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# THE NATIONAL BANKRUPTCY REVIEW COMMISSION'S RECOMMENDATION ON CLASSIFICATION OF CLAIMS IN CHAPTER 11

Scott F. Norberg<sup>1</sup>

The question of when a Chapter 11 plan may assign similar claims<sup>2</sup> to different classes, for example, by placing unsecured bank and trade debt in separate classes, is among the most hotly debated<sup>3</sup> issues under the Bankruptcy Code.<sup>4</sup> In its final report, *Bankruptcy: The Next Twenty Years*,<sup>5</sup> the National Bankruptcy Review Commission recommends adoption of a "rational business justification" standard for claims classification,<sup>6</sup> asserting that it "will bring predictability to this unsettled area of the law."<sup>7</sup> In fact, the Commission's proposal would do very little to resolve the problems that have plagued the current statute. Moreover, it would confuse the extant law governing unfair discrimination among classes of similar claims.<sup>8</sup>

The classification controversy is rooted in § 1129(a)(10) of the Code, which states that a Chapter 11 plan may be confirmed only if it has been accepted by at least one class of claims that is impaired by the plan.<sup>9</sup> In many cases, plan proponents find it necessary to allocate similar claims among several classes in order to gain acceptance by an impaired class.<sup>10</sup> While the courts are nearly

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1. Associate Dean and Professor of Law, Mississippi College School of Law. I am grateful to Craig Callen and Todd Zywicki for their helpful comments on a previous draft.

2. Claims are similar if they are of the same nature. The "nature" or "legal nature" of a claim refers to the relationship of the claim to the assets of the debtor, i.e., whether the claim is secured, unsecured, or subordinated. See, e.g., *Teamster's Nat'l Freight Indus. Negotiating Comm. v. United States Truck Co.* (*In re United States Truck Co.*), 800 F.2d 581, 584-85 (6th Cir. 1986); *J.P. Morgan & Co. v. Missouri Pac. R.R.*, 85 F.2d 351, 352 (8th Cir. 1936), cert. denied, 299 U.S. 604 (1936); *In re Los Angeles Land & Inv., Ltd.*, 282 F. Supp. 448, 453-54 (D. Haw. 1968), aff'd, 447 F.2d 1366 (9th Cir. 1971); 7 COLLIER ON BANKRUPTCY ¶ 1122.03[1][b] (Lawrence P. King ed., 15th ed. 1994).

3. See generally Scott F. Norberg, *Classification of Claims Under Chapter 11 of the Bankruptcy Code: The Fallacy of Interest Based Classification*, 69 AM. BANKR. L.J. 119 (1995).

4. 11 U.S.C. §§ 101-1330 (1997) (hereinafter "Code").

5. NATIONAL BANKR. REV. COMM'N FINAL REPORT, BANKRUPTCY: THE NEXT TWENTY YEARS (Oct. 20, 1997) (hereinafter "NBRC Report"). Full report available in print from the United States Government Print Office.

6. *Id.* at 457. The Commission first adopted the proposal at its September 19, 1996 meeting. It reaffirmed its decision at the August 11-12, 1997 meeting by a vote of five to four.

7. *Id.* at 569, 582.

8. See 11 U.S.C. § 1129(b)(1) (1997) (stating that a plan may not be confirmed if it unfairly discriminates with respect to a class that rejects the plan).

9. *Id.* § 1129(a)(10)

(The court shall confirm a plan only if all of the following requirements are met: . . . (10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.)

10. See cases cited *infra* notes 42-51. The typical case involves a single asset real estate debtor whose creditors are (1) an undersecured lender with a secured interest in the real estate, and (2) a group of unsecured trade creditors. By virtue of Code § 506(a), the undersecured lender holds a secured claim equal to the value of the real estate and an unsecured claim for the balance. 11 U.S.C. § 506(a) (1993). The lender's unsecured deficiency claim in these cases is typically huge by comparison to the total of the trade claims. Thus, if the lender's deficiency claim is classified together with the trade claims, there will be no accepting impaired class, as required by § 1129(a)(10), if the lender votes its secured and unsecured claims against the plan. See *id.* § 1126(c) (stating that a class of claims accepts a plan if at least one-half in number and more than two-thirds in amount of the claims in the class vote in favor of the plan). The debtor, therefore, must separately classify the deficiency and trade claims if it is to have any chance of confirming a plan.

unanimous in the view that the classification statute<sup>11</sup> prohibits classification schemes motivated solely by the need to secure an assenting impaired class,<sup>12</sup> they cannot agree on a test for determining when separate classification of similar claims is permissible.<sup>13</sup>

The Commission's test would allow separate classification of similar claims if the plan proposes to treat the separate classes differently and the disparate treatment is supported by a "rational business justification."<sup>14</sup> While adoption of this test would impose a uniform rule, that rule would do very little to resolve the essential problem of distinguishing between legitimate classification schemes and those designed merely to create the assenting impaired class required by § 1129(a)(10). Moreover, the Commission proposal collapses two distinct concepts: classification of individual claims and unfair discrimination among classes of claims. In providing that separate classification of similar claims depends on a business justification for treating the separate classes differently, the proposed test actually addresses discriminatory treatment of classes of similar claims—an issue properly governed by the cramdown prohibition against unfair discrimination.<sup>15</sup>

This Article concludes with an alternative proposal for amending §§ 1122 and 1129(b) and resolving the muddled state of the current case law. The proposal is simple: similar claims may be separately classified under § 1122 only if treated differently. If one of the classes votes to reject the plan, a second and distinct question is raised whether the discrimination is permissible under the cramdown prohibition against unfair discrimination. This proposal obviates the need for any inquiry into a plan proponent's motivation for a proposed classification scheme and properly assigns the discrimination question to the cramdown provision of § 1129. Finally, the cramdown prohibition against unfair discrimination should be clarified to permit disparate treatment of similar claims only when necessary to the continued operation of the business.

## I. THE UNDERLYING PURPOSE OF CLASSIFICATION

The first question of classification is why claims must be classified at all. There are two plausible rationales.<sup>16</sup> As discussed in Part IV. B. below, the core flaw in the Commission's recommendation is that it is not clearly based on either of these rationales.

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11. *Id.* § 1122:

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

12. *See, e.g.*, cases cited *infra* notes 42-51.

13. *See, e.g.*, cases cited *infra* notes 42-51.

14. NBRC Report, *supra* note 5, at 457.

15. *See* 11 U.S.C. § 1129(b)(1) (1997). To illustrate, assume a plan that assigns unsecured bank and trade claims to different classes and treats the two classes differently. Under the Commission's classification test, the propriety of the classification scheme would depend on the existence of a rational business justification for the disparate treatment of the claims in the two classes. Yet, § 1129(b)(1) addresses differential treatment of separate classes of similar claims in its prohibition against unfair discrimination. *See id.*

16. *See* Norberg, *supra* note 3, at 122-25.

One possible explanation is that Chapter 11 requires classification of claims so that distinct creditor interests are fairly represented in the balloting on a plan. In this view, the majority of claims within a class should not be able to outvote a minority in the same class if they represent different stakes in the reorganization. Thus, a plan must place secured claims, unsecured claims, and equity security interests in different classes because they represent different interests in the case. Moreover, the indirect interests<sup>17</sup> of creditors are a basis for further dividing similar claims among several classes so that distinct constituencies can be fairly represented in the voting.

Under this representative theory of classification, the treatment of claims is not the sole basis for classification. While different treatment manifestly indicates a different stake in the reorganization and thus requires separate classification,<sup>18</sup> similar claims could be separately classified, even though treated identically, if the separately classified claims represent distinct interests in the case. The only limitation on separate classification of similar claims is that all of the creditors with common indirect interests be classified together; a plan proponent could not select one or several claims to place in a separate class for the sole purpose of complying with § 1129(a)(10).<sup>19</sup>

To illustrate, employees' unsecured claims might be classified separately from lenders' unsecured claims because the employees have a special interest in the continued operation of the business, regardless of the proposed treatment of each group of claims. Otherwise, the employees, by virtue of the size or numerosity of their claims, might dictate the outcome of the vote of the unsecured creditors' class although the other unsecured creditors have no interest in the employees' continued employment. Similarly, a plan could separately classify unsecured trade claims and unsecured bank claims if the trade creditors could not afford to wait as long for payment. The creditors' different interests in the case, apart from the legal priority of their claims, would support separate classification. The plan proponent could not separately classify less than all of the employee, trade, or bank claims for the purpose of satisfying § 1129(a)(10).

A second possible rationale for the classification rules is that they are necessary to enforce the absolute priority rule and the prohibition against unfair discrimination.<sup>20</sup> In this view, the Code requires separate classes for secured claims, unsecured claims, and equity security interests because they represent different state law rights with respect to the debtor's assets and different priorities with

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17. The "interests" of a claim holder include (1) its right to payment on its claim, which is defined by the legal nature of the claim, and (2) any other, "indirect" interests. For example, an unsecured creditor, in addition to its right to payment of its claim from unencumbered assets, may have an interest in continuing to do business with the debtor or may also hold a secured claim, employment relationship, or equity interest in the debtor.

18. See 11 U.S.C. § 1123(a)(4) (1997) ("[A] plan shall – provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.").

19. Cf. cases cited *infra* notes 42-51.

20. See 11 U.S.C. § 1129(b) (1997). I sometimes refer to the absolute priority and unfair discrimination rules as the "cramdown protections." The absolute priority rule states that no junior class of claims or interests may receive any distribution under a plan unless all senior classes consent or are paid in full. See *id.* § 1129(b)(2)(B), (C).

respect to each other. If the Code did not require separate classification of dissimilar claims,<sup>21</sup> a majority of claimholders might vote to deprive the minority of their rights in violation of the cramdown protections. This more restrictive rationale for classification focuses on the nature and treatment of claims and ignores the indirect interests of the claimholders. Under this view, the classification rules simply implement the main purpose of voting in Chapter 11, which is to allocate the going concern surplus of the business among the classes of creditors. While the best interests test for confirmation of a plan mandates that each creditor receive at least as much under the plan as it would in liquidation,<sup>22</sup> voting by the various classes determines how the value in excess of the liquidation value will be distributed among the classes. By voting in favor of a plan, a class waives its cramdown rights under the absolute priority and unfair discrimination rules,<sup>23</sup> perhaps agreeing to cede some of its entitlement to a junior class in order to obtain more than it would in liquidation. Conversely, a class retains the cramdown protections by voting against the plan, thereby insisting upon treatment in accord with the legal priority of their claims at the risk of obtaining only the liquidation value of their rights.<sup>24</sup> This rationale for classification allows separate classification of similar claims only when all classes of similar claims approve the plan or the differential treatment of the classes is not unfairly discriminatory.<sup>25</sup>

## II. THE CURRENT LAW

### *A. Section 1122 and the Classification Controversy*

Section 1122 of the Bankruptcy Code states that only substantially similar claims may be placed in a single class.<sup>26</sup> It does not expressly address whether similar claims may be divided into several classes.<sup>27</sup> There is little question, however, that § 1122 permits separate classification of similar claims. It does not expressly forbid such classification.<sup>28</sup> Further, § 1129(b)(1), which prohibits unfair discrimination in the treatment of a dissenting class, plainly envisions discrimination among, and thus separate classification of, similar claims.<sup>29</sup>

By the same token, the Code is clear that the discretion to place similar claims in different classes is not unbridled and that a plan ordinarily must classify claims based on the nature of the claims. As an exception to the § 1122(a) bar against placing dissimilar claims in a single class, § 1122(b) authorizes separate classification of smaller unsecured claims when reasonable and necessary for

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21. *See id.* § 1122(a) (quoted *supra* note 11).

22. *Id.* § 1129(a)(7).

23. *See id.* § 1129(a)(8), (b).

24. *Id.*

25. *Id.*

26. *Id.* § 1122 (quoted *supra* note 11).

27. *See id.*

28. *See id.*

29. *See id.* § 1129(b)(1). *See also id.* § 1322(b)(1), which makes § 1122 applicable to classification of claims in Chapter 13 and specifically authorizes multiple classes of unsecured claims, provided that the plan does not unfairly discriminate against any such class.

administrative convenience.<sup>30</sup> This exception would be redundant if § 1122(a) did not contemplate that unsecured claims normally will be classified together.<sup>31</sup> Further, § 1129(a)(10), which requires an assenting impaired class for confirmation of a plan,<sup>32</sup> implies that § 1122 is not wholly permissive with respect to separate classification of similar claims. Otherwise, the requirement could be readily circumvented by manufacturing a class composed of even a single creditor that would accept the plan. Finally, Congress arguably enacted § 1111(b), which grants recourse status to the deficiency portion of an undersecured nonrecourse claim in Chapter 11,<sup>33</sup> to give such claims the right to dominate the vote of a class comprised of all unsecured claims if the size of the deficiency permits.<sup>34</sup> This right will be denied if an unsecured deficiency claim comprising one-third or more of the total unsecured claims may be placed in its own class.<sup>35</sup>

In sum, Chapter 11 both permits separate classification of similar claims and envisions that similar claims generally will be placed in one class.<sup>36</sup> The classification debate in the courts<sup>37</sup> and the law reviews<sup>38</sup> concerns when separate classification of similar claims is permissible.

### *B. The Confused and Inconsistent Case Law*

Seven of the circuits have considered separate classification of similar claims in Chapter 11 at least once. They agree only on the vaguely-defined principle that § 1122 does not permit classification schemes designed solely to engineer

30. *Id.* § 1122(b).

31. *See id.* § 1122(a), (b) (quoted *supra* note 11); Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (*In re Greystone III Joint Venture*), 995 F.2d 1274, 1278-79 (5th Cir. 1991), *cert. denied*, 506 U.S. 821 (1992).

32. 11 U.S.C. § 1129(a)(10) (1997) (quoted *supra* note 9).

33. *Id.* § 1111(b).

34. *See, e.g., Greystone*, 995 F.2d at 1279.

35. A class of claims is deemed to accept a plan if more than one-half in number and more than two-thirds in amount of the claims in the class vote to accept the plan. 11 U.S.C. § 1126(c) (1997).

36. *Compare* Granada Wines, Inc. v. New England Teamsters Trucking Indus. Pension Fund, 748 F.2d 42 (1st Cir. 1984), where the court stated in dictum that all similar claims must be classified together. The court actually held only that the proposed discriminatory treatment of similar claims was not justified. *See id.* at 47.

37. *See, e.g.,* cases cited *infra* notes 42-51.

38. *See* Norberg, *supra* note 3; *see also* John C. Anderson, *Classification of Claims and Interests in Reorganization Cases Under the New Bankruptcy Code*, 58 AM. BANKR. L.J. 99 (1984); William Blair, *Classification of Unsecured Claims in Chapter 11 Reorganization*, 58 AM. BANKR. L.J. 197 (1984); David Gray Carlson, *The Classification Veto in Single-Asset Cases Under Bankruptcy Code Section 1129(a)(10)*, 44 S.C. L. REV. 565 (1993); Henry J. Friendly, *Some Comments on the Corporate Reorganizations Act*, 48 HARV. L. REV. 39, 70-74 (1934); Thomas C. Given & Linda J. Philipps, *Equality in the Eye of the Beholder - Classification of Claims and Interests in Chapter 11 Reorganizations*, 43 OHIO ST. L.J. 735 (1982); Gregory K. Jones, *The Classification and Cram Down Controversy in Single Asset Bankruptcy Cases: A Need for the Repeal of Bankruptcy Code Section 1129(a)(10)*, 42 UCLA L. REV. 623 (1994); Jeffrey C. Krause, *The Bias of the Courts Against Single-Asset Real Estate Cases in Creating Bad Law in the Area of Classification*, 22 CAL. BANKR. J. 47 (1994); Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEV. J. 1 (1995); Peter E. Meltzer, *Disenfranchising the Dissenting Creditor Through Artificial Classification or Artificial Impairment*, 66 AM. BANKR. L.J. 281 (1992); Stefan A. Riesenfeld, *Classification of Claims and Interests in Chapter 11 and 13 Cases*, 75 CAL. L. REV. 391 (1987); Louis S. Robin, *Classification of Claims: An Examination of Disregarded Legislative History*, 98 COM. L.J. 225 (1993); Linda J. Rusch, *Single Asset Cases and Chapter 11: The Classification Quandry*, 1 AM. BANKR. INST. L. REV. 43 (1993); Linda J. Rusch, *Gerrymandering the Classification Issue in Chapter 11 Reorganizations*, 63 U. COLO. L. REV. 163 (1992); Charles F. Vihon, *Classification of Unsecured Claims: Squaring a Circle?*, 55 AM. BANKR. L.J. 143 (1981); Howard M. Neuger, Comment, *The Authority of a Debtor to Place Substantially Similar Claims into Separate Classes in Order to Cram Down a Reorganization Plan: Should a Bright Line Rule Requiring All Substantially Similar Claims to be Placed into a Single Class be Adopted?*, 9 BANKR. DEV. J. 567 (1993); Note, *Classification of Claims in Debtor Proceedings*, 49 YALE L.J. 881 (1940); Note, *Equity Power of Bankruptcy Courts Over Classification and Assignment of Claims*, 50 YALE L.J. 892 (1941).

compliance with § 1129(a)(10). As the Fifth Circuit stated, the "one clear rule" is that "thou shalt not classify similar claims differently in order to gerrymander" compliance with § 1129(a)(10).<sup>39</sup>

Beyond this point of common ground, the cases diverge. Although not expressly recognized by the courts, the heart of the confusion is whether claimholders' indirect interests<sup>40</sup> are relevant to classification--that is, whether the purpose of classifying claims is to (1) ensure that distinct creditor interests are fairly represented in balloting on a plan or (2) enforce the cramdown protections. If the classification rules serve a representative function, then creditors' indirect interests must be considered when classifying their claims. Under this theory of classification, holders of similar claims with divergent stakes in the reorganization should be placed in their own class. If the rationale for classifying claims is simply that classification is a necessary prerequisite to enforcing the absolute priority and unfair discrimination rules, only the nature of the claims, and not the indirect interests of the claimholders, is relevant to the classification inquiry.<sup>41</sup>

The Second,<sup>42</sup> Third,<sup>43</sup> Fourth,<sup>44</sup> Fifth,<sup>45</sup> Eighth,<sup>46</sup> and Ninth<sup>47</sup> Circuits have taken a restrictive approach, holding that similar claims may be classified sepa-

39. *Greystone*, 995 F.2d at 1279. See also cases cited *infra* notes 42-51.

40. See *supra* note 17 (explaining "indirect interests").

41. See *supra* notes 16-25 and accompanying text (discussing the underlying purpose for classifying claims).

42. *Boston Post Road Ltd. Partnership v. Federal Deposit Ins. Corp.* (*In re Boston Post Road Ltd. Partnership*), 21 F.3d 477 (2d Cir. 1994), *cert. denied*, 513 U.S. 1109 (1995) (disapproving separate classification and preferred treatment of trade claims when the preferred treatment was not necessary to continuing the business).

43. *John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs.* (*In re Route 37 Bus. Park Assocs.*), 987 F.2d 154 (3d Cir. 1993). In that case, the court disapproved the debtor's plan to separately classify trade claims and the deficiency claim, specifically rejecting the debtor's explanation that the lender's interests, as an unsecured creditor, were distinct from the interests of other unsecured creditors because the lender would vote its unsecured claim to protect its secured claim. *Id.* at 161. The court suggested, however, that a "sufficiently distinct and weighty" class of similar claims might merit separate classification because invoking the cramdown provision would then be appropriate. *Id.*

44. *Travelers Ins. Co. v. Bryson Properties XVIII* (*In re Bryson Properties XVIII*), 961 F.2d 496 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992) (holding that business reasons did not justify separate classification with identical treatment of unsecured trade and deficiency claims).

45. *Greystone*, 995 F.2d 1274. The court held that business reasons did not justify separate classification with identical treatment of unsecured trade and deficiency claims. The court explained that the debtor's purported business justification

[f]ail[ed] to distinguish between the *classification* of claims and the *treatment* of claims. [The debtor's] justification for separate classification of the trade claims might be valid if the trade creditors were to receive different treatment from [the undersecured creditor] . . . . Because there is no separate treatment of the trade creditors in this case, we reject [the debtor's] "realities of business" argument.

*Id.* at 1280.

46. *Lumber Exch. Bldg. Ltd. Partnership v. Mutual Life Ins. Co.* (*In re Lumber Exch. Bldg. Ltd. Partnership*), 968 F.2d 647 (8th Cir. 1992) (disapproving separate classification of trade and deficiency claims when the plan proposed to pay the trade claims less than the deficiency claim on the irrational explanation that preferring trade claims was necessary to continuing the business).

47. *Barakat v. Life Ins. Co. of Va.*, 99 F.3d 1520 (9th Cir. 1996) (holding bankruptcy court did not err in finding that separate classification of deficiency claim, unsecured trade claims of creditors continuing to do business with the debtor, and other general unsecured claims was improper when thousands of other companies could supply the same goods and services and thus, none of the creditors was essential to the continued operation of the business). *Accord* *Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. Partnership* (*In re Ambanc La Mesa Ltd. Partnership*), 115 F.3d 650 (9th Cir. 1997). See also *Oxford Life Ins. Co. v. Tucson Self-Storage, Inc.* (*In re Tucson Self-Storage, Inc.*), 166 B.R. 892, 898 (Bankr. 9th Cir. 1994) ("The plan, as amended, treats the deficiency claims in the exact same manner (10% distribution). Thus, the separate classification . . . is an impermissible classification made for the sole purpose of gerrymandering an affirmative vote of an impaired class.").

ately only if treated differently and stating that different treatment must serve a legitimate *business* purpose other than creating an assenting impaired class. Although this approach implies that classification depends on the nature and treatment of claims, without regard to the indirect interests of the claimholders,<sup>48</sup> the courts in these cases did not expressly disapprove consideration of claimholders' indirect interests. Rather, the courts focused on the plan proponent's motivation for the classification scheme, forbidding separate classification when motivated solely by the proponent's desire to comply with § 1129(a)(10).

In contrast to the restrictive approach, the Sixth Circuit has relied upon the indirect interests of claimholders. In *Teamsters National Freight Industry Negotiating Committee v. United States Truck Co. (In re United States Truck Co.)*,<sup>49</sup> the court did not require a business justification relating to the feasibility of the business for the debtor's proposal to allocate unsecured claims among several classes. Rather, it permitted separate classification based on the claimholders' variant non-creditor stakes in the reorganization. While professing that a classification scheme would be improper if motivated solely by the need to satisfy § 1129(a)(10), the court approved separate classification with identical treatment of similar claims.<sup>50</sup> Interestingly, several of the circuits that have purported to follow the restrictive approach have also issued opinions which appear to take the more liberal view espoused by the Sixth Circuit.<sup>51</sup> In short, there is widespread confusion and inconsistency among the courts interpreting § 1122.

### III. THE COMMISSION'S RECOMMENDATION

In response to the muddled state of the case law interpreting the current statute, the National Bankruptcy Review Commission recommended that "[s]ection 1122 should be amended to provide that a plan proponent may classify

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48. A debtor's business need to favor one class over another class of similar claims would exist regardless of the creditors' indirect interests. Consider, for example, a debtor that needs a particular service in order to continue in business. Assume that there is only one available vendor of the service and that the vendor is a prepetition creditor who insists on more favorable treatment as a condition to continuing to do business with the debtor. In this situation, the debtor's business necessity exists without regard to any special, indirect interest of the creditor in the reorganization.

49. 800 F.2d 581 (6th Cir. 1986).

50. *Id.* (stating the union committee's "unique, non-creditor" interest in the reorganization justified separate classification of its claim from other unsecured claims); *accord* *Bustop Shelters of Louisville, Inc. v. Classic Homes, Inc.*, 914 F.2d 810, 813 (6th Cir. 1990) (affirming as not clearly erroneous the lower court's order disapproving separate classification of similar claims on the ground that the only purpose was voting manipulation).

51. In *Heartland Fed. Sav. & Loan Ass'n v. Briscoe Enter. Ltd., II (In re Briscoe Enter. Ltd., II)*, 994 F.2d 1160 (5th Cir. 1993), *cert. denied*, 510 U.S. 992 (1993), the Fifth Circuit approved the debtor's plan designating three classes of unsecured creditors receiving identical treatment. The debtor's plan in that single asset case designated separate classes for (1) unsecured trade claims; (2) the unsecured claim of the undersecured first priority mortgage holder; and (3) the unsecured claim of the second priority mortgage holder (the City of Fort Worth). *Id.* at 1163. The court, although citing *Greystone* for the proposition that separate classification of similar claims must serve a business purpose, reasoned that the city, which provided \$20,000 per month of rental assistance to tenants of the project, held "interests . . . distinct from other unsecured claimholders." *Id.* at 1167.

In *Hanson v. First Bank*, 828 F.2d 1310 (8th Cir. 1987), the Eighth Circuit affirmed the bankruptcy court's order denying separate classification of unsecured trade and deficiency claims. The court explained that "the interests of [the] trade creditors are not sufficiently 'unique,'" thereby implying that, in some cases, the indirect interests of claim holders may be sufficiently distinct to merit separate classification. *Id.* at 1313.

In *Steelcase, Inc. v. Johnston (In re Johnston)*, 21 F.3d 323, 328 (9th Cir. 1994), the Ninth Circuit held that the bankruptcy court was not clearly erroneous in its conclusion that separate classification of a creditor's unsecured claim was warranted when that creditor held a security interest in assets of a third party, the creditor's claim was disputed, and the claim would be paid upon resolution of the dispute and the other unsecured claims would be paid over time.



legally similar claims separately if, upon objection, the proponent can demonstrate that the classification is supported by a 'rational business justification'.<sup>52</sup> The Commission report does not offer specific statutory language for an amended § 1122, nor does it define "rational business justification."

The report explains that the proposed test would permit separate classification of similar claims when the proponent could show a business reason for treating the separate classes differently. Thus, the report states, similar claims could not be separately classified unless treated differently, and a classification scheme would not pass muster if the plan treated two classes of similar claims differently without a valid business reason.<sup>53</sup> Importantly, the report declares that "[t]he test requires business justification, not business necessity,"<sup>54</sup> and that the issue is one of fact.<sup>55</sup> The report argues that the test would prohibit a debtor from separately classifying claims for the sole purpose of procuring an accepting impaired class for § 1129(a)(10) purposes<sup>56</sup> and that it "will bring predictability to this unsettled area of the law."<sup>57</sup> It also observes that the cramdown protection against unfair discrimination is an additional constraint on a plan proponent's ability to separately classify and disparately treat similar claims,<sup>58</sup> but does not explain how these two requirements fit together.

#### IV. ANALYSIS OF THE COMMISSION RECOMMENDATION

##### *A. The Commission Proposal Perpetuates the Problems of the Current Statute*

The principal virtue of the Commission recommendation is that it offers a uniform test: similar claims may be classified separately if a rational business justification supports different treatment of the several classes; classification schemes designed to obtain an assenting impaired class are improper.<sup>59</sup> This virtue is, however, more illusion than reality. The proposed test perpetuates the most problematic issue of classification under current law--the criteria for deciding whether a classification scheme is motivated by § 1129(a)(10). At the same

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52. NBRC Report, *supra* note 5, at 457.

53. *Id.* at 569, 578, 581-82.

Under the Commission's recommendation, the Bankruptcy Code would expressly permit a plan proponent to classify legally similar claims (e.g., unsecured bank debt and past-due pension contributions) separately and treat them differently if, upon objection, the proponent could establish it had a legitimate business reason to support the classification . . . . Justification for separate classification would be premised on disparate forms of treatment, such as immediate payment for employees and payment over time for commercial creditors, and the types of permissible distinctions made between classes might include the timing of payment or the form of payment (cash or debt instruments).

*Id.* at 569.

54. *Id.* at 581. In the next breath, the report states that "a court could *not* uphold a classification scheme . . . in the absence of persuasive evidence that the differential treatment is justified by the business needs." *Id.* The rest of the report makes clear, however, that the Commission is recommending a more liberal, business justification standard. The importance of this distinction is discussed *infra* notes 60-61 and accompanying text.

55. *Id.* at 582.

56. *Id.* at 569, 581, 582.

57. *Id.* at 569, 582.

58. *Id.* at 569-70.

59. *Id.* at 581.

time, it offers plan proponents the ability to disguise schemes designed to fulfill § 1129(a)(10) and provides broad discretion and little guidance to courts deciding the question.

In requiring a business *justification* instead of a business *necessity*, the proposed test gives plan proponents opportunity to contrive rational business reasons for classification schemes that would not have been proposed but for § 1129(a)(10).<sup>60</sup> A stricter business *necessity* test would preclude classification schemes motivated solely by the need for an assenting impaired class. If discriminatory treatment and separate classification of similar claims is *necessary* to continuing the debtor's business, it follows that the plan proponent did not designate the classes simply to fulfill § 1129(a)(10). Conversely, when a plan proposes unnecessary, but arguably rational, disparate treatment of similar claims, the question of motivation becomes quite murky. Moreover, the Commission report suggests that claimholders' indirect interests are relevant to classification,<sup>61</sup> compounding the possibilities for concocting justifications for a classification scheme.

The Commission report includes several examples of its proposed rational business justification test which illustrate this potential for abuse. One example posits a debtor's plan with two classes of unsecured claims, one comprised of large unsecured bank creditors and the other of small unsecured trade creditors who "cannot afford to wait for repayment and [with whom] the debtor wants to maintain business relations." Both classes of creditors would receive payment of half of their claims, the trade creditors in cash at confirmation and the banks over three years with interest.<sup>62</sup> Another example assumes a creditor group that proposes a plan to acquire the debtor and, in order to maintain business relations with the suppliers that currently do business with the debtor, offers to pay the trade creditors 50% over ninety days while paying unsecured bank creditors 50% over two years with interest.<sup>63</sup>

While the trade creditors in the first example may be unable to afford to wait for repayment, the debtor has no articulated or apparent business need to pay them ahead of a dissenting class of unsecured bank creditors. Similarly, payment to the trade creditors in both illustrations is accelerated in order to maintain business relations with those creditors, but the viability of the debtor's business does not depend on treating the trade creditors differently than the banks. Neither example states that the debtor could not reorganize absent paying its existing trade creditors on the more favorable terms. Indeed, the examples do not explain why a 50% distribution, coincidentally, the same distribution being made to the bank creditors, is sufficient to meet the needs of creditors who cannot afford to wait for payment and with whom the debtor desires to maintain business relations.

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60. In any event, however, and as discussed *infra* notes 67-78 and accompanying text, discriminatory treatment of separate classes of similar claims properly raises a cramdown issue, not a classification issue.

61. See *infra* notes 62-63 and accompanying text (discussing Commission report examples of the rational business justification test).

62. NBRC Report, *supra* note 5, at 581.

63. *Id.*

If the inability of trade creditors to wait for repayment, or the simple desire to continue business relations with them, is a rational business justification regardless of any business necessity of the debtor, only the most blatant instances of gerrymandering will be disapproved. At the very least, there will be a difficult question whenever a plan separately classifies trade claims from other unsecured claims and the trade class is the only assenting impaired class.

Moreover, the above examples demonstrate that the proper classification of claims would not depend solely on the creditors' rights against the property of the estate or the business needs of the debtor. The indirect interests of claimholders--e.g., their inability to wait for payment (although they have probably already waited several years for confirmation of a plan)--would be relevant to the classification question. The relevance of indirect interests opens endless possibilities for plan proponents to disguise classification schemes in fact motivated by § 1129(a)(10).

In sum, the Commission's test presents the same essential question which has preoccupied the courts under the current statute--whether the plan proponent designated multiple classes of similar claims solely to comply with § 1129(a)(10). Yet, the Commission's test would provide little guidance to courts in distinguishing between schemes motivated by the need for an assenting impaired class and those based on a rational business justification. To the contrary, it offers fertile ground for continued litigation. Ironically, the Commission's primary goals of uniformity and predictability would disappear in a haze of fact-specific cases. As questions of fact, classification decisions would be reviewed for abuse of discretion. The circumstances of each case would be determinative, and appellate decisions would have limited precedential value.

### *B. The Commission's Proposal Lacks a Coherent Theoretical Basis*

The root of the trouble with the Commission's recommendation regarding classification is that it does not rest on a coherent rationale for why claims are classified in the first place. It adopts neither the representative nor the cramdown rationale for classification.<sup>64</sup> The Commission report's statement that the rational business justification test prohibits separate classification of similar claims in the absence of differential treatment<sup>65</sup> is a clear rejection of the representative justification for claims classification. If the purpose of classification is to provide separate representation to each interest group in the case, it necessarily follows that similar claims may be classified separately, yet treated identically. At the same time, however, the Commission's test would permit consideration of the claimholders' indirect interests, suggesting that the Commission, in fact, subscribed to the representative view of classification. The particular needs of some creditors for earlier payment, without regard to any business necessity of the debtor, is, in

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64. See *supra* notes 16-25 and accompanying text (discussing these alternative purposes of classification).

65. NBRC Report, *supra* note 5, at 581.

the Commission's view, grounds to separately classify those creditors from other similar claims.<sup>66</sup> The lack of any coherent justification for the Commission's test further frustrates the goals of uniformity and predictability.

*C. The Commission Proposal Conflates Classification and Discrimination*

The Commission test confuses classification of individual claims with discrimination among classes of claims. In providing that separate classification of similar claims depends on a business justification for treating the separate classes differently, the proposed test sets a standard for discriminatory treatment of similar claims. That same issue, however, is properly governed by the cramdown prohibition against unfair discrimination,<sup>67</sup> not the classification rules. This conflation of classification and discrimination standards creates two problems.

First, the issue of unfair discrimination under the cramdown provision arises only when a *class* votes to reject the plan. The court may not confirm a plan over rejection by a class if the plan unfairly discriminates in the treatment of that class by comparison to the treatment of a class of similar claims.<sup>68</sup> In contrast, the Commission's classification test would permit any *single* creditor within an accepting (or rejecting) class to object to a classification scheme on the ground that the proposed discriminatory treatment of similar claims lacks a rational business justification.<sup>69</sup>

The Commission report gives no indication that the Commission recognized that its test would give individual creditors standing to object to discriminatory treatment. Yet, this change would significantly alter the current Code's scheme for allocating the going concern surplus value of a debtor firm by negotiation among classes of claims and equity security interests. Under the present Code, an accepting class waives its rights to protection under the absolute priority and unfair discrimination rules.<sup>70</sup> The vote of a class binds each claim in the class; the majority of claims in a class may override the cramdown rights of any dissenting claims.<sup>71</sup> Conversely, a plan must meet the cramdown requirements with respect to any dissenting class.<sup>72</sup> With respect to any dissenting class that is not paid in full, the plan may neither provide payment to any junior class nor give unfairly preferred treatment to any equal priority class.<sup>73</sup> The voting by classes thereby allocates the going concern surplus of the debtor among the classes. By making different treatment of separate classes of similar claims a matter for indi-

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66. See *supra* notes 62-63 and accompanying text (discussing Commission report examples of the rational business justification test).

67. 11 U.S.C. § 1129(b)(1) (1997).

68. *Id.*

69. An objection to classification arises under § 1129(a)(1), which states that a plan must comply with the provisions of Chapter 11. *Id.* § 1129(a)(1). As such, it may be raised by any individual creditor or party in interest.

70. *Id.* § 1129(a)(8), (b).

71. *Id.* § 1126(c). Unimpaired classes are deemed to accept the plan and thus, may not invoke the cramdown protections. *Id.* § 1126(f).

72. *Id.* § 1129(b).

73. *Id.*

vidual protection, the Commission test would obviate negotiation of the going concern surplus among the classes. A majority's acceptance of a plan would not necessarily bind individual dissenters.

Second, the rational business justification test would further confuse the law regarding unfair discrimination under the cramdown provision because it conflicts with much of the case law interpreting that provision. The business justification test would require only a rational business reason for discriminating among separate classes of similar claims, but many courts have stated that discrimination is not fair if it is not necessary.<sup>74</sup> (Other courts have approved discriminatory treatment of classes of similar claims when there is merely a "reasonable basis" for it.<sup>75</sup>) The Commission's test arguably would implicitly overrule the court decisions that require a business necessity for discrimination among classes of similar claims. On the other hand, a rational business justification test may be pointless in the face of case law requiring a business necessity.<sup>76</sup>

In many cases in which discriminatory treatment of similar claims is reasonable,<sup>77</sup> both classes will vote to accept the plan and there should be no issue regarding discrimination. The Commission report, however, offers no justification for the proposition that discriminatory treatment should be approved over a

74. See generally COLLIER ON BANKRUPTCY, *supra* note 1, ¶ 1129.04[3][a], at 1129-72 ("[t]he test . . . boils down to whether the proposed discrimination has a reasonable basis and is necessary for reorganization").

In *Greystone*, the court held that separate classification and differential treatment of unsecured deficiency and trade claims would not be proper because there was no evidence of a limited market for trade goods and services. 955 F.2d at 1279. In the absence of a demonstrated need to prefer trade claims because the debtor could not replace them, business reasons would not justify separate classification and preferred treatment. *Id.* at 1281. *Accord In re Ambanc La Mesa*, 115 F.3d 650 (9th Cir. 1997); *Barakat*, 99 F.3d at 1526; *Boston Post Rd.*, 21 F.3d at 483; *Lumber Exchg. Bldg.*, 968 F.2d at 649; *In re North Washington Ctr. Ltd. Partnership*, 165 B.R. 805 (Bankr. D. Md. 1994).

See also *Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944 (2d Cir. 1993) (approving separate classification and preferred treatment of lease claims guaranteed by banks when debtor entered post-petition financing agreement with banks promising to indemnify banks on lease guarantees); *In re AG Consultants Grain Div., Inc.*, 77 B.R. 665, 670, 676 (Bankr. N.D. Ind. 1987) (approving separate classification and preferred treatment of claims of agricultural producers with whom debtor would continue to do business; plan gave forty-nine percent of the stock of the reorganized debtor to this class to give them a stake in the continued operation of company); *Cf. Tucson Self-Storage*, 166 B.R. at 897-98 (rejecting argument that public policy requires full payment of trade claims); *In re Arn Partnership*, 140 B.R. 5 (Bankr. D.D.C. 1992) (borrowing Chapter 13 test permitting discrimination when reasonable and necessary to continue debtor's business); *In re 11, 111, Inc.*, 117 B.R. 471, 477-78 (Bankr. D. Minn. 1990) (approving separate classification and inferior treatment of insider claims as fair when "they were in a unique position to influence the ongoing financial and business operations of the debtor"); *In re Rochem, Ltd.*, 58 B.R. 641 (Bankr. D.N.J. 1985) (finding that debtor could not carry out a plan without favoring general unsecured claims over a huge tort claim because composite classification would reduce the contributions to almost nothing).

75. See, e.g., *In re 203 North LaSalle St. Ltd. Partnership*, 190 B.R. 567, 585-86 (Bankr. N.D. Ill. 1995), *aff'd*, 195 B.R. 692 (N.D. Ill. 1996), *aff'd*, 126 F.3d 955 (7th Cir.), *cert. granted*, 118 S. Ct. 1674 (1998); *In re Brown*, 152 B.R. 232, 235-37 (Bankr. N.D. Ill. 1992), *rev'd on other grounds*, *McCullough v. Brown*, 162 B.R. 506 (N.D. Ill. 1993); *In re 222 Liberty Assocs.*, 108 B.R. 971, 991-92 (Bankr. E.D. Pa. 1990); *In re Furlow*, 70 B.R. 973, 977-78 (Bankr. E.D. Pa. 1987).

76. The statement in the Commission's report that the unfair discrimination standard is additional protection for dissenting classes tends to rebut this conclusion, however. NBRC Report, *supra* note 5, at 569-70.

77. See, e.g., the examples used by the Commission to illustrate its rational business justification test, discussed *supra* notes 62-63 and accompanying text.

dissenting class' rejection of the plan when the discrimination is "reasonable," but unnecessary to the viability of the reorganized business.<sup>78</sup>

#### V. A PROPOSED ALTERNATIVE TO THE COMMISSION RECOMMENDATION

Section 1129(a)(10) underlies most classification disputes. In the absence of § 1129(a)(10), plan proponents would have no incentive to place similar claims in separate classes without a business necessity. The division of similar claims among multiple classes only increases the likelihood of one of the classes rejecting the plan. If not for § 1129(a)(10), the only classification issue would be the one expressly addressed by the Code, inclusion of dissimilar claims in one class.<sup>79</sup>

One obvious solution to the classification problems under the present Code, then, would be to repeal § 1129(a)(10). In fact, the Commission's working group on Chapter 11 issues voted to recommend repeal of § 1129(a)(10).<sup>80</sup> The full Commission, however, voted five to four against this recommendation.<sup>81</sup>

I have argued elsewhere that § 1129(a)(10) plays a critical role in Chapter 11's confirmation scheme to the extent that it mandates approval of a plan by a class of "residual owners."<sup>82</sup> In the normal non-bankruptcy operation of a corporation, shareholders exercise ultimate authority over the business through their right to vote on the election of directors and fundamental corporate changes. As residual owners, shareholders of a solvent firm have the appropriate incentives to maximize the value of the business. They hold both the potential for gain and the risk of loss from their decisions. In Chapter 11, the state law corporate voting regime is displaced by a voting system that is designed primarily to allocate the value of the firm among the various claim and equity security interest holders. Section 1129(a)(10) may be seen, however, as an (imperfect) attempt to require approval of a plan by a class of residual owners who, like shareholders in solvent corporations outside of bankruptcy, hold the appropriate incentives to maximize the value of the business.<sup>83</sup>

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78. There is no authority for departing from the absolute priority rule over the dissent of a junior class when the departure is "reasonable," but not necessary. The new value exception, or corollary, to the absolute priority rule provides that a plan may be confirmed over rejection by a class of claims, even though a junior class receives or retains property under the plan, when the junior class contributes value to the reorganization which is new, substantial, money or money's worth, *necessary*, and equivalent to the interest received or retained. See, e.g., *U.S. Bancorp Mortgage Co. v. Bonner Mall Ltd. Partnership (In re Bonner Mall Ltd. Partnership)*, 2 F.3d 899 (9th Cir. 1993), *cert. granted*, 510 U.S. 1039 (1994), *motion to vacate denied and case dismissed by* 513 U.S. 18 (1994); *Case v. Los Angeles Lumber Prod. Co.*, 308 U.S. 106 (1939).

79. See 11 U.S.C. § 1122(a) (1997) (quoted *supra* note 11).

80. NBRC Report, *supra* note 5, at 588. Several commentators have likewise called for repeal of § 1129(a)(10). See, e.g., REFORMING THE BANKRUPTCY CODE: THE NATIONAL BANKRUPTCY CONFERENCE'S CODE REVIEW PROJECT, 276-77 (1994); Randolph J. Haines, *Elimination of the Need for an Accepting Impaired Class*, 1995-96 ANN. SURV. BANKR. L. 203, 204; Kenneth N. Klee, *Adjusting Chapter 11: Fine Tuning the Plan Process*, 69 AM. BANKR. L.J. 551, 568 (1995). But see Scott F. Norberg, *Debtor Incentives, Agency Costs and Voting Theory in Chapter 11*, 46 U. KAN. L. REV. 507 (1998).

81. NBRC Report, *supra* note 5, at 588.

82. Norberg, *supra* note 80, at 134. The term "residual owners" refers to those claim or equity interest holders with the right to the balance of the income and assets of a firm after full payment of senior claims. When a firm is insolvent, the residual owners are the class or classes of creditors that will receive some, but not full, payment on their claims after full payment of any senior classes. See generally Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 106-09 (1984).

83. Norberg, *supra* note 80, at 545-47.

Assuming that § 1129(a)(10) continues as a requirement for confirmation, Chapter 11 should permit separate classification of similar claims only if the proposed scheme is not designed solely or primarily to satisfy § 1129(a)(10). Otherwise, plan proponents may easily defeat the purpose of the requirement. The following two-part proposal would achieve this goal while, at the same time, reducing litigation over the plan proponent's motivation for proposing a particular classification scheme.

First, the classification statute should provide that similar claims may be classified separately only if the plan stipulates different treatment for the separate classes. As under the Commission recommendation, the statute should prohibit separate classification with identical treatment of similar claims because such schemes serve no purpose other than to contrive an assenting impaired class. Under my approach, classification depends on the nature and treatment of claims, and the plan proponent's motives are irrelevant.

Second, a plan that separately classifies similar claims raises a separate and distinct issue if one of these classes votes to reject the plan: whether the discrimination is unfair under the cramdown provision. Pursuant to the test applied by many courts, the plan proponent must show that the discrimination is necessary to survival of the business. Such a standard would preclude classification schemes designed primarily to satisfy § 1129(a)(10). Because the unfair discrimination decisions are not consistent, § 1129(b) (not § 1122) should be clarified to provide that disparate treatment of similar claims must be necessary to the continued operation of the business, at least in those cases when the accepting class is the only assenting impaired class.

A plan proponent motivated by § 1129(a)(10) might attempt to evade this proposed rule by submitting a plan to treat the rejecting class more favorably than the accepting class of similar claims.<sup>84</sup> The prohibition against unfair discrimination plainly protects a dissenting class which the plan proposes to treat less favorably than a class of similar claims. Likewise, when a plan provides comparable, but not identical, treatment for similar claims, the unfair discrimination rule protects the dissenting class by requiring a business necessity for the discrimination. The focus in each instance is on how the discrimination affects the dissenting class because the pertinent statutory language states that a plan may "not discriminate unfairly . . . with respect to each class . . . that is impaired under, and has not accepted, the plan."<sup>85</sup>

In some cases, the preferred class will reject the plan while a less favorably treated class of similar claims votes to accept it.<sup>86</sup> Under such a plan, separate classification is based on divergent treatment; accordingly, the classification

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84. See, e.g., *Lumber Exch. Bldg. Ltd. Partnership v. Mutual Life Ins. Co.* (*In re Building Exch. Ltd. Partnership*), 968 F.2d. 647 (8th Cir. 1992); *John Hancock Mut. Life Ins. Co. v. Roswell-Hannover Joint Venture* (*In re Roswell-Hannover Joint Venture*), 149 B.R. 1014 (Bankr. N.D. Ga. 1992).

85. 11 U.S.C. § 1129(b)(1) (1997).

86. In the single asset cases, for instance, the trade class may be expected to vote for the plan, notwithstanding inferior treatment, anticipating that the general partners of the debtor will pay the trade creditors' recourse claims outside of the case. Cf. 11 U.S.C. § 723 (1997).

scheme would be permissible under my proposed test, so long as the plan does not discriminate unfairly with respect to the rejecting impaired class. Applying a literal reading of § 1129(b)(1), the preferred treatment is hardly unfair with respect to the rejecting preferred class in the sense that the dissenting class will receive less than a class of similar claims.

When a more favorably treated class of similar claims rejects the plan, the plan does not represent a negotiated allocation of the going concern value of the firm, and the preferred treatment of the dissenting class is unnecessary to the survival of the business. Because the discrimination advances no business objective, the plan should fail because it is not proposed in good faith,<sup>87</sup> it is not fair and equitable,<sup>88</sup> or, applying a less literal interpretation of § 1129(b)(1), it unfairly discriminates among similar claims by disenfranchising the more favorably treated class of its right to preclude acceptance of the plan by an impaired class.<sup>89</sup>

## VI. CONCLUSION

Instead of bringing certainty to the muddled state of the law on classifying claims in Chapter 11, the Commission recommendation would complicate it. The Commission's proposal would perpetuate the essential problem under the current statute by (1) focusing on whether the plan proponent intended to contrive compliance with § 1129(a)(10); (2) permitting separate classification of similar claims based on a "business justification" instead of business necessity; and (3) allowing consideration of claimholders' indirect interests. Moreover, the Commission's test conflates classification of claims with discrimination among classes of claims and conflicts with existing case law applying the cramdown prohibition against unfair discrimination.

As an alternative to the Commission proposal, this Article argues for a simple rule whereby classification turns exclusively on the nature and treatment of claims: similar claims must be classified separately if treated differently. If similar claims are treated differently (and therefore placed in separate classes) and one of these classes votes to reject the plan, the issue should be addressed as an unfair discrimination issue under the cramdown rule. The cramdown provision should be amended to clarify that discriminatory treatment is fair only if it is necessary to the feasibility of the business.

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87. *Id.* § 1129(a)(3) (1994); see, e.g., *In re Madison Hotel Assocs.*, 749 F.2d 410, 424-25 (7th Cir. 1984) (holding that plan must be consistent with the objectives and purpose of the Code).

88. 11 U.S.C. § 1129(b)(1) (1994).

89. In *Lumber Exchange* and *John Hancock Mut. Life Ins.*, the courts sustained objections by creditors receiving more favorable treatment than another class of similar claims. The courts disapproved the classification schemes, reasoning that the debtors' purpose was solely to obtain an accepting impaired class. *Lumber Exchange*, 968 F.2d at 649; *John Hancock Mut. Life Ins.*, 149 B.R. at 1021; accord *In re Bloomingdale Partners*, 170 B.R. 984, 998 (Bankr. N.D. Ill. 1994). The result in these cases is undoubtedly correct, but their reasoning is flawed. The issue is not classification *per se*, but unfair discrimination.



