AMERICAN BANKRUPTCY INSTITUTE

JOURNAL

The Essential Resource for Today's Busy Insolvency Professional

Feature

By Johnathan C. Bolton

Claim Buyers Beware: Timing Is Critical

Johnathan C. Bolton
Goodsill Anderson Quinn & Stifel
Honolulu

Johnathan Bolton is counsel in the Creditors' Rights and Bankruptcy Department of Goodsill Anderson Quinn & Stifel in Honolulu. He is board certified in Business Bankruptcy Law by the American Board of Certification.

In *Beal Bank USA v. Windmill Durango Office LLC (In re Windmill Durango Office LLC)*,[1] the Bankruptcy Appellate Panel (BAP) for the Ninth Circuit upheld a decision by Hon. **Linda B. Riegle** that "cause" under Federal Bankruptcy Rule 3018(a) requires something more than "a mere change of heart" and that withdrawing a previously cast vote for the purpose of strategy (*i.e.*, for the purpose of blocking plan confirmation) did not constitute "cause" under Federal Bankruptcy Rule 3018(a).

In *Windmill Durango Office*, the debtor filed a single-asset real estate case in the U.S. Bankruptcy Court for the District of Nevada, scheduling Beal Bank as its only secured creditor along with a few unsecured creditors.[2] The debtor's plan proposed stretching out Beal Bank's secured claim over time with a balloon payment due at the end of the tenth year while paying 100 percent of allowed unsecured claims without interest 90 days after confirmation.[3] Beal Bank argued, among other things, that the debtor purposely impaired the unsecured creditor class so as to force the plan on Beal Bank, the only truly impaired creditor.[4] A total of three creditors filed ballots in connection with the plan.[5] Beal Bank voted to reject the plan, and two unsecured creditors voted to accept the plan.[6]

A week before the balloting deadline, Beal Bank filed an "Unconditional Transfer and Assignment of Claim after Proof of Claim Filed" and disclosed that it was buying the claim of one of the unsecured creditors who had voted to accept the plan.[7] Three days later, Beal Bank filed a motion seeking permission, under Rule 3018(a), to withdraw the affirmative ballot filed by the assignor-creditor and to substitute it with a ballot rejecting the plan.[8] Beal Bank admitted in its motion that it purchased the unsecured claim in order to block plan confirmation, as the debtor was seeking cramdown of the plan under § 1129(b)(2)(B) and the debtor would be unable to meet the numerosity requirement of § 1126(c) if the creditor's affirmative vote was withdrawn.[9] Beal Bank alleged that its purchase of an unsecured claim to block confirmation did not constitute bad faith and asserted that it had no improper motivation in withdrawing the vote to accept the plan, but rather wanted to protect its own claim.[10] Beal Bank also pointed out that it was acting to withdraw the previously filed ballot and change the vote before the ballot deadline expired.[11]

In response, the debtor argued that Beal Bank failed to show "cause" under Rule 3018(a) for the change.[12] The debtor contended that if a creditor's proposed change is challenged, it must demonstrate the propriety of the change.[13]

The debtor cited *In re Kellogg Square Partnership*,[14] arguing that where an entity acquires a creditor's claim after the creditor voted to accept or reject the plan, the assignor-creditor's "evidenced commitment to that specific participation in the case is a permanent, binding limitation on the transferred claim."[15] At the hearing on the motion, Beal Bank admitted that it sought to change the vote "so it could block confirmation inasmuch as the debtor would not be able to meet the numerosity requirements to have a consenting impaired class."[16] Beal Bank also admitted that it knew that the creditor

1 473 B.R. 762 (9th Cir. B.A.P. (Nev.) June 27, 2012).
2 *Id.* at 767.
3 *Id.* at 768.
4 *Id.* at 770-71.
5 *Id.* at 768.
6 *Id.*
7 *Id.*
8 *Id.* at 768-69.
9 *Id.* at 769.
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 160 B.R. 332 (Bankr. D. Minn. 1993).
15 *Id.* at 769 (citing 160 B.R. at 335).
16 *Id.*

whose claim it purchased had voted to accept the plan at the time it purchased the claim.[17] However, it contended that there was nothing "untoward...in its efforts to obtain a blocking vote."[18] Beal Bank cited *Kellogg Square Partnership* for the proposition that "creditors should be given the full benefit of the right of franchise under Chapter 11 so long as it complied in the first instance with the ministerial rules governing that exercise."[19] Beal Bank argued that the original owner of the claim should be given the full benefit of his or her right of franchise to change his or her vote, especially before the ballot deadline, and the fact that the claim had been assigned to Beal Bank should be of no import.[20]

The bankruptcy court denied the motion based on its determination that Beal Bank did not show "cause" for the changing or withdrawing of the previously cast vote.[21] Specifically, the court opined that "cause" in Rule 3018(a) means more than simply changing one's mind and that "cause" cannot be shown by the fact that Beal Bank wanted to block confirmation.[22] The court opined that it was not appropriate for creditors to wait until plans were balloted and then decide what claims they were going to buy,[23] reasoning that "it did the process violence by the buying of a claim to specifically block confirmation after [the balloting was done]."[24]

In conducting its review of the bankruptcy court's ruling, the BAP first looked at *In re CGE Shattuck LLC*,[25] in which the New Hampshire bankruptcy court stated that "the test for determining whether cause has been shown should not be a difficult one to meet.[26] As long as the reason for the vote change is not tainted, the change of vote should usually be permitted. The court must only ensure that the change is not improperly motivated."[27]

On appeal, Beal Bank argued that the threshold to show "cause" under Rule 3018(a) is low and that a creditor should only need to demonstrate that it has no "tainted" or improperly motivated reason for withdrawing its vote.[28] Beal Bank also argued that "cause" under Rule 3018(a) should be *presumed* to exist when a creditor seeks to withdraw its vote before the ballot deadline, and that to deny a creditor's request to change its vote before the ballot deadline would deprive the creditor of "the full benefit of their right of franchise under Chapter 11."[29]

The BAP admitted that there was little authority addressing this issue and heavily relied on *Kellogg Square Partnership*, which also involved a creditor purchasing claims and attempting to change votes to defeat confirmation of a debtor's plan to avoid a cramdown of its secured claims.[30] The bankruptcy court in *Kellogg Square Partnership* held that allowing an assignee-creditor to change the assignor's previously cast vote would undercut "the certainty in the dynamics of reorganization under chapter 11."[31]

Interestingly, the panel stated that it did not quibble with Beal Bank's assertion that as the assignee-creditor, it had the right to seek withdrawal of the creditor's vote.[32] The bankruptcy court stated that Beal Bank missed the essential point of *Kellogg Square Partnership*: It "did not establish cause to change the vote of the assignor-creditors" from an affirmative vote to a negative vote.[33]

The panel next looked at *In re MCorp Financial Inc.*,[34] in which an unsecured creditor sought to change a vote rejecting a chapter 11 plan to accepting the plan after he reached an agreement with the debtor regarding the treatment of his claim in the plan.[35] In *MCorp Financial*, the court stated that the standard for such a change was fairly relaxed, but it listed examples that would justify vote changes, including "a breakdown in communications at the voting entity, misreading of the terms of the plan or execution of the first ballot by one without authority."[36] However, the *MCorp Financial* court ultimately denied the unsecured creditor's Rule 3018(a) motion to change his vote, determining that the requested vote change was "highly suspect" and that "the evidence [did] not overcome the possibility of improper motivation" because it was "prompted by a subsequent agreement, and was made in writing only after testimony in the confirmation hearing which made the ballot important."[37] Ultimately, in *Windmill Durango Office*, the BAP concluded that although it was a "close question," the bankruptcy court's determination that Beal Bank failed to establish "cause" under Rule 3018(a) did not amount to an abuse of discretion.[38]

Other courts that have examined this issue have found "cause" under Rule 3018(a) where creditors seek to change their negative votes to affirmative votes to accept a plan. For example, in *Texas Extrusion Corp. v. Palmer, Palmer & Coffee (In re Texas Extrusion Corp.)*,[39] a district court allowed a change of vote by the Small Business Administration (SBA) after it sought to withdraw its rejection after the time for doing so had passed. The court cited *In re Jartran*[40] for the proposition that "there may be exceptional circumstances which, in light of the spirit of Chapter 11 to promote consensual plans, would warrant such a change [of vote from rejection to acceptance] notwithstanding the unequivocal language of [Rule 3018(a)]."[41] In *Texas Extrusion*, the court held that exceptional circumstances existed that would permit a late change of ballot based on the fact that the SBA had initially rejected the plan because the debtor failed to list it as a creditor and it was not provided for.[42] The district court explained that "this is the exceptional circumstance that warrants the change of vote notwithstanding Rule 3018."[43]

17 *Id.*
18 *Id.*
19 *Id.* (citing at 160 B.R. at 335).
20 *Id.*
21 *Id.* at 770.
22 *Id.*
23 *Id.*
24 *Id.*
25 2000 Bankr. LEXIS 1806 (Bankr. D.N.H. Nov. 28, 2000).
26 *Id.* at 776.
27 *Id.* at 776. In *CGE Shattuck*, the court approved changing a "rejection" vote to "acceptance" where the original rejection was based on the failure of the plan to be consistent with the disclosure statement. The court also found that no party that accepted the plan was adversely affected by the change. The court therefore deemed the motion under Rule 3018(a) to constitute a written acceptance of the plan, as modified, in accordance with Rule 3019.
28 *Id.* at 776.
29 *Id.* at 769.
30 *Id.* at 776.
31 160 B.R. at 335.
32 473 B.R. at 776.
33 *Id.* at 777.
34 137 B.R. 237 (Bankr. S.D. Tex. 1992).
35 473 B.R. at 776-77.
36 137 B.R. at 238.
37 *Id.* at 239.
38 473 B.R. at 777.
39 68 B.R. 712 (N.D. Tex. 1986).
40 44 B.R. 331 (Bankr. D. Ill. 1984).
41 44 B.R. at 363.
42 68 B.R. at 718.
43 *Id.*

Likewise, in *In re American Solar King*,[44] a bankruptcy court permitted a creditor to change its vote from "rejection" to "acceptance" after the time for accepting the plan had expired, based on the Fifth Circuit's holding in *Texas Extrusion*,[45] stating that "Rule 3018 must not be applied in a wooden, mechanical fashion, lest it serve only as a device to aid recalcitrant creditors in their quest to selfishly scuttle otherwise equitable reorganizations on a mere technicality."[46]

Similarly, in *In re Cajun Elec. Power Co-op. Inc.*,[47] a bankruptcy court permitted a creditor to change its vote from "rejection" to "acceptance" of a plan in which the creditor changed its vote during the confirmation process in connection with a settlement achieved therein. Citing *Texas Extrusion Corp.* and *American Solar King*, the court noted that Fifth Circuit jurisprudence "suggests that subsequent negotiations between the plan proponent and the party seeking to change its ballot suffices as the required cause."[48] The court thereafter queried: "Such being the goal, what greater evidence of cause exists than where major parties in a chapter 11 proceeding negotiate a settlement of highly complex litigation, thus helping to pave the way to a consensual plan?"[49]

Likewise, in *In re Bourbon Saloon Inc.*,[50] the bankruptcy court cited *Texas Extrusion Corp.*, *American Solar King* and *Cajun Electric* for the proposition that negotiating with a creditor to achieve a consensual plan is an acceptable reason to allow a vote change. In *In re Hingham Campus LLC*,[51] a bankruptcy court also found "cause" under Rule 3018(a) to allow a bank creditor to change its vote from "rejection" to "acceptance" of a plan.

Additionally, in *In re Simplot*,[52] the bankruptcy court allowed a rejecting creditor to change its vote to an express acceptance after finding that the settlement between the debtor and the creditor leading to a change of vote was memorialized in a stipulation filed of record, explaining that "Rule 3018(a) operates, *inter alia*, to prevent undisclosed agreements between debtors and selected creditors under which additional consideration is given in return for a favorable ballot."[53]

However, in *In re Future Energy Corp.*,[54] the bankruptcy court held that a creditor would not be permitted to change its vote rejecting the plan to one of acceptance because the creditor sought leave to amend its ballot after the voting deadline had passed and no cause was offered to support the request to change its vote under Rule 3018(a).

Also, in *In re Dowdy*,[55] the bankruptcy court decided that "cause" did not exist under Rule 3018(a) to permit a judgment creditor to withdraw acceptance of the plan where the creditors alleged that a settlement agreement embodied in the plan was not authorized. The *Dowdy* court found that the complaining creditor was represented by counsel at a hearing in state court where a settlement was reached, that there was no disagreement to the terms and that the terms of the settlement agreement appeared imminently fair to all parties.[56]

Finally, in *In re Dow Corning Corp.*,[57] the bankruptcy court considered whether creditors who had previously rejected a plan could change their votes after a modification of the plan was filed. The court explained that under § 1127(d), a creditor is deemed to have accepted a plan as modified unless, within a court-specified time, the creditor changes its previous acceptance or rejection, and under Rule 3019, a plan may be modified before confirmation but after it is accepted.[58] The court found that creditors who rejected the plan should be given a chance to determine whether they wished to continue rejecting the plan once the modifications were made.[59] The court held that the motions by creditors to change their votes under Rule 3018(a) were moot and were instead found to be written acceptances of the plan as modified.[60] In view of *Windmill Durango Office* and the cases discussed herein, if a secured creditor wishes to purchase an unsecured creditor's claim to block plan confirmation, it must do so before that unsecured creditor has cast its ballot. **abi**

Reprinted with permission from the ABI Journal, Vol. XXXI, No. 9, October 2012.

The American Bankruptcy Institute is a multi-disciplinary, nonpartisan organization devoted to bankruptcy issues. ABI has more than 13,000 members, representing all facets of the insolvency field. For more information, visit ABI World at www.abiworld.org.

44 90 B.R. 808 (W.D. Tex. 1988).
45 844 F.2d 1142, 1163 (5th Cir. 1988).
46 90 B.R. at 827.
47 230 B.R. 715, 744 (Bankr. M.D. La. 1999).
48 *Id.*
49 *Id.*
50 2012 Bankr. LEXIS 1087 at *7 (Bankr. E.D. La. March 14, 2012).
51 2011 Bankr. LEXIS 3230 at *29 (Bankr. N.D. Tex. 2011).
52 2007 Bankr. LEXIS 2936 at * 46 n. 55 (Bankr. D. Idaho Aug. 28, 2007).
53 *Id.*
54 83 B.R. 470, 491 (Bankr. S.D. Ohio 1988).
55 2010 Bankr. LEXIS 634 at *6 (Bankr. E.D.N.C. Feb. 26, 2010).
56 *Id.* at *7.
57 237 B.R. 374, 377 (Bankr. E.D. Mich. 1999).
58 *Id.* at 378-79.
59 *Id.* at 379.
60 *Id.* at 380.