

## **Chapter 11 Plan Feasibility for Nonprofit Debtors Requires More Than Successful Fundraising Track Record**

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The enduring impact of the Great Recession on businesses, individuals, municipalities, and even sovereign nations has figured prominently in world headlines during the last three years. Comparatively absent from the lede, however, has been the plight of charitable and other nonprofit entities that depend in large part on the largesse of donors who themselves have been less able or less willing to provide eleemosynary institutions with badly needed sources of capital in the current economic climate.

Nonprofits have sometimes resorted to bankruptcy protection as a form of financial triage, but with mixed results. Nonprofit bankruptcies are relatively rare—in most cases, a financially strapped nonprofit will simply close its doors and file a plan of dissolution with its state regulatory authority. Even so, certain nonprofit bankruptcy cases have achieved notoriety in the last 15 years, including: (i) no fewer than eight of the 194 Catholic archdioceses in the U.S., which filed for bankruptcy as a means of managing sexual abuse litigation exposure; (ii) the National Benevolent Association, a 117-year-old charitable organization that once managed more than 70 facilities financed by the U.S. Department of Housing and Urban Development and owned and operated 18 other facilities, including residential homes for seniors, at-risk children, and the disabled; and (iii) Allegheny Health, Education, and Research Foundation, once the largest nonprofit health-care chain in Pennsylvania, which filed for chapter 11 in 1998 to

liquidate its assets amid allegations (later proved) that management raided more than 350 charitable endowments to prop up the nonprofit's ailing system.

Nonprofits seek bankruptcy protection for a variety of reasons. Regardless of the motive, however, the filings raise important questions regarding the utility of a bankruptcy filing as an effective means of dealing with the woes of nonprofits. Issues unique to nonprofits that may arise in a bankruptcy case can range from something as basic as the company's eligibility to file for bankruptcy to more complex matters concerning which assets are properly included as part of the debtor's bankruptcy estate and whether the debtor's business may be sold in bankruptcy notwithstanding nonbankruptcy regulatory rules making such transactions the exclusive province of the regulatory agency.

Another challenge confronted by nonprofits in chapter 11 cases concerns a workable exit strategy, especially if plan funding depends upon donor contributions. This obstacle was addressed in a ruling recently handed down by the Fifth Circuit Court of Appeals. In *In re Save Our Springs (S.O.S.) Alliance Inc.*, the court affirmed a decision below denying confirmation of a chapter 11 plan, ruling that "voluntary pledges [from donors] alone are too speculative to provide evidence of [plan] feasibility."

### **Chapter 11 Plan-Feasibility Requirement**

Pursuant to section 1129(a)(11) of the Bankruptcy Code, a chapter 11 plan may be confirmed only if "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan." This "feasibility" requirement had its origins in various provisions of the former Bankruptcy Act of

1898, which required that the court find that the plan was “feasible.” As articulated by the Ninth Circuit Court of Appeals in its 1985 ruling in *In the Matter of Pizza of Hawaii, Inc.*, the purpose of subsection 1129(a)(11) is “to avoid confirmation of visionary schemes which promise creditors more under a proposed plan than the debtor can possibly attain after confirmation.”

Consistent with the plain language of the statute, courts have uniformly held that the feasibility requirement does not require a guarantee of the chapter 11 plan’s success, but rather that the plan offer “a reasonable prospect” or “reasonable assurance” of success. However, courts have sometimes varied widely in their determination of how likely success has to be under the circumstances.

The proponent of a chapter 11 plan bears the burden of establishing by a preponderance of the evidence that the plan is feasible. Factors recognized by the courts as relevant to evaluating the feasibility of a proposed plan have included: (i) the prospective earnings or earning power of the debtor’s business, which must be based on sound and reasonable assumptions; (ii) the adequacy of the capital structure and working capital for the debtor’s post-confirmation business; (iii) the debtor’s ability to meet its capital expenditure requirements; (iv) economic conditions; (v) management’s ability and the likelihood that current management will stay in place; and (vi) any other material factors that would affect the successful implementation of the plan.

Courts have an affirmative obligation to evaluate a plan’s likelihood of success and to make a particular finding as to feasibility. Although the court will not conduct its own analysis of the

debtor's prospects for success, the court does play an important gatekeeper role by ensuring that the debtor has undertaken appropriate planning and analysis.

### *S.O.S.*

Save Our Springs (S.O.S.) Alliance ("S.O.S.") is a nonprofit charitable organization that sues municipalities and developers to prevent what it perceives to be irresponsible use of aquifers in the Texas Hill Country. In connection with certain of these lawsuits, attorneys' fees have been awarded against S.O.S., which was forced to seek chapter 11 protection in April 2007 when it could not satisfy the obligations.

S.O.S.'s proposed chapter 11 plan would establish a \$60,000 "creditor fund," consisting of charitable contributions from S.O.S.'s donors, within 60 days of plan confirmation. At the confirmation hearing, S.O.S. maintained that it had already obtained pledges in the amount of \$20,000 and "expressed confidence" that it could raise the balance of the creditor fund through donations within the required 60-day window. However, S.O.S.'s executive director acknowledged that it would be difficult to do so because many of S.O.S.'s donors wanted to prevent their money from being used to pay judgment creditors. The director also acknowledged that it would be "extremely difficult" to take money from S.O.S.'s general operating fund, because "[w]e struggle to meet our monthly overhead every month," and donors had been assured that donations would not go to pay judgment creditors.

Six months after the hotly contested confirmation hearing, the bankruptcy court issued an opinion refusing to confirm the chapter 11 plan. Among other things, the court explained, the

plan was not feasible because S.O.S. had not demonstrated a sufficiently “firm commitment” from its donors to contribute the plan funding. The district court affirmed on appeal.

### **The Fifth Circuit’s Ruling**

The Fifth Circuit affirmed denial of plan confirmation. Among other things, the court of appeals found that S.O.S. had failed to produce evidence of even a reasonable assurance of success.

According to the court:

S.O.S.’s argument fails, because there was no evidence showing even a reasonable assurance of success. S.O.S. points to its past financial statements showing successful fundraising campaigns. But raising funds during bankruptcy is more difficult than at other times. That is particularly true here, given that S.O.S.’s donors are hesitant to give for the purpose of paying off judgment creditors. The bankruptcy court’s conclusion that past donations are not evidence of future fundraising ability is thus appropriate.

The Fifth Circuit also emphasized that “voluntary donations” and “oral pledges” rather than “contracts . . . that commit [the donors] to give money in the future,” without any evidence that the donors would be or were capable of honoring the pledges, are “too speculative to provide evidence of feasibility.”

### **Outlook**

*S.O.S.* is emblematic of the formidable obstacles confronted by nonprofits during the Great Recession and its aftermath. Recent casualties of the still-struggling economy have included a diverse array of nonprofits, including the Southern Nevada Area Health Education Center, a Las Vegas-based nonprofit that provided community programs and education for health-care workers, which shut down after it filed a chapter 7 petition on January 20, 2011, and the 111-year-old Philadelphia Orchestra, which became the first major U.S. orchestra to file for bankruptcy when it sought chapter 11 protection on April 17, 2011. Without a reliable source of funding to fund

ongoing operating expenses or fund a chapter 11 plan, nonprofits may be forced to close their doors and liquidate their operations under state law or in chapter 7. The ruling also demonstrates that, for a nonprofit debtor, the feasibility requirement of section 1129(a)(11) demands something more than evidence of prior successful fundraising campaigns. Absent evidence of less speculative sources of capital, a proven track record of successful fundraising by a nonprofit that finds itself in chapter 11 may be insufficient to demonstrate even a reasonable assurance of plan success.

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*In re Save Our Springs (S.O.S.) Alliance Inc.*, 632 F.3d 168 (5th Cir. 2011).

*In the Matter of Pizza of Hawaii, Inc.*, 761 F.2d 1374 (9th Cir. 1985).