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United States: Bright-Line Rule: No Modification Of Substantially Consummated Chapter 11 Plan

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To promote the finality and binding effect of confirmed chapter 11 plans, the Bankruptcy Code categorically prohibits any modification of a confirmed plan after it has been "substantially consummated." Stakeholders, however, sometimes attempt to skirt this prohibition by characterizing proposed changes to a substantially consummated chapter 11 plan as some other form of relief, such as modification of the confirmation order or a plan document, or reconsideration of the allowed amount of a claim. The U.S. Bankruptcy Court for the District of Delaware recently addressed one such request in *In re Northeast Gas Generation, LLC*, 2022 WL 828263 (Bankr. D. Del. Mar. 18, 2022). Long after substantial consummation of a chapter 11 plan that gave an impaired secured creditor 100% of the reorganized debtor's equity and reinstated a portion of its secured debt, the secured creditor sought to reopen the bankruptcy case and obtain an order increasing the amount of its reinstated debt in the guise of "reconsideration" of the amount of its allowed claim. The bankruptcy court denied the request, ruling that the Bankruptcy Code bars modification of a confirmed chapter 11 plan after it has been substantially consummated, even if the proposed changes would not "materially and adversely" impact other stakeholders.

Modification of a Chapter 11 Plan

Section 1127(a) of the Bankruptcy Code states that the proponent of a chapter 11 plan on which votes have been solicited from creditors or interest holders "may modify such plan at any time *before confirmation*," unless the proposed modification violates the Bankruptcy Code's requirements regarding the classification of claims and interests or the contents of a plan. 11 U.S.C. § 1127(a) (emphasis added).

Section 1127(b) provides that the proponent of a plan or the reorganized debtor "may modify such plan at any time *after confirmation* of such plan and before substantial consummation of such plan," again unless the proposed modification violates the Bankruptcy Code's requirements regarding the classification of claims and interests or the contents of a plan. 11 U.S.C. § 1127(b) (emphasis added). It further states that "[s]uch plan as modified ... becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified, under section 1129 of [the Bankruptcy Code]."

Under section 1127(d), a creditor or interest holder who accepts or rejects a chapter 11 plan prior to its modification is deemed to accept or reject, "as the case may be, such plan as modified, unless within the time frame fixed by the court, such holder changes such holder's previous acceptance or rejection."

Section 1141(a) of the Bankruptcy Code provides that the terms of a confirmed chapter 11 plan are binding on all parties.

Under section 1101(2), "substantial consummation" of a chapter 11 plan occurs when: (i) substantially all of the property to be transferred under the plan has been transferred; (ii) the debtor or its successor has assumed the business or management of substantially all of the property dealt with by the plan; and (iii) distributions under the plan have commenced.

Special rules regarding post-confirmation plan modifications apply to individual chapter 11 debtors under section 1127(e).

Rule 3019(a) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") provides that, in a chapter 9 or chapter 11 case, the plan proponent may file with the court a modification of a chapter 11 plan after it has been accepted but prior to confirmation. It further states that:

If the court finds after hearing on notice to the trustee, any committee appointed under the Code, and any other entity designated by the court that the proposed modification does not adversely change the treatment of the claim of any creditor or the interest of any equity security holder who has not accepted in writing the modification, it shall be deemed accepted by all creditors and equity security holders who have previously accepted the plan.

Bankruptcy Rule 3019(b) establishes the procedure for post-confirmation modifications to a plan in an individual chapter 11 case.

Sections 1127 and 1141, when taken together with other related provisions of the Bankruptcy Code, impose an important element of finality in chapter 11 cases that allows stakeholders to rely on the provisions of a confirmed chapter 11 plan. *See generally* Collier on Bankruptcy ("Collier") ¶ 1127.03[2][a] (16th ed. 2022) ("In enacting section 1127(b), Congress intended to 'safeguard the finality of plan confirmation.'").

As quoted above, section 1127(b) on its face bars modification of a chapter 11 plan after it has been substantially consummated. Moreover, "[c]ourts have routinely rejected attempts by plan proponents to

circumvent section 1127(b) and change the plan merely by calling the requests a motion to modify the confirmation order, or a motion for reconsideration or to modify a plan-related document, or any application that nonetheless affects rights under the plan, such as a motion to clarify or a motion to classify claims." Collier at ¶ 1127.03[2][a] (citations omitted). Some courts have even ruled that "serial" (successive) chapter 11 filings are not permitted and that a second plan may not modify the first plan in the absence of "unanticipated changed circumstances" that were unknown at the time the prior plan was substantially consummated and substantially affected the debtor's ability to implement the prior plan. *See, e.g., Elmwood Dev. Co. v. General Elec. Pension Trust (In re Elmwood Dev. Co.)*, 964 F.2d 508, 512 (5th Cir. 1992); *Fruehauf Corp. v. Jartran, Inc. (In re Jartran, Inc.)*, 886 F.2d 859, 867 (7th Cir. 1989); *In re Triumph Christian Ctr., Inc.*, 493 B.R. 479, 489-90 (Bankr. S.D. Tex. 2013); *In re Woodson*, 213 B.R. 404, 405 (Bankr. M.D. Fla. 1997); *In re Northampton Corp.*, 39 B.R. 955, 956 (Bankr. E.D. Pa. 1984), *aff'd*, 59 B.R. 963 (E.D. Pa. 1984); *see also In re Garsal Realty, Inc.*, 98 B.R. 140, 150 (Bankr. N.D.N.Y. 1990) (a second chapter 11 case was not an attempt to modify the previous plan contrary to section 1127(b) because the new debt did not exist until after substantial consummation of the earlier plan)).

Absent modification of a chapter 11 plan or an order revoking confirmation (*see* 11 U.S.C. § 1144, which authorizes the court to revoke a confirmation order "only if such order was procured by fraud" within 180 days of confirmation), appeal of an order confirming a chapter 11 plan is the only recourse. However, such an appeal may be deemed moot absent a stay pending appeal if the plan has been substantially consummated before the appeal can be heard. *See generally* Collier at ¶ 1129.09 (discussing the doctrine of "equitable mootness").

Section 1127 is derived from sections 222 and 229 of Chapter X of the former Bankruptcy Act. 11 U.S.C. § 622 (repealed 1978). Section 222 provided, in relevant part, that "[a] plan may be altered or modified, with the approval of the judge, after its submission for acceptance and before or after its confirmation if, in the opinion of the judge, the alteration or modification does not materially and adversely affect the interests of creditors or stockholders." Section 229(c) imposed the additional prerequisite that a plan could not be modified if it had been substantially consummated. 11 U.S.C. § 629(c) (repealed 1978). It provided that "[w]hen a plan has been substantially consummated as defined in subdivision (a) of this section ... the plan may not thereafter be altered or modified if the proposed alteration or modification materially and adversely affects the participation provided for any class of creditors ... by the plan." *Id.*

Northeast Gas

In June 2020, Northeast Gas Generation, LLC and its affiliates (collectively, "NEG") filed for chapter 11 protection in the District of Delaware. The bankruptcy court confirmed NEG's chapter 11 plan on December 18, 2020, and the plan became effective four days later.

Under the plan, the claims of NEG's first-lien secured creditors were allowed in the amount of $539 million, and the first-lien creditors received: (i) 100% of the equity in the reorganized company; and (ii) $200 million in reinstated first-lien debt. The first-lien creditor class was therefore impaired. The other impaired classes consisted of equity interest holders, who received no distribution; second-lien creditors, who received no distribution; and general unsecured creditors, who shared pro rata in a $2 million fund. The first-lien, second-lien, and general unsecured classes of creditors all voted to accept the plan.

On October 7, 2021—long after NEG's chapter 11 plan was substantially consummated and the bankruptcy case was closed—NEG (now owned by the first-lien creditors) filed a motion to reopen the case (as permitted under section 350 of the Bankruptcy Code and Bankruptcy Rule 5010) for the purpose of "reconsidering" the allowed amount of the first-lien claims under section 502(j) of the Bankruptcy Code, which provides in part that "[a] claim that has been allowed or disallowed may be reconsidered for cause." Specifically, NEG sought an order: (i) bifurcating the first-lien claims into secured claims in the amount of $475 million and deficiency claims for the balance of the allowed $539 million amount; and (ii) increasing the amount of the reinstated first-lien debt from $200 million to $475 million.

According to NEG, the "only impact of the relief ... would be to reallocate how the proceeds from a disposition of the assets are allocated as between the bank's reinstated secured debt and its 100 percent equity stake." It also argued that the court had the power to grant this relief under section 105(a) of the Bankruptcy Code, which provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." By simply reconsidering the allowed amount of its first-lien claim, NEG asserted, the court was not bound by the requirements of section 1127 for modification of a plan.

The Bankruptcy Court's Ruling

The bankruptcy court denied NEG's motion.

Initially, U.S. Bankruptcy Judge Mary F. Walrath rejected NEG's argument that section 1127 did not bar the requested relief. Cases relied upon by NEG for the proposition that reconsideration of a claim under section 502(j) is distinct from modifying a plan under section 1127, she noted, were distinguishable because two of them involved chapter 13 cases, where different rules apply to modification of confirmed plans, and the courts in the two chapter 11 cases cited by NEG were not asked to modify the treatment of the claims under confirmed plans. *Northeast Gas*, 2022 WL 828263, at *2 (discussing *U.S. Dep't of the Treasury—Internal Revenue Serv. v. EB Holdings II, Inc.*, 2021 WL 535467 (D. Nev. Feb. 11, 2021); *In re Davis*, 404 B.R. 183 (Bankr. S.D. Tex. 2009); *In re Disney*, 386 B.R. 292, 303 (Bankr. D. Colo. 2008); *In re Van Dyke*, 286 B.R. 858 (Bankr. C.D. Ill. 2001)).

Moreover, Judge Walrath explained, NEG was not really seeking reconsideration of its claims, which were deemed allowed under the plan in the amount of $539 million, but instead to modify the plan to give NEG 100% of the equity of the reorganized company *plus* 100% of the reinstated first-lien debt in the increased amount of $475 million. This relief, she ruled, was barred by section 1127(b).

Judge Walrath rejected NEG's argument that the proposed change was not a modification of the plan and that, because the Bankruptcy Code does not define the term "modification," the court should be guided by section 229 of the former Bankruptcy Act. As noted, section 229 allowed "alteration or modification" of a plan after substantial consummation as long as it did not "materially and adversely affect[] the participation provided for any class of creditors ... by the plan." According to NEG, its proposed modification of the plan in this case should be permitted because it would not alter the treatment of any other class of creditors or shareholders.

Judge Walrath determined that NEG's reliance on section 229 was "inappropriate" because, in enacting section 1127(b), lawmakers "deleted the very provisions in section 229 of the Act on which NEG relies: allowing modification of a plan after substantial consummation if it does not 'materially and adversely' affect any other creditor or shareholder." *Northeast Gas*, 2022 WL 828263, at *4. This deletion, she wrote, is "a clear indication of Congress's intent to change pre-Code law and not permit modification of a plan after it has been substantially consummated, even if the change would have no materially adverse effect on any party." *Id.*

Cases cited by NEG for the proposition that section 1127(b) continues pre-Bankruptcy Code practice on this point Judge Walrath characterized as "unpersuasive" or inapposite because, among other things, the proposed changes to the plans in those cases were either expressly contemplated by the plans or were clarifications of ambiguous plans. In this case, Judge Walrath explained, NEG's chapter 11 plan did not

expressly contemplate the proposed changes, nor were those changes merely a clarification of an ambiguity. Instead, she wrote, NEG "is seeking to change the unambiguous terms of the Plan," a modification that is barred by section 1127(b). *Id.* at **6–7.

Finally, Judge Walrath rejected NEG's argument that the court had the power to grant the relief requested under section 105(a) of the Bankruptcy Code. She noted that section 105(a) cannot be used to contravene another provision of the Bankruptcy Code—here, section 1127(b)—and that, even if it could, "the equities in this case do not favor doing so." *Id.* at *8. According to Judge Walrath: (i) the first-lien creditors were sophisticated parties that accepted the terms of the plan after extensive negotiations; and (ii) any plan that provided the first-lien creditors with additional reinstated first-lien debt might not have been confirmable because it might not have received the approval of other impaired creditors or satisfied the Bankruptcy Code's feasibility requirements.

Outlook

The finality of confirmed and substantially consummated chapter 11 plans is an indispensable element of chapter 11. Without it, there would be no way to enforce the expectations of all stakeholders involved in the chapter 11 process, which produces essentially a binding contract governing stakeholders' relationships with the reorganized debtor or their allocation of the proceeds of the debtor's estate. Absent fraud on the court in connection with confirmation (and a timely request to revoke the order confirming it), the ability to unravel the terms of a court-approved plan that has been substantially consummated would undermine the entire process.

This reality is reflected in Judge Walrath's conclusion in *Northeast Gas*. The court recognized that the secured creditors' belated request for "reconsideration" of their claims was in fact an assault on the finality of a substantially consummated chapter 11 plan. The court accordingly ruled that section 1127(b) barred the relief requested and that, given the provision's clear application and the facts of the case, the court neither could (nor would) exercise its broad equitable powers to countermand that outcome.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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