Docket #0720 Date Filed: 05/18/2018

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NORTH DAKOTA

In re: **Vanity Shop of Grand Forks, Inc.**, Debtor.	Case No.: 17-30112 Chapter 11 **Hearing Date: May 22, 2018 at 9:30 am** **Re: Docket No. 646**

THE OFFICIAL COMMITTEE OF UNSECURED CREDITOR'S LIMITED RESPONSE TO THE DEBTOR'S OMNIBUS MEMORANDUM OF LAW IN SUPPORT OF CONFIRMATION OF THE DEBTOR'S SECOND PLAN OF LIQUIDATION DATED APRIL 9, 2018 (AS MODIFIED)

The Debtor's Plan[1] has been soundly rejected by both impaired classes of economic stakeholders: (1) Class 3 (Effective Date Allowed Unsecured Claims), which rejected the Plan by 71.43% in number and 40.31% in amount; and (2) Class 4 (Post Effective Date Allowed Unsecured Claims) rejected the Plan by 79.73% in number and 97.44% in amount.

The *Debtor's Omnibus Memorandum of Law in Support of Confirmation of the Debtor's Second Plan of Liquidation Dated April 9, 2018 (as modified)* (the "Confirmation Memorandum"), however, states at pg. 28, without citation to any legal authority or support, that: "Because Class 2 voted in favor of the Plan, the Plan satisfies the requirements of Section 1129(a)(10) of the Bankruptcy Code." The Debtor then proposes to cram the Plan down the throats of Class 3 and 4 creditors using the vote of this single, bogus "Convenience Class" (Class 2) to attempt to satisfy Section 1129(a)(10)'s requirement of an impaired consenting class.

The Debtor is prohibited from doing so for the following two independently sufficient reasons: (1) Congress has made clear that Section 1129(a)(10) requires that one "real" class of

[1] All capitalized terms used herein and not otherwise defined have the meanings set forth in the Plan or the accompanying Disclosure Statement.

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creditors must vote to accept the plan, and an administrative convenience class does not qualify; and (2) the Debtor's creation of the Convenience Class here was neither reasonable nor necessary, as required by Section 1122(b), but rather was created for the sole purpose of gerrymandering the vote of an impaired consenting class.

First, the legislative history explains that:

> the intent of section 1129(a)(10) is that *one "real" class of creditors must vote for the plan* of reorganization. A class that is deemed to have accepted the plan because it is unimpaired or *acceptance of a small class of claims permitted to be created for administrative convenience will not satisfy this requirement*.

S. Rep. No. 150, 97th Cong., 1st Sess. 1981 (emphasis added), quoted in *In re Dunes Hotel Assocs.*, 188 B.R. 174, 188 (Bankr. D.S.C. 1995).

Simply put, "an administrative convenience class may not be used to create an accepting class of creditors." *In re Paolini*, 312 B.R. 295, 315 n.32 (Bankr. E.D. Va. 2004); *accord In re S & W Enter.*, 37 B.R. 153, 165 (Bankr. N.D. Ill. 1984) (Congressional intent in permitting administrative convenience class is "to weed out numerous claims and thereby avoid administrative cost," not "to allow gamesmanship in vote getting" (emphasis, internal quotation marks, and citations omitted)).

Second, even if an administrative convenience class could qualify as an impaired consenting class under some circumstances (it cannot), it clearly cannot where, as here, creation of the class was neither reasonable nor necessary, but done solely to gerrymander the vote. "[U]sing Section 1122(b) for the sole purpose of meeting the requirement of Section 1129(a)(10) was not a use contemplated by Congress." *S & W*, 37 B.R. at 158.

Section 1122(b) permits the creation of an administrative convenience class only where "reasonable and necessary." 11 U.S.C. § 1122(b). "Generally, an administrative convenience class is one where the claims are so small in amount and large in number as to make dealing with

them burdensome." 7 *Collier on Bankruptcy* ("Collier") ¶ 1122.03[4][a] (16th Ed. 2018 rev.) (quoting *Oxford Life Ins. Co v. Tucson Self-Storage, Inc. (In re Tucson Self-Storage, Inc.),* 166 B.R. 892, 898 (B.A.P. 9th Cir. 1994)).

The Senate Report notes that subsection 1122(b) was added for administrative convenience and that "[p]ayments in cash of small claims *in full* is common practice in reorganization." S. Rep. No. 989, 95th Cong., 2d Sess. 118 n.26 (1978) (emphasis added). *Collier* adds:

> By providing for payment *in full* of claims that are either at or under the threshold amount set for the class, a convenience class is not impaired under section 1124 of the Code; as a consequence, under section 1126(f), such class will not be entitled to vote on the plan, thus relieving the debtor of the administrative burden of soliciting and tallying votes for the members of that class. Moreover, distribution will likely be simplified because it will not be necessary to calculate amounts and issue checks or securities for distributions of relatively small claims.

7 *Collier* ¶ 1122.03[4] (emphasis added); *see also In re Autterson*, 547 B.R. 372, 397 (Bankr. D. Colo. 2016) ("The purpose of § 1122(b) is to allow a plan to reduce the number of creditors eligible to vote. This result is accomplished by offering creditors holding small claims of perhaps a few hundred dollars each a 100% payment and thus providing that they are not impaired. By doing so, the debtor avoids the cost of sending disclosure statements, soliciting votes from the *de minimus* creditors, and making fractional distributions." (internal quotation marks and citation omitted)).

In the instant case, it is obvious that the creation of the Convenience Class was not necessary to reduce the costs of sending disclosure statements, soliciting votes, or making fractional distributions. The votes of Class 2 creditors were, in fact, solicited, and the Debtor incurred the cost of sending these parties disclosure statements and other solicitation materials. Furthermore, "[n]ecessary" in the context of section 1122(b) means "something more than just tending to ease the administrative burden." *S & W*, 37 B.R. at 162. "Treating the unsecured claims

as members of the same class must be truly burdensome before a bankruptcy court should consider deviating from the general rule and classifying them separately." *Id.*

Here, as evidenced in the Debtor's most recent Monthly Operating Report [Dkt #660], as of April 7, 2018, the Debtor was sitting on nearly $7,245,894.12 in cash. In contrast, it asserts that the approximately 547 claims in the Convenience Class—which it originally estimated to total approximately $15,000—in fact aggregate a mere $31,489.38 after voting was tabulated. *The Debtor could have easily paid these claims in full if it was truly burdensome to treat them as general unsecured claims.* Nevertheless, for a *mere savings of only about $15,000* as compared to payment in full, the Debtor artificially "impaired" the Convenience Class, solicited their votes and tallied their ballots. Because the Plan provides for payment of only 50% of the allowed amount of Convenience Class claims, the Debtor will be required to expend the same amount on solicitation of votes, calculation of amounts, and making fractional distributions on such claims. In fact, by artificially impairing the class and soliciting their votes, the Debtor expended *more* Estate funds, in the form of increased distributions, than it would not have expended if it had not artificially created this voting class and had instead included these creditors in Class 3 or 4.

If it is not too much trouble for the Debtor to solicit the votes of the Convenience Class creditors and make fractional distributions on their claims, it surely would not have been too burdensome for the Debtor to include them in Classes 3 and 4, and make distributions to them along with all the other general unsecured creditors. Where, as here, "it does not appear that the classification will save any significant costs for soliciting ballots, or administering dividends," the Court "can't create a finding of administrative convenience out of whole cloth." *In re N. Washington Ctr. Ltd. P'ship*, 165 B.R. 805, 809 (Bankr. D. Md. 1994).

Moreover, the creation of the Convenience Class is plainly not "reasonable" under the circumstances. Determining whether a proposed classification is "reasonable" within the meaning of Section 1122(b) requires a balancing "between the administrative benefits achievable under the proposed unsecured creditor classification scheme and the negative effects the scheme renders upon other entities and Code policies." *S & W*, 37 B.R. at 162. Given that the Debtor could have easily paid the Convenience Class creditors in full, but was willing to go to the trouble of soliciting their votes and administering dividends, the obvious purpose of the Convenience Class was to "manipulate and gerrymander acceptance" of the Debtor's Plan in order to cram it down the throats of the real economic stakeholders. *Autterson*, 547 B.R. at 396. Here, "not only is the separation of claims unnecessary to promote administrative convenience, it falls decisively short of being 'reasonable.'" *S & W*, 37 B.R. at 162. To find otherwise "would be to make worthless Code provisions such as Section 1129(a)(10) and to render meaningless the placing by Congress of the terms 'reasonable' and 'necessary' in Section 1122(b). In short, the Debtor's creation of separate unsecured classes is a fiction born of the necessity to satisfy Section 1129(a)(10)." *Id.* at 162-63; *see also In re Ward*, 89 B.R. 998, 1001 (Bankr. S.D. Fla. 1988) ("case law consistently disapproves efforts at manipulation of unsecured claims into inappropriate separate classifications, even when that manipulation is engaged in under the guise of promoting administrative convenience").

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served on May 18, 2018 by this Court's CM/ECF System on all parties receiving electronic notice in this case.

/s/ *Mette H. Kurth*

METTE H. KURTH