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Putting the Cart Before the Horse: Third Circuit Affirms Rejection of Plan at Disclosure Statement Stage as Patently Unconfirmable

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I. Introduction

A common refrain from disgruntled stakeholders at a disclosure statement hearing is that the proposed plan is "patently unconfirmable on its face." Plan proponents often respond by characterizing such detractions as "disguised confirmation objections" that are appropriately addressed at a subsequent confirmation hearing. The Third Circuit's decision in *In re American Capital Equipment, LLC* [FN1] should give pause to practitioners to not simply pay "lip service" to objections concerning plan confirmability at the disclosure statement stage as issues to be dealt with at a confirmation hearing. In *American Capital*, the Third Circuit held that a bankruptcy court may determine at the disclosure statement stage that a proposed plan is unconfirmable without first holding a confirmation hearing. [FN2] In the wake of *American Capital*, plan proponents facing legitimate protestations as to a plan's scheme must take special care to develop an evidentiary record in advance of a disclosure statement hearing or risk being sent back to the "drawing board."

II. Interplay Between Disclosure Statement and Confirmation Hearing

The Bankruptcy Code mandates that a disclosure statement be filed, approved and disseminated to voting parties to ensure that stakeholders are able to render an informed judgment with respect to a proposed plan. [FN3] The disclosure statement provides context for a proposed plan and assists interested parties in assessing whether the plan satisfies the requirements for confirmation and is appropriate under the circumstances. [FN4]

Section 1125(b) of the Bankruptcy Code prohibits the solicitation of votes on a plan until the proponent distributes: (1) a plan or plan summary; and (2) a written disclosure statement, approved after notice and a hearing, containing adequate information to facilitate informed voting. [FN5] Moreover, Bankruptcy Rule 2002(b) directs that all interested parties must receive at least 28 days' notice of: (1) the objection deadline for the disclosure statement, and (2) the hearing to consider approval of the disclosure statement. [FN6] The disclosure statement must be provided when the proposed plan is filed, or within a reasonable time thereafter fixed by the bankruptcy court. [FN7]

Moreover, Federal Rule of Bankruptcy Procedure 3020(b)(2) provides that a bankruptcy court "shall rule on confirmation of the plan after notice and hearing[.]" [FN8] This hearing is intended for the bankruptcy court to address outstanding objections to confirmation and to determine independently that the proposed plan satisfies the statutory prerequisites for confirmation. [FN9] Section 1125 of the Bankruptcy Code authorizes the hearing on the disclosure statement to be combined with a confirmation hearing, however, this form of relief is only expressly authorized by the statute in qualifying "small business cases." [FN10] The Third Circuit in *American Capital* cited section 1125(f)(3)(C) as authorizing the combination of a disclosure statement hearing and con-

firmation hearing, but without noting that this provision is only made applicable to statutory "small business cases" under the Bankruptcy Code. [FN11] The *American Capital* decision also authorized a bankruptcy court to consider confirmation objections at the disclosure statement stage. [FN12]

Parties raising confirmability issues at the disclosure statement stage use this vehicle to inform the bankruptcy court about potential deficiencies with a proposed plan. Even when such objections are deferred to a later confirmation hearing, parties have an opportunity to frame the issue for the bankruptcy court as well as alert other stakeholders to confirmability concerns. Challenges to confirmation at the disclosure statement stage ordinarily are treated by bankruptcy courts as premature. [FN13] Preservation of a plan proponent's due process rights to notice and a hearing militate in favor of delaying adjudication of such confirmability objections. [FN14]

A line of cases, however, have held that it is proper to address objections that a plan is unconfirmable at the disclosure statement stage. [FN15] This precedent is restricted to situations where the proposed plan is patently unconfirmable on its face, thereby obviating the need to approve a futile disclosure statement. [FN16]

III. *American Capital* Decision

A. Background

Skinner Engine Companies, Inc. ("Skinner") was founded in 1868 and manufactured steam engines for merchant ships and other ship engine parts. [FN17] Up until the 1970s, Skinner manufactured ship engines and parts that allegedly contained asbestos. [FN18] In 1998, Skinner was acquired by American Capital Equipment, LLC ("American Capital") by obtaining all of Skinner's common stock. [FN19] Both Skinner and American Capital (the "Debtors") filed Chapter 11 petitions in 2001, at which time over 29,000 asbestos claims were pending against Skinner. [FN20]

After filing, the Debtors' cases endured a protracted procedural history during which five plans were proposed over a five-year span. [FN21] The Debtors maintained insurance policies with respect to the potential asbestos liability, however, these policies generally required the Debtors to cooperate in the defense and prohibited settlement absent the insurers' consent. The Debtors sold all of their assets in 2002, after which the bankruptcy case primarily involved administration of the pending asbestos claims and the Debtors' corresponding insurance policies. [FN22]

The Debtors sought approval of the disclosure statement for the fifth proposed plan (the "Plan") at a hearing on May 7, 2009. The Plan contemplated an optional settlement process to resolve all pending asbestos claims, whereby a trust would be created using a standardized claims submission process to allow or disallow claims. [FN23] Asbestos claimants could opt out of this trust process, but those that opted in would be subject to a twenty percent surcharge of cash received from the Debtors' insurance policies (the "Surcharge"). [FN24] The Surcharge was intended to fund the claims distribution process for nonasbestos creditors and cover the trust's administrative costs. [FN25] The Debtors acknowledged that the Plan was not feasible without some form of surcharge by which to fund a distribution. [FN26]

The bankruptcy court for the Western District of Pennsylvania denied approval of the disclosure statement for the Plan on the ground that it was facially unconfirmable. The bankruptcy court found that the Plan was not proposed in good faith, was in contravention of section 1129(a)(3) of the Bankruptcy Code and was not feasible pursuant to section 1129(a)(11) of the Bankruptcy Code. [FN27] The bankruptcy court went on to find that the

Debtors would be unable to propose a confirmable plan within a reasonable time, and therefore converted the Debtors' cases to Chapter 7. [FN28] The Debtors appealed, and the United States District Court for the Western District of Pennsylvania affirmed the bankruptcy court's decision in 2010. [FN29] The Debtors further appealed to the Third Circuit Court of Appeals arguing that the bankruptcy court erred in not holding a specific hearing on plan confirmability before converting the cases, and further that such conversion was improper under the circumstances.

B. Third Circuit's Analysis

The Third Circuit considered the following issues on appeal: (1) whether a bankruptcy court may deem a plan unconfirmable without conducting a separate confirmation hearing; (2) whether the Plan was facially unconfirmable; and (3) whether conversion of the Debtors' cases to Chapter 7 was an abuse of discretion. The Third Circuit affirmed the bankruptcy court's decision in all three respects.

First, in a matter of first impression, the Third Circuit held that a bankruptcy court has the authority to find a plan unconfirmable at the disclosure statement stage without first holding a confirmation hearing. [FN30] The court of appeals first acknowledged that the text of Rule 3020(b)(2) directs that an evidentiary hearing be held before a ruling on confirmation occurs and that cases from other jurisdictions mandated an evidentiary hearing take place before a decision on confirmation is rendered. [FN31]

The Third Circuit went on to cite the precedent that bankruptcy courts may resolve an issue concerning a patently unconfirmable plan at the disclosure statement stage. [FN32] The Third Circuit cited with approval the underlying rationale of these decisions that section 105(a) empowers a bankruptcy court to "control its own docket" and eschewing a time-intensive disclosure statement and voting process where the subject plan is incompatible with the Bankruptcy Code's confirmation requirements. [FN33] The court of appeals adopted this reasoning as persuasive, and held that "a bankruptcy court may address the issue of plan confirmation where it is obvious at the disclosure statement stage that a later confirmation hearing would be futile because the plan described by the disclosure statement is patently unconfirmable." [FN34]

The opinion clarified that a patently unconfirmable plan is limited to defects that: (1) cannot be overcome by creditor voting or otherwise, and (2) concern matters upon which material facts are not in dispute or have been fully developed at the disclosure statement hearing. [FN35] The Third Circuit reasoned that since the nature of these defects would be fatal to any proposed plan, no justification exists in the "language or logic" of the Bankruptcy Code to force bankruptcy courts to "grind the same corn a second time." [FN36] The Third Circuit recognized that the fruitless process of conducting a separate confirmation hearing with respect to such a fundamentally flawed plan would create a "time-consuming and expense proposition" contrary to the interest of judicial efficiency. [FN37]

Importantly, in the same breath, the Third Circuit was careful to caution against bankruptcy courts disregarding legitimate due process concerns by "prematurely convert[ing] a disclosure statement hearing into a confirmation hearing." [FN38] The Third Circuit instructed that special care must be taken to ensure that plan proponents receive sufficient notice and that an adequate record exists to support the finding that a proposed plan is patently unconfirmable on its face. [FN39] The court of appeals concluded that concerns over due process did not exist under the circumstances in *American Capital* because the bankruptcy court's hearings were lengthy and thorough and the plan proponents received sufficient notice on April 9, 2009, that confirmability issues were likely to be considered at the May 7, 2009 disclosure statement hearing. [FN40]

Next, the Third Circuit affirmed the bankruptcy court's decision to deem the Plan patently unconfirmable based on the failure to satisfy the feasibility and good faith requirements under section 1129 of the Bankruptcy Code. With respect to feasibility under section 1129(a)(11), [FN41] the court of appeals stated that while a proposed plan need not be a guarantee to succeed, a realistic and workable solution is required. [FN42] The Third Circuit explained that a proposed plan does not satisfy the feasibility requirement "if its success hinges on future litigation that is uncertain and speculative, because success in such cases is only possible, not reasonably likely." [FN43] The Third Circuit found that the Plan was not feasible since it was overly speculative in relying on the Surcharge as the sole source of funding, both because the recovery was inherently uncertain and because the overwhelming majority of pending claims had been dismissed up until that point. [FN44] Based on the Plan's structure and dependence on some form of the Surcharge, the court of appeals deemed it too speculative, unlikely to succeed, and unable to be reformed, and thus not feasible under section 1129(a)(11). [FN45]

The Third Circuit also agreed with the bankruptcy court that the Plan was patently unconfirmable because it did not meet the good faith requirement of section 1129(a)(3). [FN46] Specifically, the court of appeals held that the inherent conflict of interest created by the Plan's scheme was incongruent with the Bankruptcy Code's objectives and precluded a finding of good faith. [FN47] The Third Circuit disagreed with the bankruptcy court's finding that the Plan was collusive, but nevertheless concluded that the Plan violated good faith due to the conflict of interest produced by the Surcharge. [FN48] First, since the Surcharge was the only source of funding, the Debtors would be incentivized to sabotage their defenses to the asbestos claims. [FN49] The Third Circuit also was troubled by the proposed claims resolution process severely limiting the insurers' procedural rights to, inter alia, propound discovery or appeal decisions, and without the backstop of the protective injunction of section 524(g). [FN50] The Third Circuit also catalogued the following troubling dissimilarities between the Plan and a section 524(g) trust: (1) the asbestos claims did not precipitate the Debtors' bankruptcy, (2) the Debtors would not contribute to the funds to satisfy creditors, (3) asbestos claimants would provide the lone source of funding through the Surcharge, and (4) the Plan's fund existed only to pay off creditors and insurers rather than future asbestos creditors. [FN51]

Finally, the Third Circuit held that the bankruptcy court did not abuse its discretion in converting the Debtors' cases to Chapter 7. [FN52] Among the nonexhaustive list of grounds to establish cause to convert a case under section 1112(b) is an inability to effectuate a plan. [FN53] The Third Circuit concurred that cause existed, explaining that where "repeatedly unsuccessful attempts at confirmation are likely to generate enormous administrative costs, often without increasing the likelihood of success, § 1112(b) recognizes the court's ability to curtail the process through the ultimate conversion or dismissal of the case[,]" and to make sure the plan "does not outlive the likelihood of its usefulness." [FN54] The Third Circuit determined that the Debtors had ample time to develop a feasible plan and could not articulate a reasonable possibility of developing a confirmable plan even if afforded more time. [FN55] Given the apparent futility of the Debtors' further pursuit of a confirmable plan, and in the face of the mounting administrative obligations of the Debtors' estates, the Third Circuit held that the bankruptcy court did not abuse its discretion in converting the Debtors' cases to Chapter 7. [FN56]

IV. Implications of *American Capital*--Not All Roads Lead To Confirmation

While the decision in *American Capital* is grounded in unique facts, it provides several important takeaways in recognizing a bankruptcy court's authority to address confirmability at the disclosure statement stage. *American Capital* is the first reported decision at the circuit court level to adopt directly the standard generally employed by lower courts to address facially unconfirmable plans during a disclosure statement hearing. The Third

Circuit's decision is rooted in the equitable powers of bankruptcy courts under section 105 of the Bankruptcy Code, which by its nature gives judges pliable authority to invoke this standard with discretion in order to manage a docket efficiently.

Absolving the requirement of having a confirmation hearing under certain circumstances, creates the potential for bankruptcy courts to rely heavily on the record developed prior to consideration of the disclosure statement. [FN57] The potential for using the existing record as a *de facto* evidentiary hearing on confirmability has strategic repercussions. Creditors may be incentivized to accelerate confirmation issues and preventing plan proponents from developing more fulsome evidentiary records in support of confirmation. Conversely, plan proponents must take caution to exercise foresight and create an adequate record with respect to section 1129's requirements where a contested confirmation hearing is anticipated.

This creates the specter of frontloaded confirmation battles where constituents jockey to develop a record with an eye toward a preemptive contested hearing for the disclosure statement. [FN58] The holding of *American Capital* is limited to a substantive plan objection of facial unconfirmability incurable through voting. Thus this limitation should serve a gate-keeping function to prevent bankruptcy courts from overreliance on evidence submitted during the Chapter 11 case to support confirmation findings.

Practitioners relying on *American Capital* must further be mindful of the Third Circuit's admonition that the interest of judicial efficiency in avoiding redundancy, while a laudable goal, cannot subsume due process protections. Plan proponents expect their day in court to respond to challenges to confirmation with the benefit of testimony and the submission of evidence. The Third Circuit specifically instructed that special care be taken to provide adequate notice of a bankruptcy court's intention to usurp the confirmation hearing at the disclosure statement stage. Based on these countervailing due process considerations, it is unlikely that the *American Capital* decision will signal the conversion of disclosure statement hearings to substantive hearings on confirmation with regularity. [FN59]

V. Conclusion

It remains to be seen the degree to which practitioners and bankruptcy courts will seize on *American Capital* in addressing plan confirmability at the disclosure statement stage. For debtors, the Third Circuit's decision likely will trigger hesitation in proposing speculative Chapter 11 plans with the intention of addressing defects during the confirmation process, particularly plans hinging on litigation recoveries. Conversely, creditors may be emboldened to force issues as to confirmability at the disclosure statement stage and try to slow down the momentum that can set in as a debtor's proposed plan nears confirmation. In the fast-paced environment of Chapter 11, where deals can be made and change the trajectory of a case dramatically, the Third Circuit's decision in *American Capital* could provide valuable ammunition for stakeholders seeking to assert leverage in advance of plan confirmation.

[FN1]. In re American Capital Equipment, LLC, 688 F.3d 145, 56 Bankr. Ct. Dec. (CRR) 223, 67 Collier Bankr. Cas. 2d (MB) 1701, Bankr. L. Rep. (CCH) P 82300, 2012 A.M.C. 2583 (3d Cir. 2012).

[FN2]. American Capital Equipment, 688 F.3d at 148.

[FN3]. 11 U.S.C.A. § 1125; see Lawrence P. King, 4 Collier on Bankruptcy ¶ 1125.02, p. 1125-7 (16th ed. rev.

2010) (hereinafter “Collier”) (“Disclosure is the pivotal concept in reorganization practice under the Bankruptcy Code.”) (citations omitted).

[FN4]. Section 1125 of the Bankruptcy Code mandates a full and fair disclosure of material information that must be adequate to allow a reasonable claim or interest holder to make an informed judgment about the treatment proposed for its claim or interest. See 11 U.S.C.A. § 1125(a)(1); General Elec. Credit Corp. v. Nardulli & Sons, Inc., 836 F.2d 184, 188, Bankr. L. Rep. (CCH) P 72160, 5 U.C.C. Rep. Serv. 2d 501 (3d Cir. 1988) (section 1125(a)(1) of the Bankruptcy Code requires a “disclosure statement containing adequate information to allow a reasonable holder to make an informed judgment about the plan”); Oneida Motor Freight, Inc. v. United Jersey Bank, 848 F.2d 414, 417, 17 Bankr. Ct. Dec. (CRR) 1272, Bankr. L. Rep. (CCH) P 72329 (3d Cir. 1988) (“The importance of full disclosure is underlaid by the reliance placed upon the disclosure statement by the creditors and the court.”).

[FN5]. 11 U.S.C.A. § 1125(b).

[FN6]. Fed. R. Bankr. P. 2002(b). A recent amendment to the Local Rules of Bankruptcy Practice and Procedure for the District of Delaware, mandates a period of 35 days' notice of a disclosure statement hearing and 28 days' notice of the objection deadline. See Local Rules of Bankr. Prac. and Procedure for the United States Bankr. Ct. for the Dist. of Del. 3017-1(a).

[FN7]. Fed. R. Bankr. P. 3016(b).

[FN8]. Fed. R. Bankr. P. 3020(b)(2).

[FN9]. See Fed. R. Bankr. P. 3020(b)(2); Matter of Williams, 850 F.2d 250, 253, Bankr. L. Rep. (CCH) P 72418 (5th Cir. 1988).

[FN10]. See 11 U.S.C.A. § 1125(f)(3)(C); see also 11 U.S.C.A. §§ 101(51B), (51C) (defining “small business case” and “small business debtor” to include those cases where noncontingent unliquidated secured and unsecured debts are less than $2,343,300). For a discussion about potential use of combined hearings beyond only “small business cases” as authorized by section 1125(f)(3)(c), see note 59 infra.

[FN11]. American Capital Equipment, 688 F.3d at 153.

[FN12]. American Capital Equipment, 688 F.3d at 154-55.

[FN13]. See, e.g., In re Monroe Well Service, Inc., 80 B.R. 324, 333, 16 Bankr. Ct. Dec. (CRR) 1077 (Bankr. E.D. Pa. 1987) (stating that objections to confirmation raised as part of objections to approval of disclosure statement could not be analyzed at that juncture in the case); Matter of Featherworks Corp., Inc., 45 B.R. 455, 457 (Bankr. E.D. N.Y. 1984) (objections to confirmability of a plan when deliberating the adequacy of the disclosure statement were premature and “must await examination of the evidence offered at the hearing on confirmation”); In re Scioto Valley Mortg. Co., 88 B.R. 168, 172 (Bankr. S.D. Ohio 1988) (issues respecting plan's confirmability must wait for confirmation hearing).

[FN14]. See In re Copy Crafters Quickprint, Inc., 92 B.R. 973, 980, 18 Bankr. Ct. Dec. (CRR) 779, 20 Collier Bankr. Cas. 2d (MB) 441, Bankr. L. Rep. (CCH) P 72524 (Bankr. N.D. N.Y. 1988) (“care must be taken to ensure the hearing on the disclosure statement does not turn into a confirmation hearing, due process considerations are protected and objections are restricted to those defects which could not be cured by voting.”); In re Wa-

terville Timeshare Group, 67 B.R. 412, 414, 15 Bankr. Ct. Dec. (CRR) 462 (Bankr. D. N.H. 1986) (refusing to address objections to confirmation at disclosure statement stage deemed appropriate as objectors would be provided with a "full opportunity" to adjudicate issues at the confirmation hearing).

[FN15]. See In re M.J.H. Leasing, Inc., 328 B.R. 363, 369, 45 Bankr. Ct. Dec. (CRR) 26, 54 Collier Bankr. Cas. 2d (MB) 1371 (Bankr. D. Mass. 2005) (observing that it is appropriate to consider an objection related to confirmation at a disclosure statement hearing) (citations omitted); In re Unichem Corp., 72 B.R. 95, 97 (Bankr. N.D. Ill. 1987), decision aff'd, 80 B.R. 448 (N.D. Ill. 1987); In re Weiss-Wolf, Inc., 59 B.R. 653, 655 (Bankr. S.D. N.Y. 1986); In re Pecht, 57 B.R. 137, 139, 13 Bankr. Ct. Dec. (CRR) 1317 (Bankr. E.D. Va. 1986); see generally Norton Bankruptcy Law and Practice 3d § 110:15 (observing that bankruptcy courts have withheld approval of a disclosure statement where the accompanying plan is unconfirmable); see also In re Main Street AC, Inc., 234 B.R. 771, 775 (Bankr. N.D. Cal. 1999) ("It is now well accepted that a court may disapprove of a disclosure statement... if the plan could not possibly be confirmed.").

[FN16]. See In re Felicity Assocs., 197 B.R. 12, 14 (Bankr. D.R.I. 1996) ("it has become standard Chapter 11 practice that when an objection raises substantive plan issues that are normally addressed at confirmation, it is proper to consider and rule upon such issues prior to confirmation, where the proposed plan is arguably unconfirmable on its face") (quotations and citations omitted). In re Valrico Square Ltd. Partnership, 113 B.R. 794, 796, 20 Bankr. Ct. Dec. (CRR) 762 (Bankr. S.D. Fla. 1990) ("Soliciting votes and seeking court approval on a clearly fruitless venture is a waste of the time of the Court and the parties.").

[FN17]. American Capital Equipment, 688 F.3d at 148.

[FN18]. American Capital Equipment, 688 F.3d at 148.

[FN19]. American Capital Equipment, 688 F.3d at 148.

[FN20]. American Capital Equipment, 688 F.3d at 148-49.

[FN21]. See American Capital Equipment, 688 F.3d at 148-52. The first plan was filed on June 6, 2001, and was subsequently amended to include a trust funded for future asbestos claimants, but was rejected by creditors. American Capital Equipment, 688 F.3d at 150. On February 24, 2004, the Debtors filed the third proposed plan seeking to create an asbestos trust pursuant to section 524(g) of the Bankruptcy Code. American Capital Equipment, 688 F.3d at 150. The third plan was accepted by vote of the creditors, but subject to a declaratory judgment breach of contract action and motion to dismiss by the Debtors' insurers. American Capital Equipment, 688 F.3d at 150-51. While the motion to dismiss was pending, the Debtors filed a fourth plan which abandoned a trust under section 524(g), and instead employed a surcharge that gave the Debtors a twenty percent cash payment from asbestos actions. American Capital Equipment, 688 F.3d at 151.

[FN22]. American Capital Equipment, 688 F.3d at 150.

[FN23]. American Capital Equipment, 688 F.3d at 150-51. The claims submission standard to be used was the "Johns-Manville Personal Injury Standard," which required a claimant to meet the following criteria: (1) show a medically diagnosed asbestos-related injury, and (2) show exposure to the Debtors' asbestos-containing products. American Capital Equipment, 688 F.3d at 150-51. Notably, the Debtors were foreclosed from utilizing a channeling injunction trust authorized under section 524(g) of the Bankruptcy Code because the Debtors' did not have a going concern. See American Capital Equipment, 688 F.3d at 151. The issue of whether a going con-

cern must be established to be eligible for a section 524(g) trust was not appealed or addressed in the Third Circuit's decision. American Capital Equipment, 688 F.3d at 151 n.2.

[FN24]. American Capital Equipment, 688 F.3d at 150-51.

[FN25]. American Capital Equipment, 688 F.3d at 151.

[FN26]. American Capital Equipment, 688 F.3d at 151-52.

[FN27]. In re American Capital Equipment, Inc., 405 B.R. 415, 423-24, 51 Bankr. Ct. Dec. (CRR) 195 (Bankr. W.D. Pa. 2009), aff'd, 2010 WL 1337222 (W.D. Pa. 2010), aff'd, 688 F.3d 145, 56 Bankr. Ct. Dec. (CRR) 223, 67 Collier Bankr. Cas. 2d (MB) 1701, Bankr. L. Rep. (CCH) P 82300, 2012 A.M.C. 2583 (3d Cir. 2012) (hereinafter "American Capital I").

[FN28]. American Capital I, 405 B.R. at 426-27.

[FN29]. Skinner Engine Co. v. Allianz Global Risk Ins. Co., No. 09-0886, 2010 WL 1337222 (W.D. Pa. Mar. 2010).

[FN30]. American Capital Equipment, 688 F.3d at 153-55.

[FN31]. American Capital Equipment, 688 F.3d at 153 (citing Fed. R. Bankr. P. 3020(b)(2)); see In re Acequia, Inc., 787 F.2d 1352, 1358, 14 Bankr. Ct. Dec. (CRR) 595, Bankr. L. Rep. (CCH) P 71111 (9th Cir. 1986) (bankruptcy court "must hold evidentiary hearing in ruling on confirmation"); Williams, 850 F.2d at 253.

[FN32]. American Capital Equipment, 688 F.3d at 154 ("Courts have recognized that 'if it appears there is a defect that makes a plan inherently or patently unconfirmable, the Court may consider and resolve that issue at the disclosure stage before requiring the parties to proceed with solicitation of acceptances and rejections and a contested confirmation hearing."') (quoting In re Larsen, 2011 WL 1671538 at *2 n.7 (Bankr. D. Idaho 2011)).

[FN33]. American Capital Equipment, 688 F.3d at 154 (citations omitted); see generally Am. Jur. 2d, Bankruptcy § 2900 ("The bankruptcy court may consider objections and refuse to approve a disclosure statement when it is apparent that the accompanying plan is not confirmable.").

[FN34]. American Capital Equipment, 688 F.3d at 154.

[FN35]. American Capital Equipment, 688 F.3d at 155 (citing Monroe Well Service, 80 B.R. at 333).

[FN36]. American Capital Equipment, 688 F.3d at 155 (quoting Acequia, 787 F.2d at 1358-59).

[FN37]. See American Capital Equipment, 688 F.3d at 154-55 (recognizing that section 105 vests a bankruptcy court with inherent power to manage its docket in the interest of judicial efficiency and going through the exercise of a confirmation hearing for a patently unconfirmable plan contradicts that interest).

[FN38]. American Capital Equipment, 688 F.3d at 155 n. 6 (internal citations and quotations omitted).

[FN39]. American Capital Equipment, 688 F.3d at 154 n. 6.

[FN40]. American Capital Equipment, 688 F.3d at 154 n. 6.

[FN41]. Section 1129(a)(11) of the Bankruptcy Code, generally referred to as the "feasibility" test, requires that the proposed plan have a reasonable likelihood of success and is not likely to be followed by the need for further financial reorganization. 11 U.S.C.A. § 1129(a)(11); In re Congoleum Corp., 362 B.R. 198, 203 (Bankr. D. N.J. 2007). "Section 1129(a)(1) requires courts to scrutinize carefully the plan to determine whether it offers a reasonable prospect of success and is workable." See 7 Collier at ¶ 1129.02 [11], 1129-52.

[FN42]. American Capital Equipment, 688 F.3d at 155-56 (citing In re Applied Safety, Inc., 200 B.R. 576, 584, 29 Bankr. Ct. Dec. (CRR) 979 (Bankr. E.D. Pa. 1996)). The Third Circuit reiterated that aection 1129(a)(11) requires the proposed plan "must be 'reasonably likely [to] succeed[] on its own terms without a need for further reorganization on the debtor's part."' (quoting Applied Safety, 200 B.R. at 584); see also In re Quigley Co., Inc., 437 B.R. 102, 142, 53 Bankr. Ct. Dec. (CRR) 170 (Bankr. S.D. N.Y. 2010) (plan was not feasible where funding source was "speculative at best and visionary at worst").

[FN43]. American Capital Equipment, 688 F.3d at 156 (citations omitted).

[FN44]. See American Capital Equipment., 688 F.3d at 156 (citing American Capital I, 405 B.R. at 422. The speculative nature of the proposed Plan was further exacerbated by the fact that the Surcharge only applied to claimants obtaining recoveries through the Plan's claim system and not those who opted out to pursue the tort claims independently. American Capital Equipment, 688 F.3d at 156.

[FN45]. American Capital Equipment, 688 F.3d at 156 ("The [Plan] is simply not reasonably likely to succeed and therefore, is not feasible. Furthermore, the feasibility issue cannot be cured, and no dispute of material fact remains, because [Debtors] admit that no plan will work without a Surcharge.").

[FN46]. American Capital Equipment, 688 F.3d at 156-57; see 11 U.S.C.A. § 1129(a)(3). A plan fails to meet the good faith requirement of section 1129(a)(3) where: (1) it is inconsistent with the Bankruptcy Code's objectives, (2) it is not proposed with honest intentions and an achievable basis for reorganization, or (3) lacks fundamental fairness in dealing with creditors. In re Lernout & Hauspie Speech Products N.V., 308 B.R. 672, 675, 42 Bankr. Ct. Dec. (CRR) 225 (D. Del. 2004) (internal citations omitted); see, e.g., In re Allegheny Intern., Inc., 118 B.R. 282, 299-300 (Bankr. W.D. Pa. 1990) (denying confirmation on bad faith grounds where plan proponent selectively purchased claims and improperly used insider information). An inquiry into good faith is fact-intensive and made on a case-by-case basis. Solow v. PPI Enterprises (U.S.), Inc. (In re PPI Enterprises (U.S.), Inc.), 324 F.3d 197, 211 (3d Cir. 2003).

[FN47]. American Capital Equipment, 688 F.3d at 158-59. The Third Circuit rejected the Debtors' argument that a previous finding that the petitions were proceeding in good faith foreclosed an inquiry into the good faith with respect to the Plan. Am. Cap. Equip., 688 F.3d at 157. The Third Circuit reasoned that the good faith analysis under section 1129(a)(3) focuses on the plan itself and is separate and distinct from whether a Chapter 11 bankruptcy petition is filed in good faith. American Capital Equipment, 688 F.3d at 157 (citing In re Combustion Eng'g, Inc., 391 F.3d 190, 247 n.67 (3d Cir. 2004)).

[FN48]. American Capital Equipment, 688 F.3d at 158.

[FN49]. American Capital Equipment, 688 F.3d at 158-59. The Third Circuit reasoned that although the Debtors would not have direct authority over settling the asbestos claims, they would still be involved in both the defense and discovery aspects based on the nature of the claims. American Capital Equipment, 688 F.3d at 158-69. This manufactured the inherent conflict of interest by which the Debtors would be required to cooperate in de-

fending against the asbestos claims, while at the same time have an interest in seeing the highest recoveries possible to fund the Plan through the Surcharge. American Capital Equipment, 688 F.3d at 159.

[FN50]. American Capital Equipment, 688 F.3d at 159 ("[W]e are troubled by the fact that the [Plan] system creates this inherent conflict, while at the same time severely limiting or eliminating Insurers' ability to take discovery, submit evidence, contest causation, or appeal a decision, and all without the protective channeling injunction of § 524(g).").

[FN51]. American Capital Equipment, 688 F.3d at 159 (explaining that these distinctions make the structure and objectives of the Debtors' Plan inconsistent with the goal of a section 524(g) trust--"maximize[ing] the value of the debtor's estate for creditors by allowing a debtor to channel all asbestos claims into the trust, so that the debtor and its affiliates or parent companies are not burdened by the asbestos claims.") (citing 11 U.S.C.A. § 524(g)(1)(A), (4)(A)(ii); Green, Patton, Jr., & Harron, Future Claimant Trusts and "Channeling Injunctions" to Resolve Mass Tort Environmental Liability in Bankruptcy: The Met-Coil Model, 22 Emory Bankr. Dev. J. 157, 160-64 (2005)).

[FN52]. Section 1112(b) requires a two-step process in which the court first determines whether there is "cause" to convert or dismiss, and next chooses between conversion and dismissal based on "the best interest of creditors and the estate." § 1112(b); In re SGL Carbon Corp., 200 F.3d 154, 159 n.8 (3d Cir. 1999). As a result of the 2005 amendments to the Bankruptcy Code, section 1112(b) now provides a nonexclusive list of 16 grounds that constitute cause for conversion. 11 U.S.C.A. § 1112(b)(4)(A) to (P); see also In re Gateway Access Solutions, Inc., 374 B.R. 556, 560-61, 58 Collier Bankr. Cas. 2d (MB) 737, Bankr. L. Rep. (CCH) P 81028 (Bankr. M.D. Pa. 2007). A determination of cause is made by the court on a case-by-case basis. See Matter of Halvajian, 216 B.R. 502, 511 (D.N.J. 1998), order aff'd, 168 F.3d 478 (3d Cir. 1998).

[FN53]. 11 U.S.C.A. § 1112(b)(4).

[FN54]. American Capital Equipment, 688 F.3d at 162-63 (quoting In re Rand, 2010 WL 6259960 at * 5 (B.A.P. 9th Cir. 2010) (internal citation omitted)).

[FN55]. See American Capital Equipment, 688 F.3d at 162-63.

[FN56]. See American Capital Equipment, 688 F.3d at 162-64. The Third Circuit specifically found that allowing the Debtors to proceed in Chapter 11 would prejudice the interests of creditors as "[p]rolonging the case will only burden the estate with mounting attorney and administrative fees," and any asbestos-related personal injury recoveries would not be contingent on confirmation of a plan as all claims were directly against the Debtors' insurers. See American Capital Equipment, 688 F.3d at 162-63.

[FN57]. See American Capital Equipment, 688 F.3d at 157 (noting that "information affecting the good faith determination might be added to the record throughout the process leading up to confirmation"); see also Acequia, 787 F.2d at 1358-59 (reasoning that although confirmation requires an evidentiary hearing, "this does not preclude the bankruptcy court from considering evidence presented by the parties at prior evidentiary hearings") (citing In re Graco, Inc., 364 F.2d 257, 260 (2d Cir. 1966)).

[FN58]. See Nicholson, Knowing When to Pull the Plug Prior to Plan Confirmation, 31 Am. Bankr. Inst. J. 52, 53 (Nov. 2012) (addressing substantive challenges to confirmation being waged at disclosure statement stage and noting that "[w]ithout passing judgment on litigation tactics employed by either debtors or creditors, such

efforts would potentially frontload confirmation battles. Depending on the circumstances, this may or may not create additional work for all parties involved as well as for bankruptcy courts.").

[FN59]. The issue of a combined hearing on confirmation and the disclosure statement has been posed as a potential solution to such concerns. See Nicholson, Knowing When to Pull the Plug Prior to Plan Confirmation, 31 Am. Bankr. Inst. J. at 53. A roadblock to this approach, however, is that combined hearings are authorized expressly by section 1125(f) only for "small business cases," and certain courts have concluded that section 105 may not be invoked in such a situation because it would contravene the statutory language of section 1125. See Nicholson, Knowing When to Pull the Plug Prior to Plan Confirmation, 31 Am. Bankr. Inst. J. at 53 (citing In re Amster Yard Associates, 214 B.R. 122, 124, 31 Bankr. Ct. Dec. (CRR) 840, Bankr. L. Rep. (CCH) P 77573 (Bankr. S.D. N.Y. 1997)).

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