

Plan Not In “Good Faith” When Impairment of Class’s Interests Is Contrived

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Under the Bankruptcy Code, a reorganization plan may be approved if (1) proposed in “good faith” under § 1129(a)(3), and (2) accepted by at least one class of creditors whose interests are impaired by the plan, see 11 U.S.C. § 1129(a)(10). In [Village Green I, GP v. Fed. Nat’l Mortgage Assoc.](#), the Sixth Circuit affirmed the district court’s reversal of a bankruptcy court’s plan approval, holding that a reorganization plan is not proposed in good faith when it impairs a particular class’s claims “transparently [as] an artifice” to fulfill the second requirement.

In *Village Green*, the debtor owed \$8.6 million on a mortgage to a single lender, and \$2400 to its attorney and accountant (“minor” claimants). The debtor proposed a reorganization plan that unquestionably impaired the first creditor’s very large interest, specifying a slow pace of repayment and removing protections from the loan agreement. The plan also provided that the minor claims would be paid over 60 days in two equal payments. The lender rejected the plan, while the attorney and accountant (constituting a “class” by themselves) accepted the plan. The Sixth Circuit rejected the lender’s argument that the minor claimants’ interests were not truly “impaired” by the 60-day delay in payment, choosing instead to read Section 1129(a)(10) literally to include any impairment, no matter how minor. However, the court pointed out that there was no rational economic justification for the 60-day delay in paying the minor claimants and that the minor claimants were “closely allied with” the debtor, indicating that the impairment of their interests was not proposed in good faith, but solely to secure approval of the plan as a whole.

Debtors should take note: the Sixth Circuit reading of “impairment” might be generous, but the court is ready and willing to use the “good faith” requirement to weed out reorganization plans that rely on token impairments to “circumvent[] the purposes of § 1129(a)(10).”

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