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Who is an Insider for Voting Purposes *in a Single Asset Chapter 11?*

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A typical single asset Chapter 11 proceeding involves a debtor, one secured lender and numerous unsecured creditors, typically trade creditors. To confirm a plan of reorganization under Chapter 11 of the Bankruptcy Code, a plan must either render all classes of claims and interests unimpaired or such classes must have accepted the plan.[1] If each class of claims or interests has not accepted a plan, confirmation can only be achieved if at least one impaired class of claims has accepted the plan,[2] not including any acceptance by an insider.[3]

In the past several years, secured creditors have taken a more aggressive role in single asset Chapter 11 proceedings, attempting to purchase unsecured claims sufficient to own more than half the number of claims in that class. By doing so, creditors hope to control the unsecured class of claims,[4] thereby precluding a reorganization without the secured lender's

[1] 11 U.S.C. § 1129(a)(8).

[2] 11 U.S.C. § 1129(a)(10). This is known as a "cramdown." A plan is "crammed down" on a creditor over its objection.

[3] Some courts have held that insider votes are not disqualified *per se*. *See* In re United Marine, Inc., 197 B.R. 942, 946, 29 Bankr. Ct. Dec. (CRR) 398. 36 Collier Bankr. Cas. 2d (MB) 654, Bankr. L. Rep. (CCH) ¶ 77033 (Bankr. S.D. Fla. 1996) ("Section 1126 nowhere provides that insider votes are automatically disqualified from the class vote computation"). *See also* Matter of Grimes Furniture. Inc.. 47 B.R. 68. 70. 12 Collier Bankr. Cas. 2d (MB) 193 (Bankr. W.D. Pa. 1985) (finding that affirmative insider votes of impaired class may be counted for purpose of Section 1126(c) when at least one other impaired class without insider accepts plan); In re Lafayette Hotel Partnership. 227 B.R. 445, 450. 41 Collier Bankr. Cas. 2d (MB) 446 (S.D.N.Y. 1998), aff'd, 198 F.3d 234 (2d Cir. 1999) (insider votes count in class consent when at least one other impaired class without insiders accepts plan).

[4] A class of claims has accepted a plan if the plan has been accepted by creditors holding at least two-thirds in amount and more than one-half in number of the allowed claims in that class who voted. 11 U.S.C. § 1126(c).

consent.' In response, some debtors have arranged for friendly individuals or entities to purchase claims to block the opposing creditors. These practices have raised the issue of who is an insider for voting purposes under a plan of reorganization.'

The Bankruptcy Code contains eighteen examples of persons defined as statutory insiders.' The relationships set forth in the Bankruptcy Code that give rise to "insider" status are preceded by the qualifier "includes."[8] Thus, courts are left to fashion appropriate guidelines for persons not enumerated in the Bankruptcy Code as insiders. In the context of plan confirmation,

[5] As one court has noted: "The potential for mischief from the buying up of claims in the Chapter 1 I context is obvious." In re DeLuca. 194 B.R. 797. 804.28 Bankr. Ct. Dec. (CRR) 1223. 35 Collier Bankr. Cas. 2d (MB) 1278 (Bankr. E.D. Va. 1996).

[6] Even if a creditor is not declared an insider, under 11 U.S.C. § 1126(e), a court can disqualify votes not cast in good faith. *See In* re Applegate Property, Ltd.. 133 B.R. 827, 835, 25 Collier Bankr. Cas. 2d (MB) 1672 (Bankr. W.D. Tex. 1991) **(disqualifying** debtor's votes rejecting creditor's plan). *See also* In re Federal Support Co., 859 **F.2d** 17, 19. Bankr. L. Rep. (CCH ¶ 72464 (4th Cir. 1988) (votes not cast in good faith are not to be counted): In re Dune Deck Owners Corp.. 175 B.R. 839, 894.26 Bankr. Ct. Dec. (CRR) 580, Bankr. L. Rep. (CCH) ¶ 76356 (Bankr. S.D.N.Y. 1995) (badges of bad faith may disqualify vote).

[7] 11 U.S.C. § 101(31). The enumerated relationships, as set forth in the definition are:

"insider" includes

A if the debtor is an **individual**

(i) relative of the debtor or a general partner of the debtor;

(ii) partnership in which the debtor is a general partner:

(iii) general partner of the debtor; or

(iv) corporation of which the debtor is a director. **officer.** or person in control;

B) if the debtor is a corporation

(i) director of the debtor:

(ii) **officer** of the debtor:

(iii) person in control of the debtor:

(iv) partnership in which the debtor is a general partner;

(v) general partner of the debtor: or

(vi) relative of a general partner. director, officer, or person in control of the debtor;

C) if the debtor is a **partnership**

(i) general partner in the debtor:

(ii) relative of a general partner in, general partner of. or person in control of the debtor:

(iii) **partnership** in which the **debtor** is a general partner:

(iii) general partner of the **debtor:** or

(iv) person in control of the debtor.

D) if the debtor is a municipality, elected **official** of the debtor or relative of an elected official of the debtor:

E) **affiliate.** or insider of an **affiliate** as if such **affiliate** were the debtor: and

F) managing agent of the debtor

[8] 11 U.S.C. § 101(31). One court has held that: "The Code's use of the word '**includes**' is intended to denote a general class for which the statute provides a nonexhaustive list of members." In re Gilbert, 104 B.R. 206, 209, 19 Bankr. Ct. Dec. (CRR) 1183 (Bankr. W.D. Mo. 1989).

some courts focus on control by the creditor over the debtor or *vice versa*[9] Courts have held that: "The primary objective of Section 1129(a)(10)'s insider component is to forestall the voting of a creditor who is so beholden to or controlled by the debtor as to in effect be an alter ego of the debtor."[10] For example, if a creditor controls a debtor or is beholden to a debtor, such control could subvert the reorganization balance created by Congress. However, other courts have held that control is insufficient to render a creditor an insider for voting purposes."[11] There are two lines of cases either limiting or expanding the open-ended definition of "insider" under the Bankruptcy Code.

A. Cases Limiting the "Insider" Definition

In *Butler v. Shaw*[12], the United States Court of Appeals for the Fourth Circuit held that a party "must exercise sufficient authority over the debtor so as to unqualifiably dictate corporate policy and the disposition of corporate assets" before being considered an insider.[13] Shaw, the president and sole shareholder of Shaw, Inc., sold his automobile dealership to Tatum who changed the name to Ed Tatum Motors (the debtor). As consideration, Shaw received an option, which he exercised, to purchase 22.22% of the stock of the debtor and Shaw, Inc. received cash and a promissory note. The debtor leased the premises from Shaw, Inc. and Tatum agreed to employ Shaw's wife and son.

After the sale, Shaw retained the title of manager although he did not exercise any managerial authority. Shaw subsequently bought additional stock in the debtor which increased his ownership to 35%."[14] When the debtor experienced difficulties, Shaw offered to relinquish his stock and to forgive

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[9] *See, e.g.. In re Gilbert.* 104 B.R. at 210 (disproportionate amount of control by debtor or creditor over each other could support exclusion of vote on basis of insider status).

[10] *Id. See also* In re UVAS Farming Corp., 89 B.R. 889, 892. Bankr. L. Rep. (CCH) ¶ 72433 (Bankr. D.N.M. 1988) ("close scrutiny is a vine that must bear fruit. It must show control. There must be found an opportunity to self-deal or exert more control than is available to other creditors").

[11] *See In re Deluca,* 194 B.R. at 804 (creditor's mere financial control of debtor did not make it insider).

[12] Butler v. David Shaw, Inc.. 72 F.3d 437, 443. 28 Bankr. Ct. Dec. (CRR) 441. Bankr. L. Rep. (CCH) ¶ 76749 (4th Cir. 1996). Although the *Butler* case involved recovery of a preference payment under § 547, the Bankruptcy Code does not distinguish between § 547 and § 1129(a)(10) for analytical purposes.

[13] *Id.* at 439.

[14] *Id.*

[15] *Id.*

[16] *Id.* at 440.

[17] *Id.* at 439.

the indebtedness owed to Shaw, Inc. in exchange for Tatum's agreement to employ Shaw for ten years. Shaw, Inc. also paid property taxes owed by the debtor because Shaw wished to avoid the embarrassment of having delinquent taxes listed in the local media.

After Shaw relinquished his stock, Tatum sold 49% of the company and used some of the money to reimburse Shaw, Inc. for the property taxes and for delinquent rent. After a Chapter 7 petition was filed, the trustee sought to recover the transfers to Shaw, Inc., alleging that Shaw, Inc. was an insider because of Shaw's close relationship with Tatum. Neither the bankruptcy court nor the district court agreed and the Fourth Circuit concurred that Shaw, Inc. was not an insider.[18]

The Fourth Circuit cited *In re Babcock Dairy Co.* for the proposition that an insider may be a person or entity whose relationship with the debtor is sufficiently close so as to subject that relationship to careful scrutiny.[19] However, the Fourth Circuit agreed with the lower courts that Shaw, Inc. did not fit within this definition and specifically rejected the argument that Shaw, Inc. was an insider because of Shaw's close relationship with Tatum.[20] After a complete review of the facts, the court concluded that even though Shaw held the title of manager of the debtor, he exercised no managerial authority over the debtor and was uninvolved in the management of the business.[21] Also, the court did not believe "that Shaw's ability to secure employment for his wife and son indicates that Shaw possesses the ability to dictate corporate policy. We therefore reject Butler's contention that Shaw exercised such a degree of control over the debtor that Shaw, Inc. should be considered an insider."[22][23][24][25][26]

Several lower courts considering the "insider" issue have adhered to the

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[18] *Id.* at 440.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.* at 443 (citing In re Babcock Dairy Co. of Ohio, Inc., 70 B.R. 662, 666 (Bankr. N.D. Ohio 1986)).

[24] *Id.* at 443.

[25] *Id.*

[26] *Id. See also* Gray v. Giant Wholesale Corp., 758 F.2d 1000, Bankr. L. Rep. (CCH) ¶ 70390, 40 U.C.C. Rep. Serv. 1480 (4th Cir. 1985) (creditor that controlled dispensation of debtor's checks was not insider or person in control where debtor determined amount of money to be placed in bank account).

Butler holding. In *In re Deluca,* the debtor, whose sole asset was a commercial office building, asserted that its secured lender was an insider, because it controlled the debtor through the collection of rents.[28] Therefore, the debtor argued, the creditor's vote against the debtor's plan should not count.[29] The court disagreed, finding that: "The mere exercise by a lender of financial control over a debtor incident to the debtor-creditor relationship does not make the lender an insider."[30] Concluding that the lender had exercised financial control over the Debtor, the court determined that alone to be insufficient to render the lender an insider.[31]

The Fourth Circuit's holding in *Butler* also has been adopted by other courts across the country. For example, in *In re Boston Publishing Company, Inc.,"* the creditors' representative sought to recover a preferential transfer from a former director of the debtor. The court noted that determination of insider status is ". . . on a case by case basis on the totality of the circumstances and the creditor's degree of involvement in the debtor's affairs.'' To be an insider, a person must have at least a controlling interest or exercise sufficient authority to unqualifiably dictate corporate policy and the disposition of corporate assets " "It is not enough that the alleged insider have only a superior bargaining position or a contractual relationship with the debtor."[32] In the absence of evidence that the defendant was a de facto director, that he or his agent exercised managerial control, or that he held sufficient

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[27] ***See, e.g.,*** In re Piece Goods Shops Co., L.P., 188 B.R. 778, 788 (Bankr. M.D.N.C. 1995) (lender was not insider because it did not control debtor). *See also* In re Krisch Realty Associates, L.P., 174 B.R. 914, 920 (Bankr. W.D. Va. 1994) (''[F]or a creditor to 'control' a debtor so as to be considered an 'insider,' the creditor must be so powerful that the debtor becomes a mere instrument or agent of the creditor. unable to make independent policy and personnel decisions.") (citations omitted): In re Practical Inv. Corp., 95 B.R. 935. 941. 20 Collier Bankr. Cas. 2d (MB) 1019 (Bankr. E.D. Va. 1989) (Chief Judge Bostetter held that for creditor to be insider, relationship must involve considerable control or higher likelihood of control on the part of the creditor).

[28] *In re Deluca,* 194 B.R. at 803.

[29] *Id.* at 803.

[30] *Id.* **at 804.**

[31] *Id.*

[32] In re Boston **Pub.** Co., Inc., 209 B.R. 157, 159, 30 Bankr. Ct. Dec. (CRR) 1059 (Bankr. D. **Mass. 1997).**

[33] *Id.* at 169.

[34] *Id.* (citation omitted).

[35] *Id.*

shares to unilaterally dictate corporate policy, the court could not conclude that the defendant was an insider.[36]

In *In re Sullivan Haas Coyle, Inc.*,[37] the court reviewed developments in insider litigation and concluded that "a high degree of control is necessary." Control is a significant factor in determining insider status.[38] Mere financial power does not amount to control over the debtor; rather "the court must find an opportunity by the defendant to self-deal or exert more control than is available to other unsecured creditors."[39] Although the defendants were involved in day-to-day decisions regarding the management of the debtor's cash position, the court concluded that they were not insiders because they did not have a stranglehold over the debtor.[40] There was no evidence that the defendants could command authority over corporate affairs or that they could unqualifiably dictate corporate policy.[41]

In re Gilbert[42] involved a creditor who admitted that his primary purpose in purchasing a claim was to assist the debtors in confirming their plan of reorganization. The United States, another creditor in this case, argued that the creditor was an insider because he and one of the debtors were the sole general partners of a financial consulting business.[43] The court concluded that the creditor was not an extrastatutory insider because the facts did not support a conclusion that the creditor's relationship with the debtor was sufficient to allow either to exercise undue influence over the other.[44] The creditor's rule as an advisor to the debtors in their bankruptcy and other business affairs did not: "reveal transactions or dealings that were impermis-

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[36] *Id.* at 170. *See also* In re Murchison, 154 B.R. 909, 913, 24 Bankr. Ct. Dec. (CRR) 482 (Bankr. N.D. Tex. 1993) (requisite control is sufficient authority over corporate debtor so as to unqualifiably dictate corporate policy and to dispose of corporate assets); *In re Babcock Dairy Co. of Ohio, Inc.*, 70 B.R. at 668 (evidence indicated that defendant had no meaningful control over any corporate affair and without such control, court could not conclude that defendant was an insider).

[37] In re Sullivan Haas Coyle, Inc., 208 B.R. 239, 243, 30 Bankr. Ct. Dec. (CRR) 911, 37 Collier Bankr. Cas. 2d (MB) 1623 (Bankr. N.D. Ga. 1997).

[38] *Id.*

[39] *Id.*

[40] *Id.*

[41] *Id. See also* In re Badger Freightways, Inc., 106 B.R. at 981 (citation omitted) (courts require finding that insider has "stranglehold" over debtor, rendering debtor "mere instrumentality or alter ego" of creditor or "powerless to act independently").

[42] 104 B.R. at 208.

[43] *Id.*

[44] *Id.* at 210.

sibly shorter than arms length.''[44] The court also found no evidence that the creditor's voting was motivated by undue influence by the debtor nor was there any intolerable bias that would render the creditor an insider.[46]

B. Cases Expanding the "Insider" Definition

Other courts have taken a more expansive view of the definition of "insider" under the Bankruptcy Code. The first line of Section 101(31) uses the term "includes," which Bankruptcy Code Section 102(3) specifically provides is *not* intended to be a word of limitation. Adopting this approach, some judges have concluded that the list of insiders set forth in Section 101(31) is not exclusive, but rather illustrative"

There are several cases that specifically deal with the "includes" rubric of Section 101(31). For example, in *In re Broumas*,[47] the Chapter 7 trustee asserted that the debtor's attorney was an extrastatutory insider.[48] The bankruptcy court agreed that the attorney was an insider and the district court affirmed this finding. The district court concluded that "actual control is not a predicate to finding someone to be an extra-statutory insider.''[51] Rather, a factual inquiry into a debtor's relationship with an alleged insider is necessary.[52]

In *Broumas,* the evidence revealed a longstanding, complex relationship between the debtor and his attorney, including "creditor and debtor, principal and agent, joint venturers, attorney and client, and landlord and tenant.''[53] They also made loans to each other and the attorney permitted the debtor to make withdrawals from his bank account.[54] On that record, the

[44] *Id.* at 210-11.

[45] *Id.* at 211.

[46] *See, e.g.,* In re Holly Knoll Partnership, 167 B.R. 381, 386, 25 Bankr. Ct. Dec. (CRR) 1042 (Bankr. E.D. Pa. 1994) (Congress' use of the word "includes" evidences its "expansive view" of insider class, suggesting that statutory definition is not limiting) (citations omitted). *See also* In re Applegate Property, Ltd., 133 B.R. 827, 832, 25 Collier Bankr. Cas. 2d (MB) 1672 (Bankr. W.D. Tex. 1991) (Congress' expansive view of the insider class).

[47] In re Broumas, 203 B.R. 385, 391 (D. Md. 1996), aff'd in part, rev'd in part on other grounds, 135 F.3d 769 (4th Cir. 1998) (unpublished decision).

[48] In *Broumas,* the Chapter 7 trustee sought to extend the insider definition for purposes of 11 U.S.C. § 547 so that transfers within one year of the bankruptcy petition, rather than 90 days for non insiders, would apply. *In re Broumas,* 203 B.R. at 391.

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.*

district court held that the bankruptcy court's "determination that Rogers was an insider was not clearly erroneous."[55]

In re Three Flint Hill,[56] involved a Chapter 11 debtor whose sole asset was an office building. Prior to the bankruptcy filing, a representative of the debtor approached a principal of Tarrant Partners who was a friend and business associate of some of the debtor's partners, to request that Tarrant pay approximately $123,000 of the debtor's trade debt. Subsequently, Tarrant voted in favor of the debtor's plan and the secured creditor objected, asserting that Tarrant was an insider.[57] The bankruptcy court agreed with the secured lender, concluding that Tarrant was an insider and did not count its vote in favor of the debtor's plan.[58]

On appeal, the district court affirmed, finding that Tarrant was an insider, in part because control is not dispositive of an insider relationship.[59] Rather the court concluded that Congress intended an insider determination to rest on a finding that: "given the relationship and conduct of the parties, the relevant transaction or arrangement was entered into based upon that relationship rather than an independent purpose or motivation."[60] The court believed that the evidence demonstrated that Tarrant entered into an agreement with the debtor at substantially less than arm's length.[61] Accordingly, the court concluded that Tarrant acted as an insider by entering into an agreement for the primary purpose of helping the debtor confirm its plan.[62]

Another court, *In re Papercraft Corp.*,[63] concluded that an existing shareholder that had purchased claims was an insider because its representa-

[55] *Id. See also, In re Holly Knoll Partnership,* 167 B.R. at 381 (entity that acquired claims to help debtor confirm cramdown plan did not fit within specific provisions of Section 101(31), but was found to be insider under the expansive "includes" rubric); *In re Applegate Ltd.,* 133 B.R. at 832 (entity selected by the debtor to acquire claims to help debtor confirm cramdown plan did not fit within specific provisions of Section 101(31), but was found to be insider under the expansive "includes" rubric).

[56] In re Three Flint Hill Ltd. Partnership, 213 B.R. 292, 295 (D. Md. 1997).

[57] *Id.* at 296.

[58] *Id.*

[59] *Id.*

[60] *Id.* at 299.

[61] *Id.* at 300.

[62] *Id.*

[63] In re Papercraft Corp., 165 B.R. 980, 984, Bankr. L. Rep. (CCH) ¶ 75905 (Bankr. W.D. Pa. 1994), opinion withdrawn and vacated, 187 B.R. 486, 27 Bankr. Ct. Dec. (CRR) 1252, 34 Collier Bankr. Cas. 2d (MB) 745, Bankr. L. Rep. (CCH) ¶ 76826 (Bankr. W.D. Pa. 1995). rev'd on other grounds, 211 B.R. 813 (W.D. Pa. 1997), aff'd and remanded, 160 F.3d 982, 33 Bankr. Ct. Dec. (CRR) 647, Bankr. L. Rep. (CCH) ¶ 77846 (3d Cir. 1998).

tive on the debtor's board of directors was an insider by definition. Shortly after the Chapter 11 petition was filed, the shareholder authorized its representative, who also sat on the debtor's board, to purchase a sufficient number of claims to control the class of unsecured creditors.

The court suggested that the few courts of appeals addressing the insider issue agree that the word "includes" suggests an expansive interpretation." Reviewing the facts, the court concluded there was enough evidence that the shareholder had a "sufficiently close relationship" with the debtor to be included as an insider. Among the facts considered were the shareholder's representative's seat on the debtor's board which provided superior access to financial and business information and the shareholder's control over the debtor." Due to his unique position, the shareholder's representative was able to obtain financial information not otherwise available.'

In *In re Holly Knoll Partnership*, the court concluded that a creditor was an insider even though it did not fit squarely within the parameter set forth in the Bankruptcy Code. The creditor was a real estate company owned by the children of the debtor's sole shareholder.[71] The children had paid their father $1,000 each for the stock in the creditor.[72] The father, who owned the debtor, continued to receive an annual salary of $100,000 from the creditor.[73] The facts led the court to conclude that the father, not the children, was the architect of the creditor's involvement in the bankruptcy.[74] Because of this, the court treated the creditor as an insider and disallowed its vote.

CONCLUSION

In recent years, the definition of an insider has received significant attention in the context of plan confirmation. Lenders have sought to designate as insiders friendly creditors who have purchased claims. On the other hand, debtors have sought to disqualify the votes of creditors who have exerted some form of control over the debtor.

Courts have split on the issue of whether to apply a limited or expansive

[65] *Id.* at 985.

[66] *Id.*

Id. at 987.

"*Id.* at 988.

[73] *Id.* at 989.

167 B.R. at 388.

[71] *Id.* at 383.

[72] *Id.*

[73] *Id.* at 387.

[74] *Id.* at 388.

definition when determining who is an insider under the Bankruptcy Code. Some courts have focused on control of the debtor over a creditor or vice versa. In the absence of control, these courts have declined to conclude that a creditor, even one with a close relationship to the debtor, is an insider. Other courts have applied a more expansive view of extrastatutory insiders. These courts have focused on the nature of the relationship rather than the amount of control. Typically, when there has been a close relationship between a debtor and a creditor, these courts have applied an expansive view and have found the creditor to be an insider.