CONFIRMING A PLAN OF REORGANIZATION FOR A NONPROFIT DEBTOR

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I. Introduction

A. The Nonprofit Sector In America

The nonprofit sector is an enormous contributor to the American economy.[1] In 2012, nonprofits accounted for 5.4% of the nation's GDP ($887.3 billion) and employed 10.3% of the country's private sector workforce (11.4 million). In 2010, nonprofits paid 9.2% of all wages paid in the U.S. ($587 billion) and between 2000 and 2010, employment in the nonprofit sector grew an estimated 18%, a rate faster than the overall U.S. economy. The sector continued to add jobs each year during the recession.

Conversely, the American economy is an enormous contributor to the nonprofit sector. According to the Urban Institute Center on Nonprofits and Philanthropy, in 2014 the total private sector direct giving to nonprofit institutions was $358.38 billion.[2] In addition to direct giving, individuals and businesses also contribute to the economic welfare of nonprofit institutions through volunteering. During 2014, more than a quarter of the adults in the U.S. contributed an aggregate of 8.7 billion hours of volunteer service to nonprofit organizations. These volunteer services had an estimated value of $179.2 billion.[3] Moreover, federal, state and local governments contribute billions of dollars to the economic welfare of nonprofit institutions annually through the provision of exemptions from income, sales, payroll and real and personal property taxes. For example, according to the National Bureau of Economic Research, the aggregate value of the exemptions from income and property taxes provided to the nonprofit hospital sector alone was $6.3 billion in 1994, which amounted to 1.7 percent of the total $169 billion in property and corporate income taxes paid by all

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[1]The Sector's Economic Impact, Independent Sector (available at https://www.independentsector.org/economic_role).

[2]The Nonprofit Sector in Brief 2015, Urban Institute (available at http://www.urban.org/sites/default/files/alfresco/publication-pdfs/2000497-The-Nonprofit-Sector-in-Brief-2015-Public-Charities-Giving-and-Volunteering.pdf).

[3]The Nonprofit Sector in Brief 2015, Urban Institute.

for-profit corporations that year.[4] Not all nonprofit corporations are tax exempt,[5] however, and not all types of tax exempt nonprofit corporations can provide donors the benefit of a tax deduction for their contributions.[6]

Nonprofits suffer from all of the same problems as for-profit corporations. They can be susceptible to tort or other liability issues (diocese bankruptcies), changing regulatory environments (hospital system bankruptcies) or declining interest in, or increased competition for, goods or services (arts and cultural organizations). However, because nonprofits are often dependent on donor contributions to meet debt service and operating expenses, many nonprofits are particularly vulnerable to economic recession.

B. Governance Structure of Nonprofit Corporations

Some nonprofits have members (nonprofit membership organizations) and some do not (non-member nonprofit organizations). At first blush, the members of a nonprofit membership organization may appear to be like shareholders of a for-profit corporation in that they have ultimate control of the entity through the ability to elect the members of the board of directors. Unlike shares in a for-profit corporation, however, membership interests in a nonprofit do not represent an economic stake in the enterprise, they cannot be transferred for value like shares of for-profit corporations, and they generally do not even entitle members to a share of the residual value of the enterprise upon

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[4]The Value of Tax Breaks for Not-for-Profit Hospitals, National Bureau of Economic Research (available at http://www.nber.org/digest/mar99/w6435.html).

[5]Tax exempt status imposes burdens that may outweigh the benefits for certain nonprofit corporations. Examples of taxable nonprofit corporations include MLB, the NBA and the NFL. MLB gave up its tax exempt status in 2007 (didn't save much money and required the league to disclose certain financial information, including the salaries of top executives). For similar reasons, the NFL announced in 2015 that is would give up its tax exempt status. The NBA has never been a tax exempt entity.

[6]Some examples of tax exempt nonprofit organizations to which donations are not tax deductible include, Labor, Agricultural, and Horticultural Organizations (IRC Section 501(c)(5) corporations), Business Leagues, Chambers of Commerce, Real Estate Boards, etc. (IRC Section 501(c)(6) corporations) and Social and Recreational Clubs (IRC Section 501(c)(7) corporations).

dissolution.[7] At their core, membership interests in a nonprofit corporation do not share the fixed risk/unlimited reward trade-off of interests in traditional for-profit corporations.

While some non-member nonprofit organizations confer the term "member" and provide special benefits to donors who provide certain levels of support to the organization, such membership interests are non-voting and do not represent a controlling interest in the entity. The board of directors of non-member nonprofit corporations are self-selecting and self-perpetuating. Directors continue to serve on the boards of non-member nonprofits until they decide to select their own replacements.

The mission of a nonprofit membership organization may either be to advance a charitable or public purpose—as in the case of a nonprofit hospital system, a nonprofit theater, National Public Radio (NPR) or Public Broadcasting Services (PBS)—or to benefit the members of the nonprofit—as in the case of a rural electrical cooperative, a local food cooperative, a university club, a country club, or a professional sports association. The mission of a nonmember nonprofit always will be to advance a charitable or public purpose.

Creditors are not the only contributors to the economic well-being of nonprofit institutions. Nonprofit entities have unique constituencies that make them fundamentally different from their for-profit cousins. These constituencies contribute value to the entity through the provision of funds, services and exemptions from taxation all without receiving an economic stake in the enterprise. This tangible consideration benefits both the recipient nonprofit as well as its creditors. Despite the unique contributions of these constituencies to the financial well-being of nonprofit entities, there are few provisions of the Bankruptcy Code addressing how these constituencies should be treated in the context of the bankruptcy of a nonprofit entity.

C. Bankruptcy Code Provisions Applicable to Nonprofits.

In fact, the term "nonprofit" is not defined in the Bank-

[7] Cf. *Matter of Wabash Valley Power Ass'n, Inc.*, 72 F.3d 1305, 1309, 34 Collier Bankr. Cas. 2d (MB) 877, Bankr. L. Rep. (CCH) P 76739 (7th Cir. 1995) ("As a not-for-profit corporation Wabash cannot pay any earnings or dividends to its members, and upon dissolution any assets remaining after payment of debts escheat to the state.").

ruptcy Code and appears only in connection with the definition of "debt relief agency," in various references to nonprofit budget and counseling agencies, and in connection with an exception to discharge for certain educational loans.[8] The closest the Bankruptcy Code comes to directly addressing nonprofit entities in its operative provisions is reference to "a corporation that is not a moneyed, business, or commercial corporation." The Bankruptcy Code provides that an involuntary petition cannot be filed against a corporation that is not a moneyed, business, or commercial corporation,[9] that a chapter 11 case of such a corporation cannot be converted into a chapter 7 liquidation unless the debtor requests the conversion,[10] and that any transfer of the property of such an entity, either during a case[11] or under a chapter 11 plan,[12] be conducted in accordance with non-bankruptcy law applicable to the transfer of property by a debtor that is not a moneyed, business, or commercial corporation.

It is not entirely clear what is meant by "a corporation that is not a moneyed, business, or commercial corporation." The term is also not defined in the Bankruptcy Code. The legislative history to the section is somewhat helpful as is specifies that "[e]leemosynary institutions, such as churches, schools and charitable organizations and foundations" are exempt from involuntary bankruptcy. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 322 (1977); S. Rep. No. 95-989, 95th Cong. 2d Sess. 32 (1978). However, because not all nonprofits are eleemosynary institutions, the legislative history is not entirely satisfactory. Although there is a lack of clarity regarding whether all nonprofit corporations benefit from the prohibition on filing involuntary petitions against a "corporation that is not a moneyed business, or commercial corporation," creditors should tread lightly when considering whether to file an involuntary petition against any nonprofit

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[8] See 11 U.S.C.A. §§ 101(12A), 109(h), 111, 502(k)(1)(A), 521(b), 523(a)(8)(A)(i), and 547(h).

[9] 11 U.S.C.A. § 303(a).

[10] 11 U.S.C.A. § 1112(c).

[11] 11 U.S.C.A. § 363(d)(1).

[12] 11 U.S.C.A. § 1129(a)(16).

entity as the risk associated with the filing of an unfounded involuntary petition are severe.[13]

Some courts have struggled to devise a workable standard for determining whether an entity—regardless of its denomination as a nonprofit—actually is a "moneyed business" or a "commercial corporation" such that it falls within the exception for the filing of an involuntary petition. See e.g., *In re Grace Christian Ministries, Inc.*, 287 B.R. 352, 40 Bankr. Ct. Dec. (CRR) 154 (Bankr. W.D. Pa. 2002) (considering whether a debtor qualified for the Section 303(a) exception where the debtor was incorporated as a non-profit entity but engaged in certain for-profit activities). The name of an organization does not define its character. "In evaluating whether an alleged debtor is a nonprofit entity that is not a moneyed business within the meaning of 11 U.S.C.A. § 303(a), the entity's corporate charter and status under state law is probative, but not determinative. . . . [I]t is also appropriate and necessary for the court to consider the nature and extent of the activities in which the entity has actually engaged." *In re Memorial Medical Center, Inc.*, 337 B.R. 388, 391 (Bankr. D. N.M. 2005); see also *In re United Kitchen Associates*, 33 B.R. 214, 216, 11 Bankr. Ct. Dec. (CRR) 83, Bankr. L. Rep. (CCH) P 69406 (Bankr. W.D. La. 1983).

Other Bankruptcy Code provisions apply to a limited subset of nonprofit organizations. For example, (i) Section 541(f) of the Bankruptcy Code applies only to debtors that are IRC Section 501(c)(3) corporations[14] and provides that property of a debtor that is an IRC Section 501(c)(3) corporation that is exempt from tax under IRC Section 501(a) may be transferred to an entity that is not such a corporation only in accordance with applicable nonbankruptcy law, and (ii) Sections 544(b)(2) and 548(a)(2) of the Bankruptcy Code

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[13]11 U.S.C.A. § 303(i).

[14]Generally speaking, an IRC Section 501(c)(3) corporation is an entity (i) that is operated exclusively for religious, charitable, scientific, public safety, literary, or educational purposes or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals; (ii) no part of the earnings of which inure to the benefit of a shareholder; (iii) no substantial portion of the activities of which are devoted to attempting to influence legislation (except as expressly permitted in the statute); and (iv) that does not participate in a political campaign on behalf of (or in opposition to) any candidate for public office.

protect certain prepetition charitable contributions by insolvent debtors to a "qualified religious or charitable entity or organization." Still other provisions of the Bankruptcy Code apply exclusively to debtors that are "health care businesses"[15] which are often, but not always, organized as nonprofit entities.[16]

II. The Chapter 11 Plan Generally

A. Structuring a Chapter 11 Plan

The goal of a chapter 11 case is to obtain the Bankruptcy Court's approval of a plan of reorganization. A plan is essentially an agreement between the debtor, on the one hand, and the holders of prepetition claims and interests that are classified under a plan, on the other. The Bankruptcy Code defines the term "claim" broadly. Essentially, the term "claim" means any "right to payment," regardless whether such right has been "reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured," and also includes a "right to an equitable remedy for breach of performance if such breach gives rise to a right of payment."[17]

In explaining the intended definition of "claim" under the Code, the House and Senate Reports provide "[b]y this broadest possible definition [of claim] . . . all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case." H.R. Rep. No. 95-595, at 309 (1977); S. Rep. No. 95-989, at 22 (1978); *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S.

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[15]The term "health care business" is broadly defined at 11 U.S.C.A. § 101(27A).

[16]For example, (i) 11 U.S.C.A. § 333 provides for the appointment of a patient care ombudsman (entitled to compensation under 11 U.S.C.A. § 330) to monitor and report on the quality of patient care, (ii) 11 U.S.C.A. § 351 provides a procedure that must be followed prior to the destruction of patient records, (iii) 11 U.S.C.A. § 503(b)(8) provides an administrative claim for the costs associated with the disposal of patient records and the transfer of patients from a closing facility to another health care business, and (iv) 11 U.S.C.A. §§ 704(a)(12) and 1106(a)(1) requires trustees and debtors-in-possession to utilize their best efforts to transfer all patients from a closing health care business to another health care business that provides substantially similar services and is in the same vicinity as the closing health care business.

[17]11 U.S.C.A. § 101(5).

552, 558, 110 S. Ct. 2126, 109 L. Ed. 2d 588, 20 Bankr. Ct. Dec. (CRR) 833, 22 Collier Bankr. Cas. 2d (MB) 1067, Bankr. L. Rep. (CCH) P 73382 (1990). Although the definition of claim is broad, the existence of a valid bankruptcy claim depends on (1) whether the claimant possessed a right to payment and, (2) whether that right arose before the filing of the petition. See *In re Chateaugay Corp.*, 53 F.3d 478, 497, 19 Employee Benefits Cas. (BNA) 1169, Bankr. L. Rep. (CCH) P 76459 (2d Cir. 1995) ("A claim will be deemed pre-petition when it arises out of a relationship recognized in, for example, the law of contracts or torts."). "A claim exists only if before the filing of the bankruptcy petition, the relationship between the debtor and the creditor contained all the elements necessary to give rise to a legal obligation—'a right to payment'—under the relevant non-bankruptcy law." Chateaugay, 53 F.3d at 497 (quotation omitted). While the existence of a claim is governed by non-bankruptcy law, the determination of when a claim arises is governed by the Code. See Chateaugay, 53 F.3d at 497 (stating that the language of the Code would determine whether the creditor's right to payment existed at the time of the filing of the debtor's petition); *In re National Gypsum Co.*, 139 B.R. 397, 405, 27 Collier Bankr. Cas. 2d (MB) 199, 34 Env't. Rep. Cas. (BNA) 1577, 22 Envtl. L. Rep. 20783 (N.D. Tex. 1992) ("While non-bankruptcy law governs the existence of a claim under the Code, it is not dispositive of the time at which a claim arises under the Code."); *In re Manville Forest Products Corp.*, 225 B.R. 862, 865–66 (Bankr. S.D. N.Y. 1998), subsequently aff'd, 209 F.3d 125, 35 Bankr. Ct. Dec. (CRR) 264, 43 Collier Bankr. Cas. 2d (MB) 1652, 50 Env't. Rep. Cas. (BNA) 1572 (2d Cir. 2000).

The Bankruptcy Code is explicit regarding who may file a proof of claim: Only a creditor or an indenture trustee may file a proof of claim[18] (or if a creditor does not timely file a proof of claim, an entity that is co-liable with the debtor on the debt,[19] or the debtor itself,[20] may file a proof of claim on the creditor's behalf). The Bankruptcy Code does not define the term interest, but it is also explicit about who may file a

[18]11 U.S.C.A. § 501(a).

[19]11 U.S.C.A. § 501(b).

[20]11 U.S.C.A. § 501(c).

proof of interest: Only an "equity security holder" may file a proof of interest. The Bankruptcy Code defines the term "equity security holder" as a "holder of an equity security of the debtor,"[21] and defines the term "equity security" as a share in a corporation,[22] a limited partnership interest in a limited partnership, or a right to purchase a share or limited partnership interest.[23] Put more succinctly, for purposes of the Bankruptcy Code, a proof of interest represents a right to the equity value of the debtor that does not obligate the holder to pay the debts of the company beyond the holder's invested capital in the debtor.

A claim or interest reflected in a proof of claim or a proof of interest is an allowed claim or interest unless the debtor or a party-in-interest files an objection to the claim or interest. If a claim or interest is objected to, the bankruptcy court will make a determination regarding the allowed amount and priority of the claim or interest.[24]

For purposes of voting on a plan, prepetition claims and interests in the debtor are grouped into various classes together with other substantially similar prepetition claims or interests.[25] Only holders of allowed prepetition claims or interests that are classified under a plan may vote on a plan.[26] While other parties-in-interest in a bankruptcy case may have standing to appear and be heard on various issues in the case, such parties are not entitled to vote on a plan. Because membership interests in a nonprofit do not ordinarily constitute "equity securities," members are arguably not entitled to file proofs of interest in a bankruptcy case or vote,

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[21]11 U.S.C.A. § 101(17).

[22]The term "corporation" is broadly defined in the Bankruptcy Code to include (i) an association that has a power or a privilege that a private corporation, but not an individual or partnership, possesses, (ii) a partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association, (iii) a joint stock company, (iv) an unincorporated company of association, or (v) a business trust, but the term specifically excludes a limited partnership. 11 U.S.C.A. § 101(9).

[23]11 U.S.C.A. § 101(16).

[24]11 U.S.C.A. § 502.

[25]11 U.S.C.A. § 1122.

[26]11 U.S.C.A. § 1126(a).

have their interests classified, or receive treatment under a bankruptcy plan.

A class of claims or interests that is not "impaired" under the plan will be conclusively presumed to have accepted the plan, and therefore, votes need not be solicited from the holders of claims or interests in such class.[27] Similarly, a class of claims or interest that will not receive or retain any property of the debtor under the plan is deemed to have rejected the plan, and votes need not be solicited from the members of such class.[28] Once a plan has been approved by the Bankruptcy Court, it becomes binding on all parties-in-interest, regardless of whether they voted in favor of the plan.

B. The Consensual Plan.

If each class of claims and interests that is impaired under the plan votes in favor of the plan (or is deemed to have voted in favor of the plan), and certain other conditions are met, the plan may be confirmed as a "consensual plan" notwithstanding the fact that not all creditors or interest holders in each class have voted in favor of the plan. A class of claims is deemed to have voted in favor of a plan if a majority of the creditors voting in the class, holding at least two-thirds of the amount of claims actually voted in the class, vote in favor of the plan.[29] A class of interests is deemed to have voted in favor of a plan if the holders of at least two-thirds of the interests in such class vote in favor of the plan.[30] While holders of priority claims may demand specific treatment under a plan on an individual basis,[31] most prepetition creditors and interest holders who are dissatisfied with their proposed treatment under a plan but have been properly classified in an accepting class have little recourse other than to contest confirmation on the basis that such creditor or interest holder will receive less under the plan than such

[27]11 U.S.C.A. § 1126(f).

[28]11 U.S.C.A. § 1126(g).

[29]11 U.S.C.A. § 1126(c).

[30]11 U.S.C.A. § 1126(d).

[31]11 U.S.C.A. § 1129(a)(9).

creditor or interest holder would receive if the debtor were liquidated under chapter 7 of the Bankruptcy Code.[32]

C. The Nonconsensual Plan.

The Bankruptcy Code provides for the confirmation of a plan even where one or more classes of claims or interests vote to reject the plan. In such instance, a plan may be confirmed on a nonconsensual basis so long as (i) all the other requirements for the confirmation of a consensual plan are met, including that at least one class of impaired creditors has voted in favor of the plan (without counting the votes of any insiders of the debtor in such class),[33] and (ii) the plan is "fair and equitable" and does not "discriminate unfairly" with respect to each class of impaired claims or interests that have rejected the plan.[34]

1. Unfair Discrimination.

The Bankruptcy Code provides that a plan must not "discriminate unfairly" with respect to any class of impaired claims or interests that has rejected the plan. As a general matter, a plan will be found to unfairly discriminate "where similarly situated classes are treated differently without a reasonable basis for the disparate treatment."[35] *In re Genco Shipping & Trading Limited*, 513 B.R. 233, 241 (Bankr. S.D.

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[32]11 U.S.C.A. § 1129(a)(7). This requirement is called the "best interests test." Because a corporation is ordinarily worth much more as a going concern than the sum of its assets in liquidation, the "best interests test" is usually not difficult to pass. However, as discussed in greater detail below, as the primary goal of a nonprofit corporation is not the maximization of value, complying with the "best interests test" in a nonprofit case may be a more difficult task than in the ordinary chapter 11 case, particularly in situations where, under state law, the assets of the nonprofit could be sold to a for-profit entity. See discussion of "best interests test" *infra*, at Section III.C.

[33]11 U.S.C.A. § 1129(a)(10).

[34]11 U.S.C.A. § 1129(b)(1).

[35]Note that while Section 1122(a) of the Bankruptcy Code mandates that any claim or interest in a particular class be substantially similar to the other claims or interests in such class, the Bankruptcy Code does not prohibit a debtor from separately classifying substantially similar claims or interests so long as the debtor is not seeking to gerrymander an accepting class and so long as there are valid business justifications for the separate classification. *Matter of Wabash Valley Power Ass'n, Inc.*, 72 F.3d 1305, 1321, 34 Collier Bankr. Cas. 2d (MB) 877, Bankr. L. Rep. (CCH) P

N.Y. 2014) (quotation omitted); cf. *In re Jim Beck, Inc.*, 214 B.R. 305, 307 (W.D. Va. 1997), aff'd, 162 F.3d 1155 (4th Cir. 1998) ("[T]he applicable distinction is not whether there exists discrimination, but whether any such discrimination is 'unfair.' "). The Bankruptcy Code does not specify the level of discrimination among similarly situated classes that is permissible, so courts have developed their own tests. Some courts require the plan proponent to show that (i) there is a legally acceptable justification for the discrimination, and (ii) the discrimination is narrowly tailored to address the stated justification for the discrimination. See, e.g., *In re Multiut Corp.*, 449 B.R. 323, 351–53, 54 Bankr. Ct. Dec. (CRR) 174 (Bankr. N.D. Ill. 2011); *In re 203 North LaSalle Street Ltd. Partnership*, 190 B.R. 567, 585–86, 28 Bankr. Ct. Dec. (CRR) 303, 34 Collier Bankr. Cas. 2d (MB) 1521 (Bankr. N.D. Ill. 1995), order aff'd, 195 B.R. 692, Bankr. L. Rep. (CCH) P 77035 (N.D. Ill. 1996), judgment aff'd, 126 F.3d 955, 31 Bankr. Ct. Dec. (CRR) 658, 38 Collier Bankr. Cas. 2d (MB) 1275, Bankr. L. Rep. (CCH) P 77529 (7th Cir. 1997), judgment rev'd on other grounds, 526 U.S. 434, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) P 77924 (1999). Other courts have adopted a rebuttable presumption test whereby discrimination among similarly situated classes is deemed to be unfair if (i) the plan classifies similarly situated creditors in separate classes, (ii) one of the classes rejects the plan; (iii) the plan treatment of the rejecting class is either a materially lower percentage recovery than the accepting class of similarly situated creditors, or provides consideration that is materially more risky than the consideration provided to the accepting class. This presumption can be rebutted if the plan proponent can establish either that the accepting class of similarly situated creditors made a substantial contribution to the reorganization that offsets the more favorable treatment, or that the disparity in treatment is consistent to what otherwise would

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76739 (7th Cir. 1995); *Matter of Briscoe Enterprises, Ltd., II*, 994 F.2d 1160, 1166–67, 24 Bankr. Ct. Dec. (CRR) 717, 29 Collier Bankr. Cas. 2d (MB) 528, Bankr. L. Rep. (CCH) P 75351 (5th Cir. 1993); *In re U.S. Truck Co., Inc.*, 800 F.2d 581, 14 Bankr. Ct. Dec. (CRR) 1327, 15 Collier Bankr. Cas. 2d (MB) 553, 123 L.R.R.M. (BNA) 2849, Bankr. L. Rep. (CCH) P 71460 (6th Cir. 1986).

occur outside of bankruptcy. See, e.g., *In re Armstrong World Industries, Inc.*, 348 B.R. 111, 121 (D. Del. 2006).

2. Fair and Equitable.

In addition to the requirement that a nonconsensual plan not "discriminate unfairly," the Bankruptcy Code provides that a nonconsensual plan be "fair and equitable" with respect to each class of impaired claims and interests that has rejected the plan. The Bankruptcy Code defines the term "fair and equitable" by example, thereby inviting the courts to consider other factors when determining whether a plan is "fair and equitable" to a rejecting class in a given case.[36] *In re 20 Bayard Views, LLC*, 445 B.R. 83, 105, 54 Bankr. Ct. Dec. (CRR) 116 (Bankr. E.D. N.Y. 2011) (the requirements of Section 1129(b)(2) "establish a floor, and satisfaction of these statutory requirements does not guarantee that the plan will meet the fair and equitable standard."). For example, in *In re Premiere Hospitality Group, Inc.*, 2013 WL 6633428, *2 (Bankr. E.D. N.C. 2013), the court ruled that a plan that complied with the specified requirements for treatment of a rejecting class of secured claims was nonetheless not "fair and equitable" because the plan allocated too much risk to the class. The minimum requirements of the "fair and equitable" test are set out in Section 1129(b)(2) of the Bankruptcy Code. That section sets out different standards depending on whether the rejecting class is a class of secured claims, a class of unsecured claims, or a class of interests.

Rejecting Class of Secured Claims — If the rejecting class is a class of secured claims, Section 1129(b)(2)(A) provides that in order for the plan to be fair and equitable, the plan must at a minimum provide: (i) that (a) the class of secured claims retain their liens in the collateral in an amount equal to the allowed amount of their secured claims, and (b) each member of the class receive deferred cash payments with a present value as of the effective date of the plan equal to the present value of the allowed secured claim, (ii) if the property is sold to a third party under the plan, that the class of secured claims receive a lien on the proceeds of the sale; or (iii) the class of secured creditors receives the indubitable equivalent of its secured claims.

Rejecting Class of Unsecured Claims — Section

[36] 11 U.S.C.A. § 1129(b)(2).

1129(b)(2)(B) sets out the minimum requirements of the fair and equitable test in regard to a rejecting class of unsecured claims. This section is commonly known as the "absolute priority rule" and provides that in order for the plan to be fair and equitable, the plan must at a minimum provide that either (i) the allowed amount of the unsecured claims in the rejecting class is paid in full, or (ii) no holder of a junior claim or interest receive or retain any property on account of such junior claim or interest.

Rejecting Class of Interests — If the rejecting class is a class of interests, Section 1129(b)(2)(C) provides that in order for the plan to be fair and equitable, the plan must at a minimum provide that (i) each holder of an interest in the class receive or retain property with a value equal to the greatest of the allowed amount of any fixed liquidation preference to which the holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or (ii) no holder of a junior interest receives or retains any property under the plan on account of such junior interest.

III. Confirmation Issues in Nonprofit Cases

A. Application of the Absolute Priority Rule in Nonprofit Cases

Issues have arisen in nonprofit bankruptcy cases regarding whether the debtor can reorganize as a nonprofit enterprise if unsecured creditors are not paid in full and vote as a class to reject the plan. Objecting classes of creditors in these cases argue that the retention of control of the nonprofit by officers, directors and members violates the absolute priority rule because these entities hold interests in the debtor that are junior to the impaired objecting class. While most courts have held that the absolute priority rule does not prohibit these parties from maintaining control of the reorganized debtor (at least in cases were the officers, directors and members do not hold any economic stake in the debtor), one commentator has suggested that unless an impaired creditor class agrees to accept less than 100% of the going concern value of the reorganized entity, the entity

should not be permitted to reorganize as a nonprofit.[37] This commentator has suggested that where impaired creditors that will not be paid in full vote to reject a plan of a nonprofit debtor, the creditors should be able to convert the entity into a for-profit enterprise and acquire the equity interests of the debtor under the plan.[38] While this argument may have merit in nonprofit cases where the officers, directors and members of the nonprofit debtor are the exclusive beneficiaries of the enterprise and have a right to the debtor's residual value, it has arguably less merit in the context of a public benefit nonprofit corporation where donors, volunteers and governmental units (all of which have contributed critical support to the enterprise through the provision of funds, services and exemptions from taxation) do not hold an equity stake in the enterprise that would be subject to classification and treatment under a plan. Moreover, this argument fails to address the fact that in most states governmental rather than private interests control whether a nonprofit may convert to a for-profit enterprise.[39]

As previously noted, the term "interest" is not defined in the Bankruptcy Code, but several sections make clear that the term is meant to address economic interests in the debtor. For example, Section 501 provides who may file a proof of claim or interest. It provides that the holder of an "equity security" may file a proof of interest, and the definition of "equity security" makes clear that the term is meant to encompass the right to share in the unlimited equity upside of an enterprise in exchange for a fixed investment. Moreover, Section 502 provides for the allowance of claims and interests that have been timely filed, and Section 1126 provides that only holders of claims or interest that have been allowed under a plan may vote to accept or reject a

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[37]Pamela Foohey, Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies To All Nonprofit Entities, 86 St. John's L. Rev. 31, 84 (2012).

[38]Foohey, 86 St. John's L. Rev. at 84.

[39]See 11 U.S.C.A. 1129(a)(16) ("All transfers of property under the plan shall be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust.").

plan.[40] Officers and directors of a corporation, while clearly parties-in-interest in a bankruptcy proceeding, do not qualify as holders of claims or interests subject to classification and treatment under a plan of reorganization merely on account of their role as officers and directors. While membership interests in a nonprofit may be considered interests in the nonprofit in the colloquial sense, they are generally not equity securities subject to classification and treatment under a plan or subject to the absolute priority rule (which applies only among classes of claims and interests classified and treated under a plan).[41]

None of the cases involving nonprofit debtors address the distinction between nonprofit membership corporations, which have members who vote to elect directors and who in some cases may be the sole beneficiaries of the organization's largesse, and non-member nonprofit organizations, which always have a charitable or public purpose and whose boards are self-perpetuating. These cases also do not directly address the definitional provisions of the Bankruptcy Code, or the fact that Section 501(a) specifies that only an "equity security holder" may file a proof of interest. The cases generally go straight to the essential characteristic of an interest being a right to the residual value of an enterprise after the satisfaction of claims.

The seminal case on the application of the absolute priority rule to a nonconsensual plan of a nonprofit debtor is *Matter of Wabash Valley Power Ass'n, Inc.*, 72 F.3d 1305, 34 Collier Bankr. Cas. 2d (MB) 877, Bankr. L. Rep. (CCH) P 76739 (7th Cir. 1995). The case involved the bankruptcy of an Indiana nonprofit electrical cooperative with twenty-four members. Each member was itself a small power company that supplied electricity to a particular rural community.

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[40]Moreover, Section 1125(a)(1) of the Bankruptcy Code, which defines "adequate information" for purposes of solicitation of a plan, speaks in economic terms, providing that a disclosure statement must contain sufficient information to enable a "hypothetical investor typical of the holders of claims and interests in the case" to make an informed judgement about the plan.

[41]See *In re Lincoln Ave. & Crawford's Home for the Aged, Inc.*, 164 B.R. 600, 25 Bankr. Ct. Dec. (CRR) 461, Bankr. L. Rep. (CCH) P 75774 (Bankr. S.D. Ohio 1994) ("It is the very essence of a nonprofit corporation that there not exist any interest in it equivalent to a stockholder in a for-profit corporation who stands to profit from the success of the enterprise.").

The coop was formed to enable these small companies to band together in order to purchase or develop power on a cost efficient basis. Each of the twenty-four members in the coop was entitled to appoint one member to the debtor's board. A dissenting creditor rejected the plan and argued, inter alia, that the provisions of the plan that enabled the members and directors to remain in control of the coop post-reorganization violated the absolute priority rule.

In considering the question whether the officers and directors were retaining interests in the coop in violation of the absolute priority rule, the court noted that the only essential element of an interest was a right to a share of the profits of an enterprise and that the right to control was not essential. Turning to controlling Indiana state law and the rules of the cooperative association, the court noted that the coop members "receive no profits, nor do they have any current or prospective ownership right in the corporate assets. Under Indiana law, any assets remaining to the cooperative after a liquidation or dissolution escheat to the state. Indeed almost the only prerogative Members share with shareholders in an ordinary business corporation is the right to elect a board of directors." Wabash Valley Power, 72 F.3d at 1313 (citation omitted).

The Seventh Circuit also considered whether the members' patronage capital account claims were entitled to be classified and receive pro rata treatment together with the claims of general unsecured creditors. The court concluded that the patronage capital claims were valid general unsecured claims and did not violate the absolute priority rule because they merely represented reimbursement claims for the excess amount of advance payments for projected power costs over the actual costs for power. Wabash Valley Power, 72 F.3d at 1315–17. But see *In re Eastern Maine Elec. Co-op., Inc.*, 125 B.R. 329, 336–39 (Bankr. D. Me. 1991) (finding that allocated patronage capital constituted an ownership interest junior to the claims of creditors). The court noted that while membership in the coop provided the members with the ability to purchase goods at lower prices, such right was not tantamount to an equity interest. "Control of the cooperative provides no opportunity, either currently or in the future, for the Members to obtain profits or any equity in Wabash's assets and control itself is not an equity interest." *Wabash, 72 F.3d at 1320.*

The debtor in In re Whittaker Memorial Hosp. Ass'n, Inc., 149 B.R. 812 (Bankr. E.D. Va. 1993), like the debtor in *Wabash*, was a nonprofit membership corporation. The court in the *Whittaker* case appears to have had an even easier time dispensing with the absolute priority rule argument. because, unlike in *Wabash*, the members in *Whittaker* were not the beneficiaries of the services provided by the debtor, which was a minority controlled hospital that served a predominantly elderly and low-income minority population. In dispensing with the argument that the retention of post-reorganization control by the members and directors of the nonprofit hospital violated the absolute priority rule, the court stated that "[t]he present group retaining control over the debtor entity does not give them anything, certainly not a favored position over HUD. It gives them problems and great anguish ahead." Whittaker, 149 B.R. at 816. See also *In re General Teamsters, Warehousemen and Helpers Union, Local 890*, 265 F.3d 869, 873–76, 38 Bankr. Ct. Dec. (CRR) 117, 168 L.R.R.M. (BNA) 2161, Bankr. L. Rep. (CCH) P 78501, 175 A.L.R. Fed. 775 (9th Cir. 2001) (finding that neither international union nor members of the local union were equity holders and the absolute priority rule was not violated by letting the local union continue in control post-reorganization); *In re Havre Aerie No. 166 Eagles*, 2013 WL 1164422, *15 (Bankr. D. Mont. 2013) ("the evidence shows that the debtor is a nonprofit and no evidence exists of present ownership or interests in the organization's profits other than the Debtor"); *In re 28th Legislative Dist. Community Development Corp.*, 55 Bankr. Ct. Dec. (CRR) 196, 2011 WL 5509140, *11 (Bankr. E.D. Tenn. 2011) ("In a case in which the debtor does not have equity holders such as a non-profit corporation or a municipality or an electric cooperative, there is no junior class and so there can be nothing that the non-existent junior class is retaining or receiving. As such, the continued operation of the debtor in this case does not violate the absolute priority rule."); *In re Indian Nat. Finals Rodeo Inc.*, 453 B.R. 387, 401 (Bankr. D. Mont. 2011) ("In the instant case the Debtor is a non-profit organization . . . no shareholders exist, and the board members and commissioners are paid no salaries and no members received dividends."); *In re Save Our Springs (S.O.S.) Alliance, Inc.*, 388 B.R. 202, 245 (Bankr. W.D. Tex. 2008), aff'd, 2009 WL 8637183 (W.D. Tex. 2009), judgment aff'd, 632 F.3d 168, 54

Bankr. Ct. Dec. (CRR) 56, 64 Collier Bankr. Cas. 2d (MB) 1686, Bankr. L. Rep. (CCH) P 81924 (5th Cir. 2011) (nonprofit environmental organization did not violate the absolute priority rule "because the Debtor, as a non-profit organization, has no equity holders").

Not all bankruptcy courts that have considered the question have concluded that the holders of membership interests in a nonprofit may retain their interests in the debtor. See *Southern Pacific Transp. Co. v. Voluntary Purchasing Groups, Inc.*, 252 B.R. 373, 44 Collier Bankr. Cas. 2d (MB) 1690 (E.D. Tex. 2000). Like the debtor in *Wabash*, the debtor in *Voluntary Purchasing Groups* was a nonprofit rural electrical coop, but the ruling that the retention of membership interests violated the absolute priority rule did not reflect a rejection of the ruling in *Wabash*. Rather, it reflected a recognition of a critical distinction between the rights of the holders of patronage stock in a rural electrical cooperative under the laws of Texas and Indiana. Whereas Indiana law provided that holders of patronage stock had no interest in any residual value remaining after satisfaction of creditor claims, Texas law provided that they did. For example, the court noted that Tex. Bus. Corp. Act Ann. Art. 6.04 provided that: "[a]fter paying, satisfying, or discharging all its debts, liabilities and obligations, . . . the corporation shall then distribute the remainder of its properties and assets, either in cash or in kind, to its shareholders according to their respective rights and interests." Voluntary Purchasing Groups., 252 B.R. at 387. Based on this distinction, the court concluded that Texas law clearly evinced an intent to treat patronage stock as an interest junior to the debts of a corporation or cooperative.

While bankruptcy court decisions on the applicability of the absolute priority rule generally reach the correct result, the failure to apply a threshold statutory analysis of whether the rights and benefits afforded members and directors of a nonprofit debtor constitute classifiable interests under a chapter 11 plan can lead to confusion about whether courts are ignoring the absolute priority rule in nonprofit cases. This is because the absolute priority rule prohibits the retention of any property by a junior class of interests over the

objection of an impaired class of unsecured claims.[42] A more careful statutory analysis regarding whether the rights and obligations of nonprofit members and directors constitute interests for which a proof of claim may be filed and which may be classified and treated under a plan of reorganization would show that the absolute priority rule is not being abrogated in these cases. Except in instances where these rights can be shown to have the characteristic of equity securities, the absolute priority rule has no application to the rights and obligations of members and directors of a nonprofit entity in chapter 11.

Perhaps courts and practitioners would benefit from a modest amendment to the Bankruptcy Code to clarify this point. First, because the term "interest" is used in several different contexts in the Bankruptcy Code,[43] the term could be replaced with the term "equity interest" in those instances where the term is intended to denote an ownership interest in the debtor. Next, the term "equity interest" could be defined to mean "a right to a share of the profits (other than employee cash compensation based on the debtor's performance) or residual value of the debtor, including any option with respect to such right." This type of definition would make clear that membership interests that are devoid of any economic stake in a debtor are not subject to classification and designation under Sections 1122 and 1123 of the Bankruptcy Code and not subject to the application of the absolute priority rule of Section 1129(b)(2)(B)(ii) of the Bankruptcy Code.

B. Feasibility Issues in Nonprofit Cases

One of the more hotly contested issues of plan confirmation is the feasibility requirement. Though the word is not used in the Bankruptcy Code, "feasibility" relates to the financial viability of a debtor under a plan of reorganization. Feasibility is met if "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to

[42]11 U.S.C.A. § 1129(b)(2)(B)(ii).

[43]For example, the term interest is used in Sections 506(a) and 522 to denote a secured creditor's "interest" in collateral, and is used in Sections 502(b)(2) and 506(b) to denote the rate paid for the use of borrowed money.

the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."[44]

The question of a plan's feasibility usually involves a battle of financial experts testifying about past, current and future financial progress and prospects (or lack thereof) of the reorganizing entity. In a case where a debtor has sought bankruptcy protection as a result of an inability to pay its operating expenses, the expert supporting the plan will ordinarily attempt to establish feasibility by explaining how the reorganized debtor will contain costs and enhance revenues. Where a debtor has filed bankruptcy as a result of improvident capital expenditures,[45] the expert supporting the plan will ordinarily attempt to establish feasibility by testifying that the reorganized debtor will be sufficiently deleveraged. The expert opposing the plan will ordinarily attack the reasonableness of the assumptions underlying the debtor's financial projections.

Though feasibility issues are often a contentious element of the plan confirmation process, courts do not apply a particularly stringent standard to a feasibility determination. In establishing the feasibility of a plan, the proponent need not provide assurance of success, but rather only a reasonable assurance of commercial viability. See *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649, 17 Bankr. Ct. Dec. (CRR) 695, Bankr. L. Rep. (CCH) P 72264 (2d Cir. 1988); *In re Machne Menachem, Inc.*, 371 B.R. 63, 71 (Bankr. M.D. Pa. 2006) ("The standards needed to achieve plan feasibility are not rigorous.") (citation omitted). "Only a reasonable assurance of commercial viability is required." *Matter of Briscoe Enterprises, Ltd., II*, 994 F.2d 1160, 1166, 24 Bankr. Ct. Dec. (CRR) 717, 29 Collier Bankr. Cas. 2d (MB) 528, Bankr. L. Rep. (CCH) P 75351 (5th Cir. 1993) (quotation omitted); *In re Prussia Associates*, 322 B.R. 572, 584, 44 Bankr. Ct. Dec. (CRR) 160 (Bankr. E.D. Pa. 2005) ("The Code does not require the debtor to prove that success is inevitable, and a relatively low threshold of proof will satisfy § 1129(a)(11) so

[44]11 U.S.C.A. § 1129(a)(11).

[45]Capital expenditures are the funds that a business uses to purchase assets such as real estate, buildings and equipment in order to obtain a future benefit. Operating expenditures are used to fund the necessary day-to-day operation of the business, such as wages, utilities, maintenance and transport costs.

long as adequate evidence supports a finding of feasibility.") (quotation omitted).

In the nonprofit context, published feasibility opinions are relatively sparse. What does exist, however, gives insight into the issues bankruptcy judges face in these types of cases—some unique to the nonprofit sector and some common to all chapter 11 cases. The reported decisions fall into four categories: nonprofits that depend entirely on donations; nonprofits that have a mixture of donations and revenue-generating business operations; nonprofits that are entirely dependent on revenue-generating business operations; and nonprofits that survive off of unique sources of funding, such as assessments of members. Each will be analyzed below.

All of the cases follow the general guidelines applicable to feasibility in their circuit; there do not appear to be any special rules applicable to nonprofit entities.[46] However, those that have a proven record of year over year donations or revenue from business operations appear to have a greater chance of confirmation than those that do not.

1. Nonprofits that depend entirely on donations.

In *In re Save Our Springs (S.O.S.) Alliance, Inc.*, 632 F.3d 168, 54 Bankr. Ct. Dec. (CRR) 56, 64 Collier Bankr. Cas. 2d (MB) 1686, Bankr. L. Rep. (CCH) P 81924 (5th Cir. 2011), the Fifth Circuit weighed in on the feasibility of a nonprofit plan of reorganization that relied exclusively on donations. The debtor maintained a website that explained its purpose and background: "The Save Our Springs Alliance works to protect the Edwards Aquifer, its springs and contributing streams, and the natural and cultural heritage of the Hill Country region and its watersheds, with special emphasis on Barton Springs . . . The Save Our Springs Alliance sprung to life in 1990 as a loose coalition of citizens fighting a massive development proposal for the Barton Creek watershed."[47] The debtor's donors numbered in the thousands, but most of the firm's revenues came "from a handful of generous

[46]For example, liquidating plans need not meet the feasibility requirement in a for-profit case. The same is true for a nonprofit. See, e.g., Machne Menachem, 371 B.R. at 72.

[47]Save Our Spring Alliance website (available at http://www.sosalliance.org/community/about-s-o-s-alliance.html).

donors." *In re Save Our Springs (S.O.S.) Alliance, Inc.*, 388 B.R. 202, 209 (Bankr. W.D. Tex. 2008), aff'd, 2009 WL 8637183 (W.D. Tex. 2009), judgment aff'd, 632 F.3d 168, 54 Bankr. Ct. Dec. (CRR) 56, 64 Collier Bankr. Cas. 2d (MB) 1686, Bankr. L. Rep. (CCH) P 81924 (5th Cir. 2011). The debtor was a frequent plaintiff in the court system, but was not always successful: "Two of its lawsuits resulted in sizable awards of attorney's fees to the defendants in those suits . . . Unable to pay the awards, S.O.S. filed for bankruptcy in April 2007." S.O.S., 632 F.3d at 171. The debtor's plan of reorganization proposed to pay $60,000 to a "credit fund" from charitable contributions made by donors within 60 days of plan confirmation. S.O.S., 632 F.3d at 171. The plan proposed to pay the fund pro rata to unsecured creditors with the balance of the unsecured claims being discharged. S.O.S., 632 F.3d at 171.

Although the Fifth Circuit correctly recognized the less than stringent standard for determining feasibility, noting that "a debtor must show by a preponderance of the evidence that its plan is feasible," the court ultimately concluded that the debtor had not met its burden. S.O.S., 632 F.3d at 172–74. Scrutinizing the debtor's financial projections, the court recognized that funds available for general operations were barely enough to allow the debtor to scrape by every month—and that there was no surplus available for payment to the creditor fund. S.O.S., 632 F.3d at 173. The debtor argued that $20,000 in pledges towards the proposed creditor fund served as "evidence of a reasonable assurance of success," and contended that it would raise the additional $40,000 required to fund the creditor fund within 60 days. S.O.S., 632 F.3d at 172.

The Fifth Circuit was unpersuaded. It found that the $20,000 in pledges was "too speculative to provide evidence of feasibility" because the pledges were oral in nature and the debtor had provided no evidence the donors could honor them. S.O.S., 632 F.3d at 173.[48] The court was also skeptical of the debtor's ability to raise the additional $40,000 required for the creditor fund, believing that donors would be hesitant to give for the purpose of paying off judgment creditors,

[48]The bankruptcy court noted that only one donor had committed to donate to the creditor fund (in an amount of $12,500). S.O.S., 388 B.R. at 242.

as opposed to making contributions to further the stated purpose of the organization. S.O.S., 632 F.3d at 172.[49]

Thus, financial projections based solely on oral pledges from sources with dubious financial ability and dependent on additional donations to be raised to pay legacy liabilities rather than to further the mission of the enterprise did not provide a "reasonable assurance of commercial viability" necessary to support the feasibility of the proposed plan.

2. Nonprofits that depend on a combination of donations and revenue-generating business operations.

Like the *S.O.S.* plan, the feasibility of the plan in *In re Indian Nat. Finals Rodeo Inc.*, 453 B.R. 387 (Bankr. D. Mont. 2011), depended, at least in part, on financial projections that contained an assumption of an increase in donations, sponsorships and revenues from ticket sales. There, no portion of the projected sponsorship growth was supported by existing pledges, and sponsorships had in fact declined each year since 2008. The debtor's general manager, however, testified that the decline in sponsorships were attributable to a reluctance of potential sponsors to contribute in the face of well-publicized collection efforts of an aggressive judgment creditor, and that this impediment would be removed once the claim was to be treated and discharged under the plan. Further, the general manager testified that the projected increase in revenues from ticket sales was reasonable based on a showing that ticket sales had increased consistently since 2005, and that the financial health of the company would be further enhanced through the implementation of certain cost-cutting measures. Indian Nat. Finals Rodeo, 453 B.R. at 402–03. The combination of the three—the removal of an existing impediment to future sponsorships, the reasonableness of increased revenue projections based on historical performance, and operating expense reductions—supported feasibility in the judgment of the bankruptcy court. Indian Nat. Finals Rodeo, 453 B.R.at 403. Had the feasibility of the financial projections hinged entirely on an assumption of increasing sponsorships revenues that

[49] And, in fact, the bankruptcy court noted that one donor testified that "he had expressly not agreed to contribute any amount to be used to fund the [creditor fund]." S.O.S., 388 B.R. at 240.

were dedicated to the payment of creditor claims rather than in furtherance of the purpose of the organization, one could reasonably assume that the debtor would have had a far more difficult time persuading the court of the plan's feasibility.

The court in *In re Tree of Life Church*, 522 B.R. 849 (Bankr. D. S.C. 2015), applied six factors to determine whether the "plan offers a reasonable assurance of success"—factors that are applied in for-profit cases and are typically followed in other jurisdictions. The six factors were as follows: "the adequacy of the capital structure; the earning power of the business; economic conditions; the ability of management; the probability of the continuation of the same management; and any other related matter which determines the prospects of a sufficiently successful operation to enable performance of the provisions of the plan." Tree of Life Church, 522 B.R. at 865 (quotation omitted).

The financial projections in *Tree of Life* were dependent, in part, on an increase of tithes and offerings. Like in *Indian National Finals Rodeo*, there were other sources of revenue supporting the feasibility of the financial projections. For example, the church projected earnings from the operation of a day-care center and a summer camp, and also had dedicated unfunded commitments from parishioners totaling $20,000 for the reduction of debt to a specific creditor. Tree of Life Church, 522 B.R. at 865. Additionally, the church was planning to sell a billboard lease, which was projected to generate significant revenue. Tree of Life Church, 522 B.R. at 865. Again, unlike in *S.O.S.*, the debtor in *Tree of Life Church* was not banking feasibility solely on an increase of donations, but also had revenue-generating business activities supporting the financial projections underlying its plan. And like the court in *Indian National Finals Rodeo*, the *Tree of Life Church* court found that the feasibility test was satisfied.

3. Nonprofit debtors that depend solely on business operations.

In re Las Vegas Monorail Co., 462 B.R. 795, 55 Bankr. Ct. Dec. (CRR) 231 (Bankr. D. Nev. 2011), involved a nonprofit debtor whose financial projections were supported exclusively by revenue-generating business operations. The debtor was forced into bankruptcy after incurring substantial debt to

fund the construction of a monorail system and finding itself unable to service the debt after the financial recession hit Las Vegas, which negatively affected operating revenue. The debtor's plan was unopposed, but the court independently denied the plan on feasibility grounds, among others. Las Vegas Monorail Co., 462 B.R. at 804.[50]

The court made short work of the feasibility analysis, including summarily rejecting the debtor's "but we are a nonprofit" argument. Las Vegas Monorail Co., 462 B.R. at 802 ("LVMC argues that its status as a nonprofit entity renders a traditional analysis inapposite. The court disagrees."). Feasibility came down to whether the judge trusted that assumptions regarding certain "future events" were sufficiently reasonable to support the financial projections underlying the debtor's plan. The court said no: "LVMC now asks the court to trust that it will do, over the next several years, that which it has been unable to do since its inception. LVMC's embrace of these multiple speculative future events to establish feasibility underscores its questionable strategy." Las Vegas Monorail Co., 462 B.R. at 802. The court denied confirmation of the plan.

In *In re Havre Aerie No. 166 Eagles*, 2013 WL 1164422 (Bankr. D. Mont. 2013), the debtor was a nonprofit civil and social club. The feasibility testimony was likewise uncontroverted, but unlike in Las Vegas Monorail, the court found the evidence sufficient to support feasibility. The debtor's accountant testified that, based on the debtor's previous five years of financial results, the reorganized debtor would be able to generate the funds necessary to pay operating expenses and meet debt service obligations under the plan. Similarly, the debtor's restructuring advisor testified that the debtor had completed significant remodeling, repairs and maintenance over the past five years, thereby minimizing the need for such expenditures on a going forward basis, and net operating revenue would be further enhanced by relief from the ongoing legal expense of the bankruptcy proceedings. Havre Aerie No. 166 Eagles, 2013 WL 1164422 at *10. Because feasibility was premised on the debtor's historical performance and sound assumptions regarding the

[50]The debtor later confirmed a plan. See Order Confirming Debtor's Fifth Amended Plan of Reorganization as Modified on March 7, 2012, Case No. 10-10464 (Bankr. D. Nev. May 21, 2012), D.E. 1120.

condition of the debtor's physical assets, operating costs and revenues (as opposed to the wholly "speculative future events" supporting the assumptions underlying the financial projections in *Las Vegas Monorail*) the Havre Aerie court concluded that the plan was feasible. Havre Aerie No. 166 Eagles, 2013 WL 1164422 at *15.

4. Nonprofits with unique sources of funding.

In re Manchester Oaks Homeowners Association, Inc., 2014 WL 961167 (Bankr. E.D. Va. 2014), involved a "community association" for a subdivision in Virginia. The association filed for bankruptcy after two homeowners obtained judgments against it, inclusive of substantial attorneys' fees and costs, based on the association's adoption of a controversial parking policy. Manchester Oaks, 2014 WL 961167 at *1–2. The debtor proposed to fund its plan of reorganization through a special assessment of its members that was not voted on by the homeowners. This assessment, not surprisingly, was contested by homeowners and turned on the court's interpretation of the debtor's "Declaration of Covenants, Conditions and Restrictions" and a Virginia statute. Manchester Oaks, 2014 WL 961167 at *4. The debtor argued that the plan was feasible because it approved a special assessment under Virginia Code § 55-514(A). The opponents argued that the Virginia statute did not apply and the assessment was not proper under the declaration in any event.

The court found that the Virginia statute did not authorize the debtor's special assessment and the debtor did not comply with the requirements of the declaration. Therefore, the assessment was invalid and the plan could not be confirmed on feasibility grounds. Manchester Oaks, 2014 WL 961167 at *7–11. This case demonstrates the variety and complexity of nonprofit cases—and their sources of funding. The source of funding in *Manchester Oaks*, if valid, would have likely supported plan feasibility. But, as in other the nonprofit cases where the debtor failed to establish that the assumptions underlying the debtor's financial projections were reasonable, the plan faltered.

C. Application of "The Best Interest Test" in Nonprofit Cases

Section 1129(a)(7) of the Bankruptcy Code requires that each holder of a claim accept the plan or "receive or retain

under the plan on account of such claim or interest in property of a value . . . that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title." Commonly called the "best interest of creditors" test, this provision has elicited few opinions in the context of nonprofit entities. One commentator has stated that this hurdle, which is not difficult to clear in the for-profit context, should not even apply in a nonprofit case.[51] Most commentators would agree that the test does apply in the nonprofit context, however, and requires courts to compare the distribution values projected under the plan with the distributions that creditors would receive under a hypothetical voluntary liquidation under chapter 7.

That said, the Bankruptcy Code provides little clarity regarding the appropriate parameters to be applied when considering the liquidation value of a nonprofit debtor for purposes of the "best interest test." On one hand, the assets of a nonprofit entity may yield a lower net liquidation value than similar assets owned by a for-profit enterprise because of additional costs associated with various compliance requirements in selling or transferring assets of a nonprofit. On the other hand, because identical assets may have greater value in the hands of a for-profit entity than in the hands of a nonprofit, and because the Bankruptcy Code specifically authorizes that sale of the property of a nonprofit debtor to a for-profit enterprise,[52] it is possible that a nonprofit could face a difficult challenge when comparing the value of creditor distributions under a reorganization plan with those under a hypothetical chapter 7 liquidation of the debtor's assets for the highest and best offer of a hypothetical for-profit purchaser. Because the Bankruptcy Code is silent regarding the assumptions that should be made when considering the liquidation value of a nonprofit debtor for purposes of the "best interest test" of Section 1129(a)(7)(A)(ii) of the Bankruptcy Code, it would be useful for Congress to clarify whether courts should measure the plan distributions

[51] See Kavita Gupta, Confirmation Issues Facing a Nonprofit Debtor, XXI ABI Journal 3 (April 2012) ("Bankruptcy Code and state law may preclude or restrict the forced sale of a nonprofit's assets," leading to the argument that the test should not apply in the first place).

[52] 11 U.S.C.A. § 541(f).

against the highest and best liquidation values that could be achieved, or rather, against the values that could be realized in a hypothetical sale to one or more other nonprofit enterprises.

The bankruptcy court in the *S.O.S.* case did address the "best interest of creditors" test but does not appear to have considered the potentially different liquidation values of the debtor under various liquidation scenarios.[53] This was perhaps due to the fact that the *S.O.S.* debtor did not own many tangible assets. In the *S.O.S.* bankruptcy proceedings, an objecting creditor merely argued that the debtor had failed to provide evidence of the liquidation value of its assets. S.O.S., 388 B.R. at 230. The court disagreed, but in ruling seems to have considered only the liquidation value of the debtor as a non-profit enterprise, ruling that the court was "satisfied that such evidence, considering the unique nature of the Debtor as a non-profit organization dependent on contributions that are voluntary and may be restricted, and of the Debtor's other assets, is sufficient proof in this case that the Plan meets the 'best interests test' of § 1129(a)(7)." S.O.S, 388 B.R. at 239 (citing *In re General Teamsters, Warehousemen and Helpers Union, Local 890*, 265 F.3d 869, 38 Bankr. Ct. Dec. (CRR) 117, 168 L.R.R.M. (BNA) 2161, Bankr. L. Rep. (CCH) P 78501, 175 A.L.R. Fed. 775 (9th Cir. 2001)); see also *In re Connector 2000 Ass'n, Inc.*, 447 B.R. 752, 765–66 (Bankr. D. S.C. 2011) (finding that the nonprofit debtor's evidence was sufficient to satisfy the best interests test).

IV. Conclusion

The nonprofit sector is both a huge contributor to, and beneficiary of, the American economy. Nonprofits are significant job creators, collectively employing over 10% of the nation's private sector workforce, and in many instances provide critical services that would otherwise have to be provided by federal, state or local governments. Although some nonprofits collect fees for services and a few may generate sufficient revenues from such activities to maintain operations, most rely on some combination of private donations, public grants, volunteer services and tax relief in or-

[53]The "best interest test" was not considered by the Fifth Circuit in its opinion.

der to survive. While nonprofit institutions suffer from many of the same financial issues as their for-profit brethren, the unique dependence on private and public support often renders nonprofits more susceptible to failure in challenging economic climates.

To be sure, many types of organizations exist under the nonprofit phylum. Some nonprofits provide a public benefit available to all and have officers and directors that receive little or no compensation for their services, while others provide a private benefit only to their members, who may be entitled to a share of the residual value of the enterprise. Some nonprofits provide services for free, while other charge substantial fees; some depend on public and private donations, while others do not. Some nonprofits have members who ultimate control the direction of the enterprise through the election of directors, while others have no members and boards of directors that are self-perpetuating.

Despite their significant role in the economy, their relative fragility to economic forces, and the diversity of their structure and purpose, there are few Bankruptcy Code provisions specifically addressing the insolvency of nonprofit entities. The Code is unclear whether all types of nonprofits are intended to benefit from the prohibition on involuntary filings afforded "corporations that are not a moneyed, business, or commercial corporations," or whether the controlling interests of officers, directors and members, absent any economic stake in the enterprise, are intended to constitute "interests" subject to classification and treatment under a plan (including the cramdown provisions of the Bankruptcy Code).[54] The Code is also silent on the question whether any special factors should be made when considering the feasibility of a reorganization plan of a nonprofit debtor or whether the best interest test should be applied to an entity that, outside of the bankruptcy case, could not be subject to a forced liquidation.

Notwithstanding the lack of statutory guidance on these questions, case law has begun to jell regarding some of these topics, of which bankruptcy practitioners across the country

[54]As noted in Section III.A. supra, this matter could be clarified by an amendment specifying that only ownership interests that represent an economic stake in the debtor are subject to classification and treatment under a plan.

should be aware. The first of these emerging rules appears to be a consensus that control rights over a debtor are generally not viewed by the courts as equity interests, subject to classification and treatment under a plan of reorganization or subject to the absolute priority rule, so long as those rights are not combined with an economic interest in the debtor (including an interest in any residual value in the debtor upon a liquidation). The second emerging rule is that nonprofits will not be given special consideration when courts consider the feasibility of the assumptions supporting a debtor's plan of reorganization and that the reliability of projections for future donations, much like revenue projections in a for-profit case, will be heavily discounted where the debtor does not have a reliable record of historical performance upon which the projections can be based, and that a bankruptcy court may be particularly skeptical about reliance on donations to pay legacy claims. Finally, we note that under current law it is unclear what assumptions should be taken when considering the hypothetical liquidation value of an nonprofit debtor for purposes of the "best interest test." Practitioners and the courts would benefit from instruction from Congress as to whether they are to consider the hypothetical liquidation of the nonprofit debtor at its "highest and best" liquidation value or at the value that would result from the sale of the assets to one or more hypothetical nonprofit purchasers.