plan to a class of unsecured creditors for a few months and denied them a small interest payment, a court applying a strict textualist approach to the

45. *See id.* § 1129(a).

46. *Id.* § 1129(b).

47. *Id.* § 1129(b)(1).

48. *Id.* § 1129(a)(10).

49. *See id.* § 1129(a)(10), (b)(1).

50. *Id.* § 1124.

51. *Id.* ("[A] class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan[:] (1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest"); Cieri, *supra* note 1, at 118.

52. For example, some courts have interpreted § 1124 to mean that even a creditor whose interests were improved can be considered impaired on the theory that the improved claim has been "altered." *E.g., In re Temple Zion*, 125 B.R. 910, 919 (Bankr. E.D. Pa. 1991).

53. *See* 11 U.S.C. § 1129(a)-(b).

54. Cieri, *supra* note 1, at 148.

statutes would consider this claim altered, and thus impaired.⁵⁵ In this example, the class of unsecured creditors—whose claim is minimally and “artificially” impaired by the plan—can cram down the plan despite another creditor’s objections, regardless of the large disparity between the amounts owed to each party by the debtor.⁵⁶

B. Circuit Split

In *In re Windsor On the River Associates, Ltd.*,⁵⁷ the Eighth Circuit refused to uphold a bankruptcy reorganization plan approved by an artificially impaired class of debtors.⁵⁸ The court reasoned that Congress intended § 1129 to promote consensual reorganization, and concluded that it would be “odd” if certain creditors could circumvent consensual reorganization through artificial impairment.⁵⁹ Additionally, the court stated in dicta that one of the primary functions of the Bankruptcy Code was to discourage side dealing, something that would surely occur if debtors were permitted to manufacture impairment to garner approval of a reorganization plan.⁶⁰

As part of its holding, the Eighth Circuit declared that satisfying § 1124 requires a factual inquiry into whether the debtor manipulated the terms of the plan to secure an approving vote using § 1129(a)(10).⁶¹ Although the court failed to articulate the exact test it would apply to determine whether the debtor’s manipulation resulted in genuine impairment,⁶² other courts have interpreted the holding to require economic necessity for the impairment.⁶³

55. See *Clarkson v. Cooke Sales & Serv. Co. (In re Clarkson)*, 767 F.2d 417, 418 n.1 (8th Cir. 1985).

56. 11 U.S.C. § 1129(a)(10); *id.* § 1124.

57. *Windsor on the River Assocs., Ltd. v. Balcors Real Estate Fin., Inc. (In re Windsor on the River Assocs.)*, 7 F.3d 127 (8th Cir. 1993).

58. *Id.* at 132.

59. *Id.* at 131.

60. *Id.* at 132.

61. *Id.*

62. See *In re Windsor On the River Assocs., Ltd. v. Balcors Real Estate Fin., Inc. (In re Windsor on the River Assocs., Ltd.)*, 7 F.3d 127 (8th Cir. 1993).

63. *W. Real Estate Equities, L.L.C. v. Vill. at Camp Bowie I, L.P. (In re Vill. at Camp Bowie I, L.P.)*, 710 F.3d 239, 244 (5th Cir. 2013). Other courts have used the same interpretation of the Eighth Circuit’s standard. See, e.g., *In re Ridgewood Apartments of DeKalb Cnty., Ltd.*, 183 B.R. 784, 789 (Bankr. S.D. Ohio 1995); *In re Gramercy Twins Assocs.*, 187 B.R. 112, 118 (Bankr. S.D.N.Y. 1995); *In re W.C. Peeler Co., Inc.*, 182 B.R. 435, 437 (Bankr. D.S.C. 1995); *In re Inv. Fla. Aggressive Growth Fund, Ltd.*, 168 B.R. 760, 766–67 (Bankr. N.D. Fla. 1994).

Taking a strict textualist approach, the Ninth Circuit, in *In re L & J Anaheim Associates*, defined impairment using § 1124's plain language.⁶⁴ As a result, the court chose to uphold the reorganization plan even though it was proposed and approved by an artificially impaired class of creditors in a cramdown vote.⁶⁵ The proposed plan compelled the sale of the real property at issue to pay off creditors.⁶⁶

The Ninth Circuit upheld the plan's confirmation because the creditor, who proposed and voted to approve the plan, lost contractual remedies available to it against the debtor as a result of the sale.⁶⁷ The plan's proponent satisfied § 1124's alteration requirement because the creditor lost these previously available contractual remedies.⁶⁸ The court disregarded the fact that the creditor attempted to foreclose in the first place but was prevented from doing so when the debtor filed for bankruptcy,⁶⁹ and instead chose to focus its reasoning on the plain satisfaction of the statute.⁷⁰ Most importantly, the court's decision has been interpreted to mean that a creditor's rights are impaired when they are *altered* and not necessarily *harmed*.⁷¹ The Fifth Circuit used the Ninth Circuit's definition of impairment in *In re Village at Camp Bowie I, L.P.* to preclude a motive-based inquiry into why Village impaired the trade creditors' claim, because the court determined the creditors' rights were altered.⁷²

IV. ANALYSIS

Using § 1129(a)(10), Village crammed down the reorganization plan despite the objections of Western, whose secured interest had a value more than fifty times the amount owed to the trade creditors.⁷³ As this large disparity in value demonstrates, courts must look beyond the plain language of the statute to ensure that they fairly

64. *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc.* (*In re L & J Anaheim Assocs.*), 995 F.2d 940, 943 (9th Cir. 1993).

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. Schechter, *supra* note 4.

72. *W. Real Estate Equities, L.L.C., v. Vill. at Camp Bowie I, L.P.* (*In re Vill. at Camp Bowie I, L.P.*), 710 F.3d 239, 245 (5th Cir. 2013).

73. *Id.*

approve reorganization plans. The Fifth Circuit, then, erred by following the Ninth Circuit's strict textualist approach. By strictly adhering to the Bankruptcy Code's language, the Fifth Circuit ignored why the Bankruptcy Code permits cramdown plans and harmed future creditors in bankruptcy reorganization plans.

*A. The Bankruptcy Code Should Be Read
to Require a "Harmed" Rather Than "Altered"
Standard of Impairment*

Courts often demonize cramdown reorganization plans because such plans do not reflect the goal of consensual reorganizations that the Bankruptcy Code purports to champion.⁷⁴ However, courts have justified the use of cramdown reorganizations in cases where the consenting class is "also hurt and nonetheless favors the plan."⁷⁵ When a class of creditors that is actually hurt by the plan still favors the plan, a court can infer that the plan is fair because those creditors presumably voted in good faith in favor of reorganization, rather than liquidation.⁷⁶

A historical analysis of the circumstances leading up to the creation of the modern § 1129 further supports the idea that the statute requires the plan to "hurt" an approving creditor.⁷⁷ According to 11 U.S.C. § 861, the predecessor to § 1129, a party could cram down a reorganization plan as long as the mortgagee, the party making the loan for a mortgage on real property, received the appraised value of the property.⁷⁸ The statute treated the mortgagee as a consenting class whose consent could be used to approve a reorganization plan.⁷⁹ Plans approved using this technique were often extremely inequitable, because debtors could make cash payments for real property in depressed markets for a value equal to the

74. *In re 266 Washington Assocs.*, 141 B.R. 275, 287 (Bankr. E.D.N.Y. 1992) (describing the path to cramdown reorganization as "torturous"), *aff'd sub nom. In re Washington Assocs.*, 147 B.R. 827 (E.D.N.Y. 1992); Meltzer, *supra* note 2, at 312 (stating that Chapter 11's goal is "to foster plans of reorganizations which are consensual to the greatest possible extent").

75. Cieri, *supra* note 1, at 147.

76. *Id.*

77. *Windsor on the River Assocs., Ltd. v. Balcors Real Estate Fin., Inc. (In re Windsor on the River Assocs., Ltd.)*, 7 F.3d 127, 131 (8th Cir. 1993); Cieri, *supra* note 1, at 147.

78. 11 U.S.C. § 861 (1976).

79. *In re Windsor on the River Assocs., Ltd.*, 7 F.3d at 131.

depressed appraised value.⁸⁰ This forced the creditor to accept the reorganization plan, no matter how inequitable.⁸¹

Congress sought to prevent this type of inequitable result by amending the Bankruptcy Code in 1984.⁸² The changes to the Code allocated power to creditors in reorganization plans by explicitly requiring the accepting class to be impaired.⁸³ That is, a creditor receiving the depressed market value of the property in the situation mentioned above would not be considered impaired and, thus, could not be used to approve a cramdown plan.⁸⁴ This congressional history indicates an intent to empower creditors in cramdown plans, whereas artificial impairment weakens larger creditors in reorganization plans, contrary to congressional intent. The Fifth Circuit failed to address any of the statutory history surrounding the 1984 amendment.⁸⁵ Instead, the court reasoned that the statute must be read as written, unless there are ambiguities.⁸⁶

The Ninth Circuit largely ignored these policy concerns with its plain-language reading of the statute,⁸⁷ leading the Fifth Circuit to make the same mistake.⁸⁸ Because the Fifth Circuit did not require that the plan “hurt” the consenting class, Village was able to gerrymander a consenting class’s approval using artificial impairment.⁸⁹ Under the plan, the trade creditors’ claim was impaired but definitely not “harmed,” because the plan guaranteed the creditors nearly full payment within three months of confirmation.⁹⁰ The only loss the creditors suffered under the plan was \$900 in interest payments.⁹¹

The Eighth Circuit’s opinion better reflects the underlying rationale of the Bankruptcy Code. By rejecting artificial impairment and looking into the reasons that a plan impairs a creditor’s claims,

80. *Id.*

81. *Id.*

82. Meltzer, *supra* note 2, at 312.

83. *Id.*

84. *Id.* at 312–13.

85. See *W. Real Estate Equities, L.L.C., v. Vill. at Camp Bowie I, L.P.* (*In re Vill. at Camp Bowie I, L.P.*), 710 F.3d 239 (5th Cir. 2013).

86. *Id.* at 246.

87. See *L & J Anaheim Assocs. v. Kawasaki Leasing Int’l, Inc.* (*In re L & J Anaheim Assocs.*), 995 F.2d 940 (9th Cir. 1993).

88. *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 245.

89. See *id.* at 243–47.

90. *Id.* at 243.

91. See *id.* at 243 n.3.

the Eighth Circuit's opinion ensures that the class of creditors approving the plan was genuinely harmed.⁹² In its opinion, the Eighth Circuit stated that a creditor's claim would not be considered impaired by a reorganization plan if "the alteration of rights in question arises solely from the debtor's exercise of discretion."⁹³ Consequently, in the Eighth Circuit, an inquiry is necessary to determine if the plan actually hurts a party in order to satisfy the underlying policy of the statute.⁹⁴

In *In re Village at Camp Bowie I, L.P.*, there is no question that the plan impaired the trade creditors' rights under § 1124,⁹⁵ but the problem arises when the reason for impairment is examined. Village's decision to withhold payment from the unsecured creditors was, without more information, an act of pure discretion. This can be inferred from the fact that Village's pre-petition owners had to infuse \$1.5 million into the business as part of the plan, giving them the cash on hand to pay off the small claim held by the trade creditors.⁹⁶ As a result, the Eighth Circuit would have rejected the plan because, on its face, there was no compelling reason to delay payment to the trade creditors.⁹⁷ It is important to mention that by rejecting the Eighth Circuit's test, the Fifth Circuit never looked into why Village impaired the rights of the unsecured creditors.⁹⁸ It is entirely possible that there was an economic reason aside from discretion for impairing the trade creditors' rights, but that question will remain unanswered. The court's limited reading of the statute denies any further inquiry into the debtor's motive for the chosen impairment.

B. Adopting Ninth Circuit Precedent Will Harm Future Creditors.

The failure of the Fifth and Ninth Circuits to consider the consequences of the strict textualist approach that they have adopted is a huge shortcoming of both opinions.⁹⁹ One particularly chilling

92. *Windsor on the River Assocs., Ltd. v. Balcor Real Estate Fin., Inc. (In re Windsor on the River Assocs., Ltd.)*, 7 F.3d 127, 132 (8th Cir. 1993).

93. *Id.*

94. *Id.*

95. See 11 U.S.C. § 1124 (2012).

96. *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 243.

97. 11 U.S.C. § 1124.

98. See *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 245–48.

99. *W. Real Estate Equities, L.L.C., v. Vill. at Camp Bowie I, L.P. (In re Vill. at Camp*

effect of these courts' application of § 1129(a)(10) is that it would encourage debtors to view the statute as an alternative to refinancing when debtors are unable to refinance on the open market.¹⁰⁰ If a debtor knows that it can use the Bankruptcy Code to reorganize its debt using artificial impairment, the debtor is more likely to refinance in this manner than on the open market, especially if the project lacks financial promise.¹⁰¹ Furthermore, permitting artificial impairment would certainly lead to side dealing between creditors and debtors.¹⁰² Scenarios where a debtor would seek out the approving vote of a small, unsecured class of creditors in exchange for a beneficial reorganization plan would become common. Unfortunately, both the Fifth and Ninth Circuits failed to address any of these possible concerns. Instead, they chose to ignore the huge impact their decisions will have on creditors' rights in the future.

Perhaps the most problematic development associated with the Ninth Circuit's precedent is that it entirely swallows consensual reorganization plans promoted under § 1129(a).¹⁰³ As Meltzer suggests, "Plan proponents could circumvent the impairment requirement at will by impairing creditors in trivial ways. As we have seen, a mere temporary delay in payment can constitute impairment. A 99% payment constitutes impairment. Even enhanced treatment constitutes impairment."¹⁰⁴ Debtors working to secure a reorganization plan will always find a way to impair a class of creditors who would be willing to approve a mutually beneficial reorganization plan. As a result, § 1129(a) would serve no purpose because all reorganization plans would be approved using the cramdown provision. This would render a large secured creditor's vote meaningless because they are always impaired under the plan, and never the party sought by the debtor to secure a cramdown plan.¹⁰⁵

It is inferred from the Eighth Circuit's opinion that courts should

Bowie I, L.P.), 710 F.3d 239 (5th Cir. 2013); *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc.* (*In re L & J Anaheim Assocs.*), 995 F.2d 940 (9th Cir. 1993).

100. *Windsor on the River Assocs., Ltd. v. Balcors Real Estate Fin., Inc.* (*In re Windsor on the River Assocs., Ltd.*), 7 F.3d 127, 132 (8th Cir. 1993).

101. *Id.*

102. *Id.*

103. 11 U.S.C. § 1129(a) (2012).

104. Meltzer, *supra* note 2, at 319.

105. *See, e.g., In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 243; *In re L & J Anaheim Assocs.*, 995 F.2d at 942–43.

investigate the reasons a plan impaired a creditor's rights, to prevent artificial impairment and protect creditors' rights from the harms mentioned above.¹⁰⁶ Some scholars argue that imposing a court-based inquiry into the motivations behind impairment will lead to problematic results.¹⁰⁷ For example, opponents of the Eighth Circuit decision argue that all impairment results from discretion, and no matter what kind of economic framework or reason is presented, the impairment of a creditor is solely based on debtor discretion.¹⁰⁸ This argument, like the Ninth and Fifth Circuits' approaches, takes textualism to the extreme. Of course all impairment will result from discretion, but the Eighth Circuit decision sought to add to the statute a fact-finding inquiry to the reasons behind the exercise of discretion.¹⁰⁹ To receive court approval of a plan, a debtor need only justify the reasons for impairing a creditor's claim, but that justification cannot include manufacturing a consenting class.¹¹⁰

In his article *On the River of Artificial and Arbitrary Impairment: An Erroneous Analysis*,¹¹¹ Eric W. Lam presents a particularly harmful interpretation of the Eighth Circuit opinion using a hypothetical.¹¹² His hypothetical outlines a bankruptcy reorganization plan that includes a debtor who will use incoming cash flow, from revenue generated by the business, to repay a loan to a secured creditor over the course of ten years without an infusion of capital.¹¹³ Additionally, the plan calls for repayment of an unsecured class of creditors' claims totaling \$13,000 over the course of two years, also using revenue from the business.¹¹⁴ A projection estimates that, after paying all of its monthly obligations and operating the business, the business will have a cash surplus of \$13,000 after the first month, enough to pay the class of unsecured

106. See *Windsor on the River Assocs., Ltd. v. Balcor Real Estate Fin., Inc.* (*In re Windsor on the River Assocs., Ltd.*), 7 F.3d 127, 132 (8th Cir. 1993).

107. Eric W. Lam, *On the River of Artificial and Arbitrary Impairment: An Erroneous Analysis*, 70 N.D. L. REV. 993, 1003 (1994).

108. *Id.*

109. See *In re Windsor on the River Assocs., Ltd.*, 7 F.3d at 132.

110. *Id.*

111. Lam, *supra* note 107.

112. *Id.* at 1001–02.

113. *Id.* at 1001.

114. *Id.*

trade creditors.¹¹⁵ Lam suggests that if the debtor decided to use the excess capital to invest in the business for improvements, a court adopting the Eighth Circuit's opinion would view this decision as an act of discretion that qualified as artificial impairment.¹¹⁶ As a result, Lam believes that the court would not approve a vote from these creditors to cram down the plan, because the creditors' impairment was based solely on the debtor's discretion.¹¹⁷

Lam's reasoning appears to be flawed. If the business were dependent on the improvements to create the revenue necessary to pay both classes of creditors under the reorganization plan, the court would have determined this necessity during its inquiry, and would not have viewed this solely as an exercise of discretion.¹¹⁸ The hypothetical suggested by Lam is a perfect example of a situation where an inquiry-based analysis of the reasons for impairment would be extremely effective, rather than the opposite as he suggests.¹¹⁹ It is very unlikely that a court would find the investment of capital back into the business to constitute a "technique" of the debtor to "create an impaired accepting class."¹²⁰ Instead, a court faced with this hypothetical would find that the plan necessarily impaired unsecured creditors' rights, giving the indicia of fairness needed by the statutes for a cramdown reorganization plan's approval. Indeed, the court could approve the plan knowing that the debtor's reason for impairing the creditor's claim was not to secure a consenting vote, but instead a necessary business decision.

Instead of making a specific inquiry into the precise reason for the impairment as the Eighth Circuit advocated, the Fifth Circuit relied on the provision contained in § 1129(a)(3),¹²¹ which requires that a party propose his or her reorganization plan in good faith.¹²² Under that global approach, if the bankruptcy court finds that a party proposed the plan in good faith, no other inquiry into a debtor's

115. *Id.*

116. *Id.* at 1002.

117. *Id.*

118. See *W. Real Estate Equities, Inc. v. Vill. at Camp Bowie I, L.P. (In re Vill. at Camp Bowie I, L.P.)*, 710 F.3d 239, 244 (5th Cir. 2013); *Windsor on the River Assocs., Ltd. v. Balcro Real Estate Fin., Inc. (In re Windsor on the River Assocs., Ltd.)*, 7 F.3d 127, 132 (8th Cir. 1993).

119. Lam, *supra* note 107, at 1001–03.

120. Cieri et al., *supra* note 1, at 148.

121. 11 U.S.C. § 1129(a)(3) (2012).

122. *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 247.

motive for impairing the claims of a class of creditors is necessary.¹²³ This cannot be the standard that bankruptcy courts adopt because it places too much power in the debtor's hands and drastically reduces a larger creditor's control during the reorganization process.¹²⁴ Overall, good faith is a sloppy standard that is much easier to satisfy than a need-based review.¹²⁵ While good faith might be an alternative to the artificial impairment problem, it is not a total or desirable solution. Bad faith and artificial impairment are not synonyms.¹²⁶ The bankruptcy court in *In re Village at Camp Bowie I, L.P.* found that Village proposed the plan in good faith, despite the clear artificial impairment involved in the case.¹²⁷ Adopting the good faith argument places some limitations on artificial impairment, but is not a complete bar like a need-based review would be. To properly adjudicate disputes involving artificial impairment, courts must not rely on the low bar of good faith used by the Fifth Circuit.

V. CONCLUSION

The Ninth Circuit incorrectly took a staunch textualist approach to its reading of the Bankruptcy Code, and the Fifth Circuit incorrectly followed that precedent. Such precedent has a damaging effect on large, undersecured creditors in the approval of bankruptcy reorganization plans. The Fifth Circuit decision takes textualism to the extreme and ignores the reasons that cramdown reorganizations are permitted under § 1129(a)(10).¹²⁸ When Congress created the modern § 1129, it was conscious of past problems created by cramdown reorganization plans.¹²⁹ Although the express language of the statute does not require courts to look into the reasons a plan impaired a creditor's claim, courts like the Eighth Circuit correctly imported this kind of inquiry into the statute, and for good reason.

The split between the Eighth and Ninth Circuits is well

123. *Id.* at 248.

124. *See id.* at 247–48; *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc. (In re L & J Anaheim Assocs.)*, 995 F.2d 940, 942–43 (9th Cir. 1993).

125. *See In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 247–48; *In re Temple Zion*, 125 B.R. 910, 920 (Bankr. E.D. Pa. 1991).

126. *See In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 247–48.

127. *Id.*

128. *Id.* at 247.

129. Meltzer, *supra* note 2, at 312.

established.¹³⁰ The Fifth Circuit decision is the most recent to take a side on the issue of gerrymandering a voting class using the Bankruptcy Code's cramdown provision.¹³¹ As the growing split indicates, this is a contentious issue and the Supreme Court must take action and overturn the Ninth Circuit's precedent,¹³² clarifying the issue for courts that face it in the future.

130. The list of cases opting to follow the Eighth Circuit is growing rapidly. See, e.g., *In re All Land Invs., LLC*, 468 B.R. 676, 690 (Bankr. D. Del. 2012); *In re Daly*, 167 B.R. 734, 737 (Bankr. D. Mass. 1994); *In re N. Washington Ctr. Ltd. P'ship*, 165 B.R. 805, 810 (Bankr. D. Md. 1994).

131. *In re Vill. at Camp Bowie I, L.P.*, 710 F.3d at 247–48.

132. *L & J Anaheim Assocs. v. Kawaski Leasing Int'l, Inc.* (*In re L & J Anaheim Assocs.*), 995 F.2d 940 (9th Cir. 1993).