PUBLICATION

Proposing a Chapter 11 Reorganization Plan in Good Faith

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Good faith is generally understood to mean honesty or sincerity of intention. But in the law, things are often not as straightforward as that. It has been called an intangible and abstract quality and said to include such concepts as an honest belief, the absence of malice and the absence of fraud. It has also been said that good faith is an individual concept borne from the minds of men as derived from their inner spirit such that it may not be evidenced by words alone.

To be confirmed, Chapter 11 of the Bankruptcy Code requires that "the plan has been proposed in good faith and not by any means forbidden by law," yet the Code does not define "good faith" in either its general definitions or its chapter specific definitions. Given that so much is potentially riding on confirmation of the plan, and in light of the otherwise vague notions of good faith, it is important for creditors to know how courts have construed the term in this context. Such understanding is essential for creditors to evaluate a debtor's plan.

As a general matter, a reorganization plan must fairly achieve results consistent with the Bankruptcy Code to satisfy the good faith requirement of Section 1129. Some courts have explained that the "fairly achieve results" standard is satisfied if the plan is reasonably likely to achieve the required results. In legal parlance, this is a relatively low standard. When considering whether a plan is proposed in good faith, courts will look to the honesty and good intentions of the proponent while also asking if the plan is a legitimate attempt to reorganize the business. The party challenging a plan has the burden of persuasion, but the bankruptcy court also has an independent duty to evaluate the good faith behind the plan. The analysis is conducted in light of the totality of the circumstances surrounding the plan. These general principles still leave parties somewhat in the dark. It is helpful to look at the good faith issue in the context of some exemplary cases.

Courts have found plans to satisfy the good faith requirement and confirmed the plans under the following scenarios:

- A plan may be proposed as a means of resolving tort liability claims that jeopardize the debtor's survivability.
- A plan may be proposed to modify a mortgage.
- A plan may be proposed to release claims against the debtor's officers and directors.
- A plan may be proposed jointly by the official unsecured creditors committee and debtors.
- A plan may be proposed to preserve the debtor's business while maximizing the return to creditors.
- A plan may be confirmed even though the debtor allegedly has the ability to make higher payments.
- A plan may be confirmed even though it provides only nominal remuneration to unsecured creditors if the debtor does not have the ability to treat them better, particularly if the plan does not preserve a lavish lifestyle for the debtor.
- A plan may be confirmed even if the debtor has a history of reluctant compliance with court orders.

In each of these scenarios, the court found the negative factors raised by objecting parties to be outweighed by the positive factors under the totality of the circumstances. In other words, as will be demonstrated, it takes more than a minor misstep and obstinacy to derail a reorganization plan.

Courts have found good faith lacking and denied confirmation of a reorganization plan under the following circumstances:

- A plan that was contingent upon a favorable ruling from the appellate court – overruling the bankruptcy court's determination of the enforceability of a contractual provision – was not proposed in good faith because the court could not conclude that the plan was reasonably likely to achieve the objectives of the Bankruptcy Code.
- A plan that allowed the debtor to maintain a lavish lifestyle that included two homes and extensive travel while paying a pittance to creditors was not proposed in good faith.
- A plan proposed in a case in which the debtor's assets exceeded its liabilities by $2 million was not proposed in good faith because it did not require payments to secured creditors for four years and did not provide for liquidation of assets to fund the plan.

In another case, a plan was not proposed in good faith because the debtor was capable of making substantially greater payments. Likewise, a plan was not proposed in good faith when its primary purpose was to reform a bilateral contract in a manner that resolved the other party's claims in debtors' favor and the debtors were current in the payments to other creditors and the contracting party was the only unsecured party. These cases reveal that a plan may be subject to a successful challenge on good faith grounds if it is proposed to take an unfair advantage over creditors or to preserve the debtor's luxurious lifestyle.

When it comes to the determination of good faith under Section 1129, there is no easy answer or formulaic evaluation. Instead, the plan must be evaluated in light of the goals of the Bankruptcy Code, particularly giving the debtor a fresh start while maximizing the return for creditors. In reviewing the cases, the fundamental principles that emerge are: (1) a plan will not be denied confirmation for lack of good faith whether the totality of the circumstances shows good faith despite some negative considerations, and (2) a plan will be denied confirmation for lack of good faith when the totality of the circumstances demonstrate that the debtor is seeking to protect its own interests to the detriment of the creditors.