

891 F.3d 848

United States Court of Appeals, Ninth Circuit.

IN RE FAGERDALA USA—LOMPOC, INC., Debtor,
Pacific Western Bank; Coastline
re Holdings Corp., Appellants,
v.
Fagerdala USA—Lompop, Inc., Appellee.

No. 16-35430

|
Argued and Submitted March
9, 2018 Portland, Oregon

|
Filed June 4, 2018

Synopsis

Background: Chapter 11 debtor moved to designate votes on its proposed Chapter 11 plan. The United States Bankruptcy Court for the District of Oregon granted motion, and secured creditor whose votes on recently purchased claims were designated appealed. The District Court, No. 3:15-cv-01792-MO, Michael W. Mosman, Chief Judge, affirmed. Creditor appealed.

Holdings: The Court of Appeals, N.R. Smith, Circuit Judge, held that:

[1] secured creditor's failure to make an offer to purchase all the claims of every member of general unsecured class, but only the claims of creditors that held a majority of the unsecured claims numerically, was not, by itself, sufficient evidence of bad faith to warrant the designation of votes that it cast on proposed plan as holder of these recently acquired claims, and

[2] in deciding whether to designate the votes that creditor with a preexisting secured claim sought to cast on proposed plan in its capacity as holder of recently acquired general unsecured claims, bankruptcy court should not have considered only whether allowing creditor to vote the purchased claims would give it an unfair advantage over other creditors, without considering the creditor's motivation in acquiring these claims.

Reversed, vacated and remanded.

West Headnotes (22)

[1] Bankruptcy

🔑 Particular cases and issues

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3785 Findings of Fact
51k3787 Particular cases and issues
Court of Appeals would review for clear error a bankruptcy court's ultimate determination of good faith, when deciding whether to designate votes on proposed Chapter 11 plan. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[2] Bankruptcy

🔑 Conclusions of law;de novo review

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3782 Conclusions of law;de novo review
While the Court of Appeals would review for clear error a bankruptcy court's ultimate determination of good faith, when deciding whether to designate votes on proposed Chapter 11 plan, the Court would apply de novo review if the bankruptcy court somehow misunderstood the nature of the legal question, or if it devised some novel multi-factor test for addressing the “good faith” issue. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[3] Federal Courts

🔑 What constitutes clear error, and effect thereof

170B Federal Courts
170BXVII Courts of Appeals
170BXVII(K) Scope and Extent of Review
170BXVII(K)2 Standard of Review
170Bk3576 Procedural Matters
170Bk3603 Findings

170Bk3603(6) What constitutes clear error, and effect thereof
 Legal error is clear error in the ultimate determination.

Cases that cite this headnote

so designated were not attempting to protect their own proper interests, but were, instead, attempting to obtain some benefit to which they were not entitled. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[4] Bankruptcy

🔑 Acceptance

51 Bankruptcy
 51XIV Reorganization
 51XIV(B) The Plan
 51k3541 Acceptance
 51k3541.1 In general
 “Designation” of votes on proposed Chapter 11 plan means that the votes will not be counted in deciding whether a class voted to accept or reject the plan. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[7] Bankruptcy

🔑 Acceptance

51 Bankruptcy
 51XIV Reorganization
 51XIV(B) The Plan
 51k3541 Acceptance
 51k3541.1 In general
 Entity acts in “bad faith,” and thus its vote on proposed Chapter 11 plan may be designated, when it seeks to secure some untoward advantage over other creditors for some ulterior purpose. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[5] Bankruptcy

🔑 Acceptance

51 Bankruptcy
 51XIV Reorganization
 51XIV(B) The Plan
 51k3541 Acceptance
 51k3541.1 In general
 Concept of “good faith,” as bearing on whether votes on proposed Chapter 11 plan may be designated, is a fluid one, and no single factor can be said to inexorably demand an ultimate result, nor must a single set of factors be considered. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[8] Bankruptcy

🔑 Acceptance

51 Bankruptcy
 51XIV Reorganization
 51XIV(B) The Plan
 51k3541 Acceptance
 51k3541.1 In general
 “Bad faith,” such as will permit court to designate an entity's vote on a proposed Chapter 11 plan, does not include enlightened self interest, even if it appears selfish to those who do not benefit from it. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[6] Bankruptcy

🔑 Acceptance

51 Bankruptcy
 51XIV Reorganization
 51XIV(B) The Plan
 51k3541 Acceptance
 51k3541.1 In general
 Designation of votes on proposed Chapter 11 plan, on ground that votes were solicited, procured, or cast other than in “good faith,” is appropriate when those whose votes are

[9] Bankruptcy

🔑 Acceptance

51 Bankruptcy
 51XIV Reorganization
 51XIV(B) The Plan
 51k3541 Acceptance
 51k3541.1 In general
 In deciding whether to designate votes on proposed Chapter 11 plan, as not having been solicited, procured or cast with requisite good faith, court must keep in mind the difference

between a creditor's self interest as creditor and a motive which is ulterior to the purpose of protecting creditor's interest, with only the latter warranting a finding of "bad faith." 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[10] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

Mere fact that creditor has purchased additional claims for the purpose of protecting his own existing claim does not demonstrate bad faith or an ulterior motive, and is not a proper basis for designating creditor's vote on proposed Chapter 11 plan. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[11] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

Purchasing claims for the purpose of blocking confirmation of proposed Chapter 11 plan is not to be condemned. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[12] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

Secured creditor's failure to make an offer to purchase all the claims of every member of general unsecured class, but only the claims of creditors that, while holding only about 10%

of general unsecured debt, held a majority of the unsecured claims numerically, was not, by itself, sufficient evidence of bad faith to warrant the designation of votes that it cast on debtor's proposed Chapter 11 plan in its capacity as holder of these recently acquired general unsecured claims. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[13] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

While entity's offer to purchase all of the claims in class is certainly an indicator of its good faith, its failure to do so cannot be evidence of bad faith, such as will permit the designation of votes that entity casts on the acquired claims. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[14] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

Doing something allowed by the Bankruptcy Code and case law, without evidence of some ulterior motive, cannot be bad faith, such as will permit the designation of votes on proposed Chapter 11 plan. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[15] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance

51k3541.1 In general

In deciding whether to designate the votes that creditor with a preexisting secured claim sought to cast on debtor's proposed Chapter 11 plan in its capacity as holder of recently acquired general unsecured claims, bankruptcy court should not have considered only whether allowing creditor to vote the purchased claims would give it an unfair advantage over other creditors, without considering creditor's motivation in acquiring these claims and whether creditor had acted to secure some untoward advantage over other creditors for some ulterior motive, other than simply protecting its preexisting secured claim. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[16] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

Focus of court's "bad faith" inquiry, in deciding whether to designate the votes that creditor casts on proposed Chapter 11 plan, should be on creditor's motive, particularly, on whether creditor has an ulterior motive and is seeking to secure some untoward advantage. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[17] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

Creditors do not need to approach reorganization plan votes with a high degree of altruism, and with desire to help the debtor and their fellow creditors, in order to avoid having their votes designated. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[18] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

If creditor acted out of enlightened self interest in acquiring the claims that it seeks to vote on proposed Chapter 11 plan, then it is not to be condemned, and its votes are not to be designated, simply because its actions frustrate the debtor's desires, not even if creditor purchased the claims for the very purpose of blocking confirmation of debtor's proposed plan. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[19] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3541 Acceptance
51k3541.1 In general

"Bad faith" may be found, of kind sufficient to designate the votes that a creditor casts on proposed Chapter 11 plan in its capacity as holder of recently acquired claims, when creditor acquired the claims, not in attempt to protect its own proper interests, but in attempt to obtain some benefit to which it was not entitled, such as when it purchased the claims less out of an interest in maximizing the return on its claim than of diverting the progress of the proceedings to achieve an outside benefit. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[20] Bankruptcy

🔑 Acceptance

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan

51k3541 Acceptance

51k3541.1 In general

“Bad faith” may be found, of kind sufficient to warrant the designation of votes on proposed Chapter 11 plan, when a non-preexisting creditor purchased the claim that it seeks to vote for the purpose of blocking an action against it, when competitors purchased claims to destroy debtor’s business in order to further their own, or when debtor arranged to have an insider purchase claims. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[21] Bankruptcy

🔑 Acceptance

51 Bankruptcy

51XIV Reorganization

51XIV(B) The Plan

51k3541 Acceptance

51k3541.1 In general

Merely protecting a claim to its fullest extent cannot be evidence of “bad faith,” such as will warrant the designation of votes on proposed Chapter 11 plan. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[22] Bankruptcy

🔑 Acceptance

51 Bankruptcy

51XIV Reorganization

51XIV(B) The Plan

51k3541 Acceptance

51k3541.1 In general

In order for court to designate votes on proposed Chapter 11 plan, there must be some evidence beyond negative impact on other creditors. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

*851 Appeal from the United States District Court for the District of Oregon, Michael W. Mosman, Chief Judge, Presiding, D.C. No. 3:15-cv-01792-MO

Attorneys and Law Firms

Teresa H. Pearson (argued) and David W. Hercher, Miller Nash Graham & Dunn LLP, Portland, Oregon; David K. Eldan, Parker Milliken Clark O’Hara & Samuelian, Los Angeles, California; for Appellants.

Douglas R. Pahl (argued), Perkins Coie LLP, Portland, Oregon, for Appellee.

Before: N. Randy Smith, Morgan Christen, and Andrew D. Hurwitz, Circuit Judges.

OPINION

N.R. SMITH, Circuit Judge:

Under 11 U.S.C. § 1126(e), a bankruptcy court may not designate claims for bad faith simply because (1) a creditor offers to purchase only a subset of available claims *852 in order to block a plan of reorganization, and/or (2) blocking the plan will adversely impact the remaining creditors. Bad faith requires more. *See Figter Ltd. v. Teachers Ins. & Annuity Ass’n of Am. (In re Figter)*, 118 F.3d 635, 639 (9th Cir. 1997). At a minimum, there must be some evidence that a creditor is seeking “to secure some untoward advantage over other creditors for some ulterior motive.” *Id.* Accordingly, the bankruptcy court erred when it refused to analyze whether Pacific Western acted under an “ulterior motive,” beyond its “mere enlightened self interest” in protecting its secured claim. *Id.* In the absence of some ulterior motive, the mere failure to make purchase offers to all outstanding creditors does not support a bad faith finding—even if the outstanding creditors will be adversely affected by a decision to block the reorganization plan.

I. Factual Proceedings

A. The Parties

Fagerdala USA—Lompoc, Inc., the debtor, owns real property worth approximately \$6 million. Pacific Western Bank, through its wholly-owned entity, Coastline RE Holdings Corp. (collectively “Pacific Western”), holds the senior, secured claim (in excess of \$3.95 million) on Fagerdala’s real property.

B. Bankruptcy Court Proceedings

Fagerdala filed for Chapter 11 bankruptcy on August 14, 2014. Fagerdala filed an initial reorganization plan on November 14, 2014 and a first amended plan of reorganization on April 27, 2015. Both plans placed Pacific Western's claim in Class 1, and the general unsecured claims in Class 4.¹ All claims were deemed impaired in both plans.² Therefore, to “cramdown” the plan under § 1129(a)(10), Fagerdala needed the approval of at least one impaired class.

¹ Class 2 contained only a tax claim by Santa Barbara County and Class 3 consisted of an insider claim by Maxwell Morgan, which was subordinated to Pacific Western.

² Specifically, Pacific Western's claim was impaired because the proposed interest rate was lower than the penalty interest rate for the loan, and both plans modified the length of the term and other loan provisions.

To block Fagerdala's proposed plan, Pacific Western purchased a number of the general unsecured claims. Pacific Western's legal counsel testified that its “motivation was to acquire for the bank a blocking position in the unsecured class” and that the sole goal was “to do what was best for [Pacific Western] economically.” Pacific Western provided its legal counsel a budget, which was insufficient to purchase all the general unsecured claims. Pacific Western's offer to purchase was rejected by some unsecured creditors, and it could not contact other unsecured creditors. Further, Pacific Western's counsel testified that he did not seek to purchase (1) claims that were valued at zero; (2) claims he believed were either insider controlled or would alert Fagerdala to Pacific Western's claim purchases; or (3) claims to which Fagerdala objected. Ultimately, Pacific Western purchased more than half of the claims by number, but only approximately ten percent by value (approximately \$13,000) (hereinafter “Purchased Claims”).

Fagerdala filed its second amended plan on June 2, 2015. The next day, Pacific Western voted its secured claim and the Purchased Claims against the plan. Because the Purchased Claims constituted at least “one-half in number” of the general unsecured class, Pacific Western's votes were sufficient to block the second amended plan. § 1126(c).

*853 After the vote, Fagerdala moved to designate the votes of the Purchased Claims, arguing that Pacific Western had not purchased the claims in good faith. The bankruptcy court heard argument on the motion on June 10, 2015, and August 25, 2015. At the outset of the hearing, the bankruptcy court stated it wanted an answer to the question of “whether or not the bank offered to buy all the claims, or did they just buy a few.” Pacific Western's counsel stated that he “did not attempt to buy every claim” and that “[w]ith respect to any claim that I did not attempt to buy, there were specific, and, in my view, good reasons to not attempt to buy it.” He also offered examples of prior cases where a creditor had sought to block a plan by purchasing claims. In response, the bankruptcy court explicitly stated, as “a matter of law,” it was not going to consider Pacific Western's motivation or rationale for offering to purchase only a subset of claims.

The bankruptcy court then granted Fagerdala's designation motion, stating:

The plan of reorganization under consideration proposes to pay Class 4 claims in full with interest within 60 days of confirmation. It is undisputed that unsecured creditors will not be paid in a liquidation or in the event this reorganization fails and [Pacific Western] forecloses.

I conclude that designation is appropriate in this case **because [Pacific Western] will have an unfair advantage over the unsecured creditors who did not receive a purchase offer and who hold the largest percentage of claims in this in terms of amount.**

....

Good faith does not require a creditor to act with selfless disinterest. And the fact that a creditor purchases claims to take a blocking position is not, per se, bad faith under [§ 1126]. **However, a creditor's conduct in further of its own interest should not result in an unfair disadvantage to other creditors.** [*In re Pleasant Hill Partners, L.P.*, 163 B.R. 388 (Bankr. N.D. Ga. 1994)].

That principle was a factor in—in *Figter* where the court affirmed the bankruptcy court's denial of a motion under Section 1126(e). In doing so the court in *Figter* **specifically noted that the secured creditor offered to purchase all of the unsecured claims at issue.** See also [*Principal Mut. Life Ins. Co. v. Lakeside Assocs. (In re*

Deluca), 194 B.R. 797 (Bankr. E.D. Va. 1996)]. [255 *Park Plaza Assocs. Ltd. v. Conn. Gen. Life Ins. Co. (In re 225 Park Plaza Assocs. Ltd.)*, 100 F.3d 1214 (6th Cir. 1996)].

Allowing [Pacific Western] to block confirmation by purchasing such a small percentage of the unsecured debt in this case would be highly prejudicial to the creditors holding most of the unsecured debt; and, therefore, I am going to designate.

With the Purchased Claims removed from voting, Fagerdala had sufficient creditors in the general unsecured class to accept the plan. The bankruptcy court ultimately confirmed the fourth amended plan.³

³ In between the two hearings, Fagerdala filed a third amended plan. The third amended plan split Class 1 into two parts: Class 1A (containing Pacific Western's secured claim), and Class 1B (containing the Purchased Claims). Even though Fagerdala moved the Purchased Claims into a different class, it treated both Class 1B and Class 4, the remaining unsecured general creditors, the same. These classes were left in place in the fourth amended plan, which the bankruptcy court confirmed on September 14, 2015.

C. District Court Proceedings

The district court affirmed the bankruptcy court's designation of the Purchased *854 Claims with reservation. Pacific Western timely appealed. We have jurisdiction under 28 U.S.C. § 158(d)(1), and we reverse.⁴

⁴ Fagerdala's Motion to Dismiss the Appeal as Moot, filed after this case was submitted, is **DENIED**.

II. Standard of Review

[1] [2] [3] We review the bankruptcy court's ultimate determination of good faith for clear error. *Figter*, 118 F.3d at 638. “To the extent that our review requires us to define the general parameters of a good faith determination, we are reviewing a question of law. To the extent that we must review a pure historical fact determination, we are reviewing a question of fact.” *Id.* “[A]n appellate court must correct any legal error infecting a bankruptcy court's decision. So if the bankruptcy court somehow misunderstood the nature of the [legal

question]—or if it devised some novel multi-factor test for addressing that issue—an appellate court should apply *de novo* review.” *U.S. Bank Nat'l Ass'n v. Vill. at Lakeridge, LLC*, — U.S. —, 138 S.Ct. 960, 968 n.7, 200 L.Ed.2d 218 (2018). Legal error constitutes clear error in the ultimate determination. *Cf. Koon v. United States*, 518 U.S. 81, 100, 116 S.Ct. 2035, 135 L.Ed.2d 392 (1996).

III. Discussion

Pacific Western argues that the district court erred by considering only the effect of Pacific Western's actions, without respect for its motivation. We agree. The bankruptcy court found that “designation is appropriate in this case because [Pacific Western] will have an unfair advantage over the unsecured creditors who did not receive a purchase offer and who hold the largest percentage of claims in this in terms of amount.” In the bankruptcy court's ruling, only two facts were relevant: (1) Pacific Western did not make an offer to all unsecured creditors; and (2) if Pacific Western's Purchased Claims were voted, it would “have an unfair advantage” and be “highly prejudicial” to other creditors. However, under § 1126(e), neither of these considerations—alone or together—are by themselves sufficient to support a finding of bad faith. To explain, we outline the basic principles of good faith determinations under § 1126(e) and then turn to the two errors made by the bankruptcy court.

A. General Principles of Good Faith Under § 1126(e)

[4] “On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith....” § 1126(e). To “designate” means the votes for the claims will not be counted in voting to accept or reject the plan. *Figter*, 118 F.3d at 638. The definition of “good faith” is not provided in statute and was “left to the courts” by Congress. *Id.*

[5] [6] [7] “[T]he concept of good faith is a fluid one, and no single factor can be said to inexorably demand an ultimate result, nor must a single set of factors be considered.” *Id.* at 639. Generally, § 1126(e) “appl[ies] to those who were not attempting to protect their own proper interests, but who were, instead, attempting to obtain some benefit to which they were not entitled.” *Id.* at 638. An entity acts in bad faith when it “seeks to secure some

untoward advantage over other creditors for some ulterior purpose.” *Id.* at 639.

*855 [8] [9] [10] [11] However, as “fluid” as the concept of good faith may be, bad faith explicitly does not include “enlightened self interest, even if it appears selfish to those who do not benefit from it.” *Id.* “It is always necessary to keep in mind the difference between a creditor’s self interest as a creditor and a motive which is ulterior to the purpose of protecting a creditor’s interest.” *Id.* Thus, “the mere fact that a creditor has purchased additional claims for the purpose of protecting his own existing claim does not demonstrate bad faith or an ulterior motive.” *Id.* “[P]urchas[ing] ... claims for the very purpose of blocking confirmation of ... [a] proposed plan” “is not to be condemned.” *Id.*

B. Failure to Offer to Purchase all Claims in a Class

[12] Neither *Figter* nor the Bankruptcy Code support the bankruptcy court’s conclusion that failing to make an offer to all members of a class is (by itself) sufficient evidence of bad faith. In *Figter*, the creditor sought to purchase all the claims in the class, but that fact was only one—of several—that contributed to the bankruptcy court’s finding of good faith. 118 F.3d at 640. The *Figter* creditor was not advancing another plan, was not a competing entity in the apartment-owning business, faced a complex lien situation if the building was divided into condos (rather than keeping it as an apartment building) as proposed in the debtor’s plan, and “acted to protect its interests as [the] major creditor.” *Id.* Considering all those facts as a whole, we found the bankruptcy court did not commit clear error by finding the *Figter* creditor acted in good faith. *Id.* The fact that the *Figter* creditor offered to purchase all claims was not the singular, dispositive factor; it was one among several.

[13] [14] It is also true that, while offering to purchase all claims is certainly an indicator of *good faith*, failing to do so cannot be evidence of *bad faith*. As we have explicitly emphasized: “the mere fact that a creditor has purchased additional claims for the purpose of protecting his own existing claim does not demonstrate bad faith or an ulterior motive.” *Id.* at 639; *see also* 225 *Park Plaza Assocs.*, 100 F.3d at 1219 (“Indeed, ‘the mere fact that a purchase of creditors’ interests is for ... securing the approval or rejection of a plan does not of itself amount to bad faith.’ If bad faith could be found any time a claim is purchased to block approval of a plan, there would be no

incentive to purchase claims.” (citations omitted) (quoting *In re Allegheny Int’l Inc.*, 118 B.R. 282, 289 (Bankr. W.D. Pa. 1990)); *In re Dish Network Corp. v. DBSD N. Am. Inc.* (*In re DBSD N. Am. Inc.*), 634 F.3d 79, 102 (2d Cir. 2011) (“Merely purchasing claims in bankruptcy ‘for the purpose of securing the approval or rejection of a plan does not of itself amount to bad faith.’ ” (quoting *In re P-R Holding Corp.*, 147 F.2d 895, 897 (2d Cir. 1945))). “Thus, if [the creditor] acted out of enlightened self interest, it is not to be condemned simply because it frustrated [the debtor’s] desires. That is true, even if [the creditor] purchased [the] claims for the very purpose of blocking confirmation of [the debtor’s] proposed plan.” *Figter*, 118 F.3d at 639. Blocking a plan takes only a numerical majority of the class, not the entire class or a majority of the class by value. § 1126(c) (“A class of claims has accepted a plan if such plan has been accepted by creditors ... that hold at least two-thirds in amount and more than one-half in number of the allowed claims....”). Doing something allowed by the Bankruptcy Code and case law, without evidence of ulterior motive, cannot be bad faith. Not offering to purchase all the claims in a class (to later use those claims to block a plan) is not—alone—sufficient to evidence the bad faith necessary to designate votes under § 1126(e)). As such, the *856 bankruptcy court erred by finding bad faith based on Pacific Western’s decision to not offer to purchase all the general unsecured claims.

C. Consideration of the Effect of Blocking a Plan on Other Creditors

[15] The bankruptcy court’s conclusion that allowing Pacific Western to vote the Purchased Claims would give it an “unfair advantage” over other creditors incorrectly examined only the *negative effect* of the action, not the *motivation* of the creditor, and failed to establish whether Pacific Western had acted to “secure some untoward advantage over other creditors *for some ulterior motive.*” *Figter*, 118 F.3d at 639 (emphasis added). The bankruptcy court borrowed the concept of “unfair advantage” from *In re Pleasant Hill Partners*, a Northern District of Georgia Bankruptcy Court decision, which held that “[t]he creditor’s conduct in furtherance of its own interest ... should not result in unfair disadvantage to other creditors or the debtor.” 163 B.R. at 395. However, this concept is not supported by our case law in *Figter* nor the precedents in other Circuits.

[16] [17] [18] *Figter* certainly stated that determining 5 good faith was a “fluid” concept and that “no single factor” or “single set of factors” was conclusive. 118 F.3d at 639. However, we also pointedly stated that there is a “necessary” distinction between “a creditor's self interest as a creditor and a motive which is ulterior to the purpose of protecting a creditor's interest.” *Id.* To ensure this distinction is maintained, *Figter* repeatedly focuses the bad faith inquiry on the *motive* of the creditor, particularly, on whether the creditor has an “ulterior motive,” and is seeking “to secure some untoward advantage.” *Id.* We explicitly held that creditors do not need “to approach reorganization plan votes with a high degree of altruism and with the desire to help the debtor and their fellow creditors. *Far from it.*” *Id.* (emphasis added). Thus, a creditor's actions are not bad faith simply because they “appear selfish to those who do not benefit from it.” *Id.* “[I]f [the creditor] acted out of enlightened self interest, it is not to be condemned simply because it frustrated [the debtor's] desires. That is true, *even if [the creditor] purchased [the] claims for the very purpose of blocking confirmation of [the debtor's] proposed plan.*” *Id.* (emphasis added).

[19] [20] [21] [22] Rather, bad faith is determined when the creditor was “not attempting to protect [its] own proper interests, but ... w[as], instead, attempting to obtain some benefit to which [it] w[as] not entitled.” *Id.* at 638 (emphasis added). As the Second Circuit noted, bad faith is found when “[t]he purchasing party ... was less interested in maximizing the return on its claim than in diverting the progress of the proceedings to achieve an outside benefit.” *In re DBSD N. Am. Inc.*, 634 F.3d at 104 (emphasis added).⁵ Noted examples of bad faith include: a non-preexisting creditor “purchas[ing] a claim for the purpose of blocking an action against it,” competitors purchasing claims to “destroy *857 the debtor's business in order to further their own,” or a debtor arranging to have an insider purchase claims. *See Figter*, 118 F.3d at 639 (citing *In re Keyworth*, 47 B.R. 966, 971–72 (Bankr. D. Colo. 1985); *In re MacLeod Co.*, 63 B.R. 654, 655 (Bankr. S.D. Ohio 1986); *In re Allegheny Int'l, Inc.*, 118 B.R. at 289; *In re Holly Knoll P'ship*, 167 B.R. 381, 389 (Bankr. E.D. Pa. 1994); *In re Applegate Prop., Ltd.*, 133 B.R. 827, 834–35 (Bankr. W.D. Tex. 1991)). Merely protecting a claim to its fullest extent cannot be evidence of bad faith. There must be some evidence beyond negative impact on other creditors.

This definition reflects the purpose behind the “good faith” requirement, which was enacted in response to the Fifth Circuit's decision in *Texas Hotel Securities Corp. v. Waco Development Co.*, 87 F.2d 395 (5th Cir. 1936). *See Young v. Higbee Co.*, 324 U.S. 204, 211 n.10, 65 S.Ct. 594, 89 L.Ed. 890 (1945). In *Texas Hotel*, Waco Development, which owned the Roosevelt Hotel, filed for bankruptcy. 87 F.2d at 397. Waco Development's proposed reorganization plan granted a third-party the lease to operate the hotel. *Id.* A Texas Hotel subsidiary had held the lease to operate the hotel in the past, but after it defaulted, the lease was cancelled by judicial order. *Id.* at 398–99. Texas Hotel purchased enough claims to block the plan, with the “hope[] to force [a plan] that would give them again the operation of the hotel or other wise [sic] reestablish an interest that they felt they justly had in the property.” *Id.* at 398. The district court disallowed the votes. *Id.* at 397. However, on appeal, the Fifth Circuit held the Bankruptcy Act did not authorize scrutinizing the motivations of those purchasing claims and allowed the claims to be voted. *Id.* at 400. Later, in *Young*, the Supreme Court noted that the “good faith” provisions were enacted to “bar creditors from a vote who were prompted by such a purpose [as seen in *Texas Hotel*].” 324 U.S. at 211 n.10, 65 S.Ct. 594.

Here, the bankruptcy court expressly refused to consider Pacific Western's motivations or determine whether Pacific Western was seeking an “untoward advantage over other creditors for some ulterior motive,” i.e., “to obtain some benefit to which [Pacific Western] w[as] not entitled.” *Id.* 638–39.⁶ The bankruptcy court erred both by considering the effect on other creditors, without additional evidence of bad faith, and not making actual findings on Pacific Western's motivations.

⁶ Contrary to Fagerdala's arguments on appeal, the bankruptcy court explicitly stated it was not considering Pacific Western's motivation as a matter of law; only the *fact* that Pacific Western had not made an offer to all creditors mattered.

IV. Conclusion

Therefore, we reverse the district court's order affirming the bankruptcy court, vacate the bankruptcy court's order granting Fagerdala's motion to designate the Purchased Claims, and remand this case to the bankruptcy court

for proceedings consistent with this opinion.⁷ Each party shall bear its own costs.

⁷ In addition to the designation issue, Pacific Western argued that the bankruptcy court erred by allowing the Purchased Claims to be segregated from the other general unsecured claims. In its briefing, Fagerdala conceded the classification issue if the bankruptcy court were reversed on the designation question. Since we find the bankruptcy court committed legal error

by designating the votes of the Purchased Claims, we also find that Fagerdala has conceded that Purchased Claims were improperly classified separately from the other general unsecured claims.

REVERSED, VACATED, and REMANDED.

All Citations

891 F.3d 848, 65 Bankr.Ct.Dec. 204, 18 Cal. Daily Op. Serv. 5506, 2018 Daily Journal D.A.R. 5321

End of Document

© 2018 Thomson Reuters. No claim to original U.S. Government Works.