

♪One is The Loneliest  
Number♪<sup>1</sup>: Chapter 11  
Single Asset Real  
Estate Cases

34<sup>th</sup> Annual Judge Alexander Paskay Seminar  
on Bankruptcy Law and Practice  
American Bankruptcy Institute  
Tampa, FL  
March 5, 2010

**Written Materials Prepared By:**  
**Robin E. Phelan, Esq.**  
**Hope E. Hughes, Esq.**  
**Haynes and Boone, LLP**  
**2323 Victory Avenue, Suite 700**  
**Dallas, Texas 75219**

---

<sup>1</sup> Three Dog Night

# SINGLE ASSET REAL ESTATE CASES

## TABLE OF CONTENTS

- I. INTRODUCTION
- II. SECTION 101(51B): THE SARE TEST
  - A. Is the real property a single property or project?
  - B. Does the real property generate substantially all of debtor's gross income?
  - C. Is the debtor conducting a substantial business other than operating the real property?
- III. SECTION 362(d): RELIEF FROM THE AUTOMATIC STAY
  - A. Cause – Lack of Adequate Protection
  - B. Cause – Other Than Adequate Protection
    - 1. Lack of Equity
    - 2. Effective Reorganization
    - 3. Procedure for Obtaining Stay Relief
  - C. § 362(d)(3): Single Asset Real Estate
    - 1. § 362(d)(3)(A): Reasonable Possibility of Being Confirmed Within a Reasonable Time
    - 2. § 362(d)(3)(B): Monthly Payments
    - 3. Bad Faith Dismissals
- IV. CHAPTER 11: Cramdown
  - A. Unfair Discrimination
  - B. Fair and Equitable
    - 1. Secured Creditor Cramdown – 11 U.S.C. § 1129(b)(2)(A)
    - 2. Deferred Cash Payments – U.S.C. § 1129(b)(2)(A)(i); Value of Claim including discount rates and interest rates
    - 3. Figuring the Rate of Return
    - 4. Unsecured Creditor Cramdown – 11 U.S.C. § 1129(b)(2)(B)
    - 5. Interest Holders – U.S.C. § 1129(b)(2)(C)
  - C. Absolute Priority Rule
- V. CREDIT BIDDING
- VI. RECENT CHAPTER 11 CASES

## SINGLE ASSET REAL ESTATE CASES

### TABLE OF AUTHORITIES

#### FEDERAL CASES

*In re 360 Inns, Ltd.*, 76 B.R. 573 (Bankr. N.D. Tex. 1987)

*Ad Hoc Group of Timber Noteholders v. Pac. Lumber Co. (In re Scotia Pac. Co.)*,  
508 F.3d 214 (5th Cir. 2007)

*In re AG Consultants Grain Div., Inc.*, 77 B.R. 665 (Bankr. M.D. Ind. 1987)

*Arnold & Baker Farms v. U.S. (In re Arnold & Baker Farms)* 85 F.3d 1415 (9th Cir. 1996)

*Bank of America National Trust & Savings Association v. 203 North LaSalle St. Partnership*,  
U.S. 434 (1999)

*In re Birdneck Apartment. Assocs., II, L.P.*, 156 B.R. 499 (Bankr. E.D. Va. 1993)

*Brite v. Sun Country Dev. (In re Sun Country Dev.)*, 764 F.2d 406 (5th Cir. 1985)

*In re Cambridge Woodbridge Apartments, L.L.C.*, 292 B.R. 832 (Bankr. N.D. Ohio 2003)

*In re Carlsbad Dev. I, LLC*, No. 08-27768, 2009 Bankr. LEXIS 754 (D. Utah Mar. 6, 2009)

*Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939)

*In re CBJ Dev.*, 292 B.R. 467 (B.A.P. 9th Cir. 1996)

*In re Cellular Info. Sys., Inc.*, 171 B.R. 926 (Bankr. S.D.N.Y. 1994)

*In re CGE Shattuck, LLC*, 1999 WL 33457789 (Bankr. D.N.H. Dec. 20, 1999)

*In re Club Golf Partners, L.P.*, 2007 WL 1176010 (E.D. Tex. Feb. 15, 2007)

*In re Computer Optics, Inc.*, 126 B.R. 664 (Bankr. D.N.H. 1991)

*Corestates Bank, N.A. v. United Chem. Techs., Inc.*, 202 B.R. 33 (E.D. Pa. 1996), rev'd,  
196 B.R. 716 (Bankr. E.D. Pa. 1996)

*In re Costa Bonita Beach Resort, Inc.*, No. 09-00699, 2009 Bankr. LEXIS 2704  
(D.P.R. July 24, 2009)

*In re Crosscreek Apartments, Ltd.*, 213 B.R. 521 (Bankr. E.D. Tenn. 1997)

*C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304  
(2d Cir. 1997)

*In re Deluca*, 1996 WL 910908, 1996 WL 910908 (Bankr. E.D. Va. 1996)

## SINGLE ASSET REAL ESTATE CASES

- In re Digby*, 47 B.R. 614 (Bankr. N.D. Ala. 1985)
- In re Dilts*, 126 B.R. 470 (Bankr. W.D. Pa. 1991)
- In re Dupell*, 235 B.R. 783 (Bankr. E.D. Pa. 1999)
- In re Fi-Hi Pizza, Inc.*, 40 B.R. 258 (Bankr. D. Mass. 1984)
- In re Fisher*, 29 B.R. 542 (Bankr. D. Kansas 1983)
- In re Fontainebleau Las Vegas Holdings, LLC*, No. 09-2148-BKC-AJC (Bankr. S.D. Fla. Dec. 7, 2009)
- In re Future Energy Corp.*, 83 B.R. 470 (Bankr. S.D. Ohio 1988)
- Frankford Trust Co. v. Dublin Props. (In re Dublin Props.)*, 12 B.R. 77 (Bankr. E.D. Pa. 1981)
- In re Gene Dunavant & Son Dairy*, 75 B.R. 328 (Bankr. N.D. Tenn. 1987)
- In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213 (Bankr. D.N.J. 2000)
- In re Heather Apartments, L.P.*, 366 B.R. 45 (D. Minn. 2007)
- In re Hollanger*, 15 B.R. 35 (Bankr. W.D. La. 1981)
- In re Hulen Park Place, Ltd.*, 130 B.R. 39 (N.D. Tex. 1991)
- In re Indian Palm Assocs., Ltd.*, 61 F.3d 197 (1995)
- In re Indian River Estates, Inc.*, 293 B.R. 429 (Bankr. N.D. Ohio 2003)
- JP Morgan Chase Bank, N.A., v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns)* Case No. 09-11435, Adv. No. 09-01132 (Nov. 17, 2009)
- John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assoc.*, 987 F.2d 154 (3d Cir. 1993)
- In re Jones*, 189 B.R. 13 (Bankr. E.D. Okla. 1995)
- In re Kara Homes, Inc.*, 363 B.R. 399 (D.N.J. 2007)
- Kham & Nate's Shoes No. 2 v. First Banks*, 908 F.2d 1351 (7th Cir. 1990)
- In re Kkemko, Inc.*, 181 B.R. 47 (Bankr. S.D. Ohio 1995)
- In re Kowalsky*, 235 B.R. 590 (Bankr. E.D. Tex. 1999)
- In re LDN Corp.*, 191 B.R. 320 (Bankr. E.D. Va. 1996)

SINGLE ASSET REAL ESTATE CASES

- In re Manion*, 127 B.R. 887 (Bankr. N.D. Fla. 1991)
- In re Mazzeo*, 167 F.3d 139 (9th Cir. 1999)
- In re Meadow Glen, Ltd.*, 87 B.R. 421 (Bankr. W.D. Tex. 1988)
- In re Mendoza*, 111 F.3d 1264 (5th Cir. 1997)
- Metro. Life Ins. Co. v. San Felipe@Voss, Ltd.*, 115 B.R. 526 (S.D. Tex. 1990)
- In re Modern Glass Specialist, Inc.*, 42 B.R. 139 (Bankr. E.D. Wis. 1984)
- In re Monnier Bros. Inc.*, 755 F.2d 1336 (8th Cir. 1985)
- In re Mortgage Inv. Co. of El Paso*, 111 B.R. 604 (Bankr. W.D. Tex. 1990)
- In re MTM Realty Trust*, No. 08-13428-JMD, 2009 U.S. Dist. LEXIS 580 (Bankr. D.N.H. Mar. 9, 2009)
- Nazareth Nat'l Bank & Trust Co. v. Trina-Dee, Inc. (In re Trina-Dee, Inc.)*, 26 B.R. 152 aff'd, 731 F.2d 170 (3d Cir. 1984)
- In re Neff*, 60 B.R. 448 (Bankr. N.D. Tex. 1985), aff'd 785 F.2d 1033 (5th Cir. 1986)
- Norwest Bank Worthington v. Ahlers*, 108 S.Ct. 963 (1988)
- In re Nw. Timberline Enters., Inc.*, 348 B.R. 412 (Bankr. N.D. Tex. 2006)
- In re Oceanside Assocs.*, 192 B.R. 232 (Bankr. S.D. Cal. 1996)
- In re Pacific Lumber*, No. 08-40746 (5th Cir. Sept. 29, 2009)
- In re Palmetto Greens Golf & Country Club, LLC*, No. 09-04465-8-JRL, 2009 Bankr. LEXIS 3772 (D.N.C. Nov. 18, 2009)
- In re Park Ave. Partners Ltd. P'ship*, 95 B.R. 605 (Bankr. E.D. Wis. 1988)
- In re Paxson Elec. Co.*, 242 B.R. 67 (Bankr. M.D. Fla. 1999)
- In re Peerman*, 109 B.R. 718 (Bankr. W.D. Tex. 1989)
- In re Pegasus Agency, Inc.*, 101 F.3d 882 (2nd Cir. 1996)
- In re Pelham Street Assoc.*, 131 B.R. 260 (Bankr. D. R.I. 1991)
- In re Philadelphia Newspapers*, No. 09-11204 (Bankr. E.D. Pa. Nov. 10, 2009)
- Pleasant Pointe Apartments, Ltd. v. Kentucky Hous. Corp.*, 139 B.R. 828 (W.D. Ky. 1992)

## SINGLE ASSET REAL ESTATE CASES

- In re Powell*, 223 B.R. 225 (Bankr. N.D. Ala. 1998)
- In re Prairie Hills Golf & Ski Club, Inc.*, 255 B.R. 228 (Bankr. D. Neb. 2000)
- In re Prop. Techs., Ltd.*, 263 B.R. 750 (Bankr. E.D.Va. 2001)
- In re PWS Holding Corp.*, 228 F.3d 224 (3rd Cir. 2000)
- In re R & G Props., Inc.*, No. 08-10876, 2009 Bankr. LEXIS 1320 (D. Vt. Apr. 16, 2009)
- In re Raglin*, 110 B.R. 259 (Bankr. W.D. Tex. 1989)
- In re Revco, D.S., Inc.*, 99 B.R. 768 (Bankr. N.D. Ohio 1989)
- In re River Hills Apartments Fund*, 813 F.2d 702 (5th Cir. 1987)
- In re Robertson*, 244 B.R. 880 (Bankr. N.D. Ga. 2000)
- In re S.E.T. Income Props., III*, 83 B.R. 791 (Bankr. N.D. Okla. 1988)
- In re Saddlebrook Subdiv., LLC*, No. 08-04296-8-JRL, 2008 Bankr. LEXIS 3298 (E.D.N.C. Dec. 8, 2008)
- In re Self*, 239 B.R. 877 (Bankr. E.D. Tex. 1999)
- In re Simons* 113 B.R. 942 (Bankr. W.D. Tex. 1990)
- In re Skains*, 46 B.R. 500 (Bankr. W.D. La. 1984)
- In re Spacek*, 112 B.R. 162 (Bankr. W.D. Tex. 1990)
- In re Syed*, 238 B.R. 133 (Bankr. N.D. Ill. 1999)
- In re Tex. State Optical, Inc.*, 188 B.R. 552 (Bankr. E.D. Tex. 1995)
- United Merchs. & Mfrs., Inc. v. Equitable Life Assurance Soc’y of the U.S.*, 674 F.2d 134 (2d Cir. 1982)
- In re Trident Corp.*, 19 B.R. 956 (Bankr. E.D. Pa. 1982), *aff’d*, 22 B.R. 491 (Bankr. E.D. Pa. 1982)
- United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988)
- In re Vallambros Holdings, LLC*, No. 08-40791, 2009 Bankr. LEXIS 2583 (S.D. Ga. May 21, 2009)
- In re Vargas Realty Enters. Inc.*, No. 09-10402 (SMB), 2009 WL 2929258 (Bankr. S.D.N.Y. July 23, 2009)

## SINGLE ASSET REAL ESTATE CASES

*In re Vill. Walk, LLC*, No. 07-32930 (LMW), 2008 Bankr. LEXIS 1873 (D. Conn. May 29, 2008)

*In re VIP Motor Lodge, Inc.*, 133 B.R. 41 (Bankr. D. Del. 1991)

*In re Webb Mtn, LLC*, No. 3:07-CV-437, 2008 U.S. Dist. LEXIS 10030 (E.D. Tenn. Feb. 8, 2008)

*In re Wieberg*, 31 B.R. 782 (Bankr. E.D. Mo. 1983)

*Rich v. Maryland Nat'l Bank*, 42 B.R. 350 (Bankr. D. Md. 1984)

*Sandy Ridge Dev. Corp. v. La. Nat'l Bank (In re Sandy Ridge Dev. Corp.)* 881 F.2d 1346 (5th Cir. 1989)

*Stewart v. Gurley*, 745 F.2d 1194 (9th Cir. 1984)

*Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007)

*United Merchs. & Mfrs., Inc. v. Equitable Life Assurance Soc'y of the U.S.*, 674 F.2d 134 (2d Cir. 1982)

*United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983)

*Vincent Props., Inc. v. Five Star Partners, L.P. (In re Five Star Partners, L.P.)*, 193 B.R. 603 (N.D. Ga. 1996)

## **FEDERAL STATUTES**

11 U.S.C. § 1124

11 U.S.C. § 1129(b)(1)

11 U.S.C. § 1129(b)(2)(A)(i)(I)

11 U.S.C. § 1129(b)(2)(A)(i)(II)

11 U.S.C. § 1129(b)(2)(A)(ii) (II)

11 U.S.C. § 1129(b)(2)

11 U.S.C. § 1129(b)(2)(B)

11 U.S.C. § 361

11 U.S.C. § 362(d)

11 U.S.C. § 362(d)(1)

## SINGLE ASSET REAL ESTATE CASES

11 U.S.C. § 362(e)(2)

11 U.S.C. § 362(g)

### **OTHER AUTHORITIES**

124 Cong. Rec. H. 11,104 (daily ed. Sept. 28, 1978 (remarks of Rep. Don Edwards)); 124 Cong. Rec. S. 17,421 (daily ed. Oct. 6, 1978)

Jeffrey C. Krause, Panelist, National Conference of Bankruptcy Judges 2009, *Real Estate: Cold is Hot—Valuation, Single Assets and Guarantor Issues; Issues Arising for Debtors and Insiders in Complex Multi-Debtor Real Estate Cases* (Oct. 20, 2009)

Keith Aurzada, United States: *Single Asset Real Estate Cases—Enforcing the Stay May be Difficult Under the New Bankruptcy Code*, <http://www.mondaq.com/unitedstates/article.asp?articleid=48476> (last visited Jan. 10, 2010)

Kenneth N. Klee, *All You Ever Wanted To Know About Cramdown Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133 n. 87 (1979)

Kenneth N. Klee, *One Size Fits Some: Single Asset Real Estate Bankruptcy Cases*, 87 Cornell L. Rev. 1285, 1292 (2002)

The contested Confirmation: Traps, Potholes and Strategies in a Cramdown, by Phelan and Smith, American Bankruptcy Institute 17<sup>th</sup> Annual Southwest Bankruptcy Conference (2009)

# SINGLE ASSET REAL ESTATE CASES

## I. INTRODUCTION

In 1994, Congress added the term Single Asset Real Estate (“SARE”) to the Bankruptcy Code.<sup>2</sup> The Code provides a three-part test for determining whether real property should be classified as SARE: (1) the real property must constitute a single property or project, other than residential real property with fewer than four residential units; (2) the real property must generate substantially all of the gross income of a debtor who is not a family farmer; and (3) the debtor must not conduct any substantial business other than operating the real property and activities incidental.<sup>3</sup>

Moreover, Congress mandated an expedited timeframe in which SARE debtors must either file a confirmable Chapter 11 plan or begin making payments to creditors.<sup>4</sup> Within 90 days after the debtor files its petition (or 30 days after the court determines the case involves SARE), the SARE debtor must either (1) file a reorganization plan with a reasonable possibility of being confirmed within a reasonable time or (2) begin making monthly payments equal to the non-default contract<sup>5</sup> interest rate to the SARE’s secured creditors.

Congress provided the expedited timeframe in SARE cases to provide relief in a common bankruptcy situation. Many times, the owner of an encumbered property files for bankruptcy in an attempt to prevent a major secured creditor from foreclosing. Once the bankruptcy petition is filed, the debtor is protected from foreclosure by the automatic stay. The debtor files a bankruptcy petition even though “there is no real hope that the owner can come forth with a viable confirmable Chapter 11 plan”.<sup>6</sup> Essentially, Congress wanted to prevent debtors from “fil[ing] abusive Chapter 11 petitions to stave off creditors when debtors have no hope of reorganizing.”<sup>7</sup>

## II. SECTION 101(51B): THE SARE TEST

In recent cases, bankruptcy courts have determined what is and is not SARE by applying the Code’s three-part test. While in most SARE cases the threshold issue is whether the debtor is conducting any substantial business other than operating the real property, a few cases also analyze the first two prongs.

### A. Is the real property a single property or project?

Finding that real property is a single property or project satisfies the first prong of the SARE test. A debtor who operates multiple properties may oppose SARE classification by arguing that it

---

<sup>2</sup> Unless noted otherwise, in this paper, “Bankruptcy Code,” “the Code,” “section” or “§” refer to Title 11 of the United States Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).

<sup>3</sup> § 101(51B). Prior to 2005 there was an additional requirement that the non-contingent, liquidated secured debts be no more than \$4 million.

<sup>4</sup> § 362(d)(3); *In re MTM Realty Trust*, No. 08-13428-JMD, 2009 U.S. Dist. LEXIS 580, at \*3 (Bankr. D.N.H. Mar. 9, 2009).

<sup>5</sup> Prior to 2005 the Code required payment at a fair market rate.

<sup>6</sup> *In re Kkemko, Inc.*, 181 B.R. 47, 51 (Bankr. S.D. Ohio 1995).

<sup>7</sup> *Ad Hoc Group of Timber Noteholders v. Pac. Lumber Co. (In re Scotia Pac. Co.)*, 508 F.3d 214, 223 (5th Cir. 2007).

## SINGLE ASSET REAL ESTATE CASES

does not operate a single property or project. A recent bankruptcy case illustrates this point.<sup>8</sup> In that case, an individual, Vargas, owned all shares in each of four debtor corporations. The secured creditor provided undisputed facts supporting a finding of SARE. Each corporation owned one building that consisted of four or more apartments or residential units. Vargas acquired the properties separately over a 20-year period. Further, each building was located on its own tax lot. The four debtor corporations each filed a Chapter 11 petition to prevent the secured creditor from foreclosing its mortgage. The creditor then moved for relief from the automatic stay and for a declaration that SARE secured its mortgage.

The court commented that the debtors provided no evidence to oppose the creditor's SARE contention. Instead, the debtors merely argued they operated as a single debtor that in turn operated four properties, not a single property. Even if the court regarded all the debtors as a single entity operating separate properties, however, it still would have found the case involved SARE. The court concluded that the SARE definition is not restricted to a single piece of real estate.<sup>9</sup> Instead, the definition encompasses "multiple pieces of real estate operated as a single project by a debtor."<sup>10</sup> Ostensibly, even if the debtors had convinced the court that they operated as a single entity, the court would have held the four properties constituted a single project because of the common management and the common mortgage.

Similarly, although a debtor conducts multiple projects, a court may determine that the debtor satisfies the first SARE criterion.<sup>11</sup> For example, one court classified as a SARE debtor an owner and developer who planned various projects on a parcel of land.<sup>12</sup> The court concluded the property was a single project because the developer instituted a common plan or scheme and intended to create and develop a planned community. The planned community initially consisted of three units, one residential house and two commercial units. The debtor reserved the right to develop the property and planned to build additional commercial and residential units. On the other hand, all units would be members of the Association, own shares of the community, share expenses, vote on Association matters, and comply with the Association's rules and bylaws. The court concluded that multiple planned projects notwithstanding, because the debtor declared the entire property a planned community, the case involved a single project, so the debtor satisfied the first prong of the SARE test.<sup>13</sup>

### **B. Does the real property generate substantially all of debtor's gross income?**

Cases usually mention the second prong of the SARE test in passing.<sup>14</sup> Few cases have

---

<sup>8</sup> *In re Vargas Realty Enters. Inc.*, 2009 WL 2929258, at \*2 (Bankr. S.D.N.Y. July 23, 2009).

<sup>9</sup> *Id.* at \*4.

<sup>10</sup> *Id.*

<sup>11</sup> *See In re Vill. Walk, LLC*, No. 07-32930 (LMW), 2008 Bankr. LEXIS 1873, at \*11 (D. Conn. May 29, 2008).

<sup>12</sup> *Id.* at \*10.

<sup>13</sup> *Id.*

<sup>14</sup> *See, e.g., In re Vargas Realty Enters. Inc.*, 2009 WL 2929258, at \*3 (Bankr. S.D.N.Y. July 23, 2009) ("[E]ach Property is a rental building that derives substantially all if not all of its income from the rent paid by the tenants."); *In re Costa Bonita Beach Resort, Inc.*, No. 09-00699, 2009 Bankr. LEXIS 2704, at \*9 (D.P.R. July 24, 2009) (All debtor's income derived from residential unit sales, residential unit leases and commercial leases. Therefore, the beach resort condominium generated all of the debtor's gross income, satisfying prong two of the SARE test.); *In re MTM Realty Trust*, No. 08-13428-JMD, 2009 Bankr. LEXIS 580, at \*5 (D.N.H. Mar. 9, 2009) (Rental income generates all the debtor's gross income.).

## SINGLE ASSET REAL ESTATE CASES

actually addressed the issue.<sup>15</sup> Courts that have addressed the issue have held that a debtor deriving a significant percentage of its revenues from non-real property sources is not a SARE debtor.<sup>16</sup> Moreover, courts have decided that “gross income” produced by the property or project is not limited to present income. Therefore, a debtor who owns property that was previously used and intended to be used in the future as income-producing property will qualify as a SARE debtor.<sup>17</sup> Similarly, courts have determined that undeveloped property generating no income satisfies the second SARE prong.<sup>18</sup>

### **C. Is the debtor conducting substantial business other than operating the real property?**

The issue presented in most SARE cases is whether the debtor is conducting substantial business other than operating the real property and incidental activities. Generally, companies that use real estate to conduct businesses are not SARE debtors. On the other hand, real estate development companies, residential home builders, commercial property lessors and residential property lessors with four or more residential units are classified as SARE debtors.

In *Scotia Pacific*<sup>19</sup>, the debtor owned approximately 200,000 acres of private timberland. The debtor derived its income solely from harvesting and selling timber. The debtor not only employed more than sixty employees, but also hired independent contractors to help with its business. “Sophisticated operations” (planning, growing, and maintaining the timber) occurred on the timberland.<sup>20</sup> The debtors also built and maintained roads on the property. These facts persuaded the court that the debtor engaged in substantial business other than operating the real property and incidental activities.<sup>21</sup> Moreover, the court concluded that the debtor’s sale of timber was an activity extending beyond the sale or lease of the underlying land.<sup>22</sup>

In making its decision, the Fifth Circuit considered five cases that analyzed the third prong of the SARE test. First, in *In re Kkemko*, a bankruptcy court determined a debtor who operated a marina did not satisfy the SARE test.<sup>23</sup> That debtor did not simply rent moorings. It also stored, repaired, and winterized boats. The marina also provided showers, sold gas, and provided activities for its customers. Because of these “diverse activities,” the bankruptcy court held that the debtor’s marina was not SARE.<sup>24</sup>

---

<sup>15</sup> Jeffrey C. Krause, Panelist, National Conference of Bankruptcy Judges 2009, Real Estate: Cold is Hot—Valuation, Single Assets and Guarantor Issues; Issues Arising for Debtors and Insiders in Complex Multi-Debtor Real Estate Cases (Oct. 20, 2009).

<sup>16</sup> *Id.* (citing *In re CGE Shattuck, LLC*, 1999 WL 33457789 (Bankr. D.N.H. Dec. 20, 1999)).

<sup>17</sup> *Id.* (citing *In re Syed*, 238 B.R. 133, 140 (Bankr. N.D. Ill. 1999) (finding no authority holding that the phrase “generates substantially all of the gross income of a debtor” is limited solely to present income)).

<sup>18</sup> *Vill. Walk* at \*9 (citing *In re Oceanside Assocs.*, 192 B.R. 232, 236 (Bankr. S.D. Cal. 1996)).

<sup>19</sup> *Ad Hoc Group of Timber Noteholders v. Pac. Lumber Co. (In re Scotia Pac. Co.)*, 508 F.3d 214 (5th Cir. 2007).

<sup>20</sup> *Id.* at 224.

<sup>21</sup> *Id.* at 224-25.

<sup>22</sup> *Id.* at 225.

<sup>23</sup> *Id.* at 221 (citing *In re Kkemko, Inc.*, 181 B.R. 47, 49 (Bankr. S.D. Ohio 1995)).

<sup>24</sup> *Id.*

## SINGLE ASSET REAL ESTATE CASES

The second case, *In re Club Golf Partners, L.P.*, involved a golf club<sup>25</sup> that operated a variety of revenue-producing activities.<sup>26</sup> The debtors employed third-party employees, sold memberships, charged access fees for the golf course and other amenities, and sold merchandise, food, and beverages in a pro shop and restaurant.<sup>27</sup> The bankruptcy court determined that a debtor did not satisfy the third prong of the SARE test when its “business activities [were] variegated and multiple and . . . dependent on the entrepreneurial efforts and ongoing hard work of its principals and other employees.”<sup>28</sup> The court further noted that the debtor did not “simply lease its property to tenants as the owner of true single asset real estate such as an apartment house does.”<sup>29</sup>

Third, in *In re Prairie Hills Golf & Ski, Inc.*, a bankruptcy court held that the debtor, an operator of a golf and ski club, was not a SARE debtor when its business involved other significant income-producing activities.<sup>30</sup> The debtor built and maintained roads on the land, developed the golf and ski areas, and operated farmland on the property. Because of these activities, the debtor did not simply “hold a passive real-estate investment and did not merely own income-producing buildings and raw lands.”<sup>31</sup>

Fourth, in *In re CBJ Development*, a debtor who operated a hotel was not a SARE debtor.<sup>32</sup> The Bankruptcy Appellate Panel concluded that operating a hotel, which includes employing a significant number of people to clean rooms and linens and provide other services requires “substantially more day to day activity than does the operation of an apartment complex.”<sup>33</sup> The court also commented that operating the hotel was “sufficiently active in nature to constitute a business other than the mere operation of property.”<sup>34</sup>

Finally, the Fifth Circuit discussed and distinguished *In re Kara Homes, Inc.*, where the bankruptcy court had determined the debtor satisfied the SARE test.<sup>35</sup> The *Kara Homes* court “explained that a business would not be a SARE if a ‘reasonable and prudent person would expect to generate substantial revenues from the operation activities *separate and apart from the sale or lease of the underlying real estate.*’”<sup>36</sup> The debtor in *Kara Homes* owned real estate and built and sold homes and condominiums. The debtor’s activities included acquiring land; designing homes and condominiums for that land; arranging construction; marketing and selling homes; and building common spaces, amenities, and roads. The court found that the property constituted SARE because the debtor’s activities were incidental to selling homes or condominiums rather than constituting

---

<sup>25</sup> A place where a round of golf is played; as opposed to the object that propels a golf ball.

<sup>26</sup> *Id.* (citing *In re Club Golf Partners, L.P.*, 2007 WL 1176010, at \*6 (E.D. Tex. Feb. 15, 2007)).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*; see also *In re Vargas Realty Enters. Inc.*, No. 09-10402 (SMB), 2009 WL 2929258, at \*4 (Bankr. S.D.N.Y. July 23, 2009) (Each debtor owned an apartment building that “derive[d] substantially all, if not all, of its income from the rent paid by the tenants.” Moreover, the court reasoned that because all “real property requires some work to maintain or enhance its value[.]” repairing and improving the properties constitutes incidental activities.)

<sup>30</sup> *Id.* at 222 (citing *In re Prairie Hills Golf & Ski Club, Inc.*, 255 B.R. 228, 230 (Bankr. D. Neb. 2000)).

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* (citing *In re CBJ Dev.*, 292 B.R. 467, 473-74 (B.A.P. 9th Cir. 1996) (citations omitted)).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* (citing *In re Kara Homes, Inc.*, 363 B.R. 399 (D.N.J. 2007));

<sup>36</sup> *Scotia Pac.* at 223 (citing *Kara Homes*).

## SINGLE ASSET REAL ESTATE CASES

substantial business.<sup>37</sup> A reasonable and prudent person would not expect to generate substantial revenues from the debtor's activities apart from the actual sales. The Fifth Circuit distinguished *Kara Homes* by reasoning that the sale of homes includes the sale of the real estate, while the debtor in *Scotia Pacific* operated its business to sell timber, not the underlying real estate.<sup>38</sup>

More recent cases follow the analysis and holdings in *Scotia Pacific* and its cited cases that passive investments constitute SARE. For example, in *In re MTM Realty Trust*,<sup>39</sup> the court determined the case involved SARE when the debtor simply collected rent from four tenants.<sup>40</sup> Additionally, the court examined an exhibit that listed details of the debtor's business checks. From its examination, the court concluded the case involved SARE because the debtor paid expenses common to commercial real estate buildings: electricity for signs and parking lot lights, phone services, insurance and taxes, trash removal, building improvements, landscaping, and its mortgage.<sup>41</sup> The checks supported the court's finding that the debtor's business operations were intrinsic to, rather than separate and distinct from, owning and managing real estate.<sup>42</sup>

In another recent SARE case, the court determined the property constituted SARE when the debtor planned potential business activities (a marina and an international vacation program).<sup>43</sup> The court reasoned because the potential business activities were in their developmental stages, the debtor was not presently conducting any business operations other than owning and managing the real estate.<sup>44</sup> Congress' use of the present tense in § 101(51B) "suggests that only current activities may be considered in determining whether the debtor is conducting substantial business activities other than the operation of the property."<sup>45</sup> Interestingly, the court also remarked that the debtor's participation in common stock did not comprise "substantial business activity" because the debtor, as a shareholder, would only receive dividends, which is passive income.<sup>46</sup>

Therefore, recent SARE cases indicate that the third prong of the SARE test often involves a relatively passive debtor.<sup>47</sup> The SARE debtor is subject to "stringent requirements [that] expedite the time frame for SARE debtors to file a plan of reorganization or commence making monthly payments."<sup>48</sup> In SARE cases, "the automatic stay is promptly lifted" if the debtor fails to meet those stringent requirements.<sup>49</sup>

### III. SECTION 362(d): RELIEF FROM THE AUTOMATIC STAY

---

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> No. 08-13428-JMD, 2009 Bankr. LEXIS 580 (D.N.H. Mar. 9, 2009)

<sup>40</sup> *Id.* at \*6.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at \*6, \*7.

<sup>43</sup> *In re Costa Bonita Beach Resort, Inc.*, No. 09-00699, 2009 Bankr. LEXIS 2740, at \*10 (D.P.R. July 24, 2009).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at \*10-11.

<sup>46</sup> *Id.* at \*10.

<sup>47</sup> *But see, In re Kara Homes, Inc.*, *supra* where the debtor was a residential developer.

<sup>48</sup> *Scotia Pacific* at 225.

<sup>49</sup> *Id.*

## SINGLE ASSET REAL ESTATE CASES

Bankruptcy Code § 362(d) provides that on the request of a party in interest, and after notice and hearing, the court shall grant relief from the stay:

- (1) for cause, including lack of adequate protection of an interest in property of such party in interest;
- (2) with respect to a stay of an act against property under subsection (a) of this section, if—
  - (A) the debtor does not have an equity in such property; and
  - (B) such property is not necessary to an effective reorganization...<sup>50</sup>

If either of the two alternatives listed above are satisfied, the bankruptcy court must grant relief from the automatic stay. Section 362(g) provides that in a hearing on a motion for relief from the automatic stay, “the party requesting such relief has the burden of proof on the issue of the debtor’s equity in property,” while “the party opposing the relief has the burden on all other issues.”<sup>51</sup> However, the moving party must first establish a prima facie case in support of its request for relief from the automatic stay.<sup>52</sup>

It is not necessary for a creditor to have a secured claim in order to obtain relief from the stay. Bankruptcy courts have granted stay relief to many types of parties including plaintiffs involved in prepetition actions against the debtor in order to permit the litigation to proceed in the pending forum. Such relief is generally granted where the pending litigation is very near trial, the issues at question are controlled solely by state law, and the presiding judge is already familiar with the factual and legal principles of the case or has disposed of several preliminary matters.

### **A. Cause – Lack of Adequate Protection**

Although “cause” is not defined by the Bankruptcy Code, it does specifically include “the lack of adequate protection of an interest in property” of the requesting party.<sup>53</sup> Even though the term “adequate protection” defies precise definition under the Bankruptcy Code, examples are given in § 361. The examples include (i) requiring the debtor to make a cash payment or periodic cash payments to the creditor seeking stay relief; (ii) providing to such creditor an additional or replacement lien to secure its claim; or (iii) granting such other relief as will result in the realization by such entity of the indubitable equivalent of such entity’s interest in such property.<sup>54</sup>

The concept of adequate protection was deliberately left nebulous by Congress when it drafted the Bankruptcy Code. A secured creditor holding an interest in property of the estate should

---

<sup>50</sup> 11 U.S.C. § 362(d).

<sup>51</sup> 11 U.S.C. § 362(g).

<sup>52</sup> *In re Prop. Techs., Ltd.*, 263 B.R. 750, 753-54 (Bankr. E.D. Va. 2001); *In re Self*, 239 B.R. 877, 880 (Bankr. E.D. Tex. 1999) (citing *In re Kowalsky*, 235 B.R. 590, 594 (Bankr. E.D. Tex. 1999); *In re Powell*, 223 B.R. 225, 232 (Bankr. N.D. Ala. 1998); *Vincent Props., Inc. v. Five Star Partners, L.P. (In re Five Star Partners, L.P.)*, 193 B.R. 603 (N.D. Ga. 1996)); *In re Paxson Elec. Co.*, 242 B.R. 67, 70 (Bankr. M.D. Fla. 1999) (citing *In re Cummings*, 221 B.R. 814, 818 (Bankr. N.D. Ala. 1998)).

<sup>53</sup> See 11 U.S.C. § 362(d)(1).

<sup>54</sup> 11 U.S.C. § 361.

## SINGLE ASSET REAL ESTATE CASES

not be damaged as a result of a decline in value of that property stemming from its use by the debtor during the pendency of the case, when the creditor is stayed by operation of law from acting to protect its interests. As might be expected, given the vague definition of adequate protection in the Bankruptcy Code, bankruptcy courts have wide discretion in approving appropriate measures to ensure adequate protection of a secured creditor's interest. The standard of review is abuse of discretion.<sup>55</sup> Common measures of adequate protection include payment of cash installments, granting additional or replacement liens, requiring that taxes be paid and insurance maintained, and the implementation of strict reporting and accounting measures.

### **B. Cause – Other Than Adequate Protection**

The “cause” standard contained in Bankruptcy Code § 362(d)(1) is “broad and extends beyond the concept of a lack of adequate protection mentioned in the statutes.”<sup>56</sup> A continuing failure to maintain required regular payments has occasionally been held, in and of itself, to constitute sufficient cause for granting a motion to modify stay.<sup>57</sup> More frequently, however, cessation of payments must be coupled with other detriment to the creditor to constitute cause.

“Cause” has also been construed to include a “bad faith filing.”<sup>58</sup> The term “bad faith” has no clear definition when used in connection with the filing of a bankruptcy petition; although, the Second Circuit has summarized a list of factors as guideposts for determining whether a bankruptcy filing was done in bad faith.<sup>59</sup>

In some cases, courts have found that “cause” exists to lift the stay to allow unsecured creditors to pursue state court litigation against the debtor. When determining whether “cause” exists to lift the automatic stay with regard to pending litigation, some courts apply a three-prong test:

- (i) whether any great prejudice to either the bankruptcy estate or the debtor will result from the prosecution of the lawsuit;
- (ii) whether the hardship to the non-debtor party by continuation of the automatic stay considerably outweighs the hardship to the debtor; and
- (iii) whether the creditor has a probability of success on the merits of his case.<sup>60</sup>

---

<sup>55</sup> *In re Mazzeo*, 167 F.3d 139 (9th Cir. 1999); *In re Mendoza*, 111 F.3d 1264 (5th Cir. 1997).

<sup>56</sup> *Rich v. Maryland Nat'l Bank*, 42 B.R. 350, 354 (Bankr. D. Md. 1984); *see also In re Indian River Estates, Inc.*, 293 B.R. 429, 433 (Bankr. N.D. Ohio 2003) (“As used in [Section] 362(d)(1), the term ‘cause’ is a broad and flexible concept which permits a bankruptcy court, as a court of equity, to respond to inherently fact-sensitive situation.”) (citing *In re Tex. State Optical, Inc.*, 188 B.R. 552, 556 (Bankr. E.D. Tex. 1995)).

<sup>57</sup> *In re Trident Corp.*, 19 B.R. 956, 958 (Bankr. E.D. Pa. 1982), *aff'd*, 22 B.R. 491 (Bankr. E.D. Pa. 1982) (citing *In re Hinkle*, 14 B.R. 202, 204 (Bankr. E.D. Pa. 1981)); *see also In re Jones*, 189 B.R. 13, 15 (Bankr. E.D. Okla. 1995) (citing *Hinkle*, 14 B.R. at 204).

<sup>58</sup> *See In re Cambridge Woodbridge Apartments, L.L.C.*, 292 B.R. 832, 837 (Bankr. N.D. Ohio 2003) (holding that bad faith in filing petition for bankruptcy is basis for lifting the automatic stay) (citations omitted).

<sup>59</sup> *C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304, 1311 (2d Cir. 1997) (citing *Pleasant Pointe Apartments, Ltd. v. Kentucky Hous. Corp.*, 139 B.R. 828 (W.D. Ky. 1992)).

<sup>60</sup> *In re Robertson*, 244 B.R. 880, 882 (Bankr. N.D. Ga. 2000) (citations omitted).

## SINGLE ASSET REAL ESTATE CASES

In *In re Revco, D.S., Inc.*,<sup>61</sup> the bankruptcy court concluded that cause existed to modify the stay to allow the movant to continue with state court litigation when a complaint and counterclaims had been filed in state court, a jury trial had been requested, discovery was in progress, and all issues were based entirely on state law.

### 1. Lack of Equity

If the debtor does not have equity in the subject property and the debtor has not met its burden of proving that the property is necessary to an effective reorganization, a court must grant relief from the automatic stay. This outcome is the result of the legislative determination that “the property has no significant bearing upon the reorganization case and that, therefore, there is not sufficient policy or procedural consideration which justifies barring a creditor from exercising rights regarding the property which contract or statute afford.”<sup>62</sup>

The test for determining whether the debtor has any equity in the property in question compares the total amount of liens on the property against the property’s current value.<sup>63</sup> In concert with the plain language of the statute, the majority of courts hold that all liens must be considered, including those of creditors that may not be seeking relief from stay.<sup>64</sup> A creditor is not required to establish a complete lack of equity, as a secured creditor is entitled to some cushion in order to pay the costs of foreclosure.<sup>65</sup>

### 2. Effective Reorganization

If a lack of equity is established, the debtor then has the burden of proving that the property is necessary for an effective reorganization. To meet its burden of proof, the debtor must show there is a reasonable expectation that it will present and confirm a plan of reorganization that will result in a successful restructuring within a reasonable period of time.<sup>66</sup> The reasonable probability of success may not be grounded on speculation.<sup>67</sup> The standard of proof is a sliding scale depending on the status of the bankruptcy. In *United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*,<sup>68</sup> the United States Supreme Court indicated that the inability of the debtor to propose a confirmable plan of reorganization within the first several months of a bankruptcy case was an indicator that no “effective” reorganization was possible.

The case law makes it clear that debtors should not be permitted to remain in bankruptcy in perpetuity, hoping for favorable market changes months or years in the future, while using the automatic stay to frustrate creditors’ attempts to recover their collateral.

---

<sup>61</sup> 99 B.R. 768, 777 (Bankr. N.D. Ohio 1989).

<sup>62</sup> *In re Digby*, 47 B.R. 614, 623 (Bankr. N.D. Ala. 1985).

<sup>63</sup> *In re Indian Palm Assocs., Ltd.*, 61 F.3d 197, 206-07 (1995) (citations omitted).

<sup>64</sup> *See id.* at 207 (citing *Nazareth Nat’l Bank & Trust Co. v. Trina-Dee, Inc.* (*In re Trina-Dee, Inc.*), 26 B.R. 152, 154, *aff’d*, 731 F.2d 170 (3d Cir. 1984)); *Stewart v. Gurley*, 745 F.2d 1194, 1196 (9th Cir. 1984).

<sup>65</sup> *In re Skains*, 46 B.R. 500, 502 (Bankr. W.D. La. 1984).

<sup>66</sup> *In re Pegasus Agency, Inc.*, 101 F.3d 882 (2nd Cir. 1996); *John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assoc.*, 987 F.2d 154 (3d Cir. 1993).

<sup>67</sup> *In re Dupell*, 235 B.R. 783, 790 (Bankr. E.D. Pa. 1999) (citing *Frankford Trust Co. v. Dublin Props.* (*In re Dublin Props.*), 12 B.R. 77, 81 (Bankr. E.D. Pa. 1981)).

<sup>68</sup> 484 U.S. 365 (1988).

### 3. Procedure for Obtaining Stay Relief

A party can request relief from the automatic stay by filing a motion in the bankruptcy case. Section 362(e) requires a hearing within 30 days of the filing of such a motion. The court may treat the first hearing as a preliminary hearing, but a final hearing must be commenced within 30 days of any preliminary hearing, unless the movant consents to an extension.<sup>69</sup> Actual trial procedures vary in each bankruptcy court. The stay may terminate if (a) the debtor fails to request a timely hearing, (b) the court fails to schedule a hearing, (c) the court adjourns a scheduled hearing on its own motion, or (d) the court holds a hearing but issues no order of continuance within the 30-day period. The debtor bears the burden of ensuring that the stay does not terminate automatically.<sup>70</sup>

#### C. § 362(d)(3): Single Asset Real Estate

Section 362(d)(3) reduces a secured creditor's economic loss by curtailing the Chapter 11 process or requiring the debtor to make cash payments to the secured creditor.<sup>71</sup> The Chapter 11 process is curtailed because a reasonably confirmable plan must be filed quickly, within 90 days after the petition date or 30 days after the debtor's property is designated SARE. Alternatively, the debtor may choose to make cash payments equal to non-default contract interest rates. If the debtor fails to meet either of these requirements, the automatic stay is lifted, and the secured creditor may foreclose. The provision "shifts risk of delay from the secured lender to the debtor."<sup>72</sup>

#### 1. § 362(d)(3)(A): Reasonable Possibility of Being Confirmed Within a Reasonable Time

The threshold issue under § 362(d)(3)(A) is whether the debtor can establish that its plan has a reasonable possibility of being confirmed.<sup>73</sup> In *Saddlebrook Subdivision*, the debtor's subdivision was only 33-43% complete. The debtor needed more than \$2,000,000 to complete phase one of construction. Moreover, the debtor needed \$900,000 within two months to complete 32 lots. The bank holding a first priority deed of trust on the real property refused to provide any additional funding. Further, the debtor lacked any credible source for alternative funding.<sup>74</sup> The court concluded the plan had no reasonable prospect of being confirmed because the debtor's plan

---

<sup>69</sup> Section 362(e) was amended under the BAPCPA to provide that in a case under chapter 7, 11, or 13 involving a debtor that is an individual, the automatic stay terminates 60 days after a request is made for relief from the stay, unless (i) the court reaches a final decision during that 60-day period or (ii) the 60-day period is extended by agreement of all parties in interest, or by the court on a finding of good cause. 11 U.S.C. § 362(e)(2).

<sup>70</sup> *In re River Hills Apartments Fund*, 813 F.2d 702, 707 (5th Cir. 1987).

<sup>71</sup> Kenneth N. Klee, *One Size Fits Some: Single Asset Real Estate Bankruptcy Cases*, 87 Cornell L. Rev. 1285, 1292 (2002).

<sup>72</sup> *Id.*

<sup>73</sup> *See In re Saddlebrook Subdiv., LLC*, No. 08-04296-8-JRL, 2008 Bankr. LEXIS 3298, at \*9 (E.D.N.C. Dec. 8, 2008).

<sup>74</sup> The debtor claimed he had secured a letter of intent from a financing company. According to the debtor, the funding was to be conditioned upon 25% interest rate and the financing company receiving a first lien on the debtor's property, to the detriment of other lienholders. The debtor failed to produce the letter of intent, however. The court remarked that the financing company had conditioned funding on "onerous" terms, suggesting that even had the letter of intent been produced, the "onerous" terms would have hindered a finding that the plan was confirmable. *See id.* at \*9-10.

## SINGLE ASSET REAL ESTATE CASES

required additional funding, but the debtor had no willing lender or buyer.<sup>75</sup> “The debtor’s hope that market conditions [would] improve in the future [was] not enough.”<sup>76</sup>

Similarly, “preliminary expressions of interest in financing” will not support a finding that a plan has a reasonable possibility of being confirmed.<sup>77</sup> Rather, confirmable plans require “hard funding commitments.”<sup>78</sup> Moreover, a court could determine a plan is not confirmable and is really not a plan at all if the debtor has “unfettered discretion” to choose between various options, including refinancing the secured debt, selling the property, or finding new investors, along with the debtor failing to specify deadlines or default provisions.<sup>79</sup> The Utah bankruptcy court opined that “the Debtor, even after almost two years, simply want[ed] more time—more time to obtain financing, more time for the market to rebound, and more time under the protection of the automatic stay.”<sup>80</sup>

### 2. § 362(d)(3)(B): Monthly Payments

The SARE debtor in *In re Heather Apartments, L.P.*,<sup>81</sup> took a more direct approach in its quest to extend the time it would remain protected under the automatic stay. That debtor did not file a plan, and it did not begin making monthly cash payments. Instead, before the 90-day period had expired, it filed a motion for extension of time under § 362(d)(3). The debtor alleged there was “cause” under § 362(d)(3) to extend the date on which it had to begin making cash payments to the secured creditor because the SARE property would likely be sold.<sup>82</sup>

While a court may extend the date on which a debtor must begin making cash payments,<sup>83</sup> the court in *Heather Apartments* stated that “something extraordinary in the circumstances” is required to constitute cause for excusing compliance.<sup>84</sup> The court also noted that excusing compliance for cause requires “something that tips the equities of a case outside the balance that Congress envisioned and then reinforced by establishing the underlying requirement.”<sup>85</sup> Thus, in analyzing this case, the court used as a backdrop Congress’ concern with “the relative unfairness of lengthy delay in Chapter 11 cases involving single asset real estate projects.”<sup>86</sup> Congress wanted to

---

<sup>75</sup> *Id.* at \*10.

<sup>76</sup> *Id.*

<sup>77</sup> See *In re Carlsbad Dev. I, LLC*, No. 08-27768, 2009 Bankr. LEXIS 754, at \*9 (D. Utah Mar. 6, 2009).

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*; but see *In re Carlsbad Dev. I, LLC*, No. 08-27768, 2009 Bankr. LEXIS 754, at \*10 (D. Utah Mar. 6, 2009) (noting that “the standard for interpreting § 362(d)(3)(A) is nearly identical to the standard for interpreting whether property is ‘necessary for an effective reorganization’ in § 362(d)(2)(B)”) and *In re R & G Props., Inc.*, No. 08-10876, 2009 Bankr. LEXIS 1320, at \*31 (D. Vt. Apr. 16, 2009) (concluding that the debtor met its burden of showing it was possible for a reorganization to succeed within a reasonable time, 60 days). Therefore, 60 days may be considered a reasonable time.

<sup>81</sup> 366 B.R. 45 (D. Minn. 2007).

<sup>82</sup> Although the debtor indicated there was a possibility it would file a plan of reorganization and that it would then seek a determination that the plan had a reasonable possibility of being confirmed within a reasonable time, it had not done so when it submitted its motion. Therefore, the court determined the alternative request (extension of time to file a plan) was not ripe. *Id.* at 47 n. 3.

<sup>83</sup> § 362(d)(3) (Courts may extend the compliance date to “such later date as the court may determine for cause . . .”).

<sup>84</sup> *Heather Apartments* at 47.

<sup>85</sup> *Id.* at 48.

<sup>86</sup> *Id.* at 49 (citing *In re LDN Corp.*, 191 B.R. 320, 326 (Bankr. E.D. Va. 1996)).

## SINGLE ASSET REAL ESTATE CASES

ensure that “where the case does not early kick forward toward confirmation, a debtor [will] compensate its mortgagee for the time-value of the mortgagee’s debt investment [by making cash payments equal to] interest at the original contractual rate.”<sup>87</sup> The court determined, therefore, that a debtor must provide a “concrete substitute for the creditor’s statutorily-fixed expectation of payment, if the debtor is to be excused.”<sup>88</sup> The court remarked that the debtor had no buyer ready to purchase the property.<sup>89</sup> One prospective buyer had only expressed an interest in purchasing the real property and had given no details to support its assurance that it could finance the deal. The expressed interest did not provide a basis for the court to conclude that the property could be liquidated quickly and for a sufficient amount.<sup>90</sup>

The court reasoned that “under § 362(d)(3), . . . the focus is entirely on an *in hand realization of cash* by the creditor, *during the pendency of the case*, while the property remains in the debtor’s hands.”<sup>91</sup> Keeping in mind that the goal is to avoid lengthy delay in SARE cases, a debtor can only be excused from promptly making monthly cash payments if it can show “a very substantial likelihood that the creditor would receive an equivalent value from another source, quickly enough to minimize its risks of recovering the time value of money.”<sup>92</sup> Therefore, a debtor would likely need to show proof of an executed purchase agreement, a binding lending commitment from the prospective purchaser, and “substantial progress toward satisfying the details of a closing.”<sup>93</sup> If the debtor fails to provide such proof, it has little chance of a court granting an extension absent making monthly cash payments to the mortgagee.<sup>94</sup>

### 3. Bad Faith Dismissals

The Bankruptcy Code provides for conversion or dismissal of a Chapter 11 bankruptcy case for cause.<sup>95</sup> Section 1112(b) enumerates a non-exhaustive ten-factor list for determining whether a case should be converted or dismissed for cause. As the list is non-exhaustive, bankruptcy courts have broad discretion to determine whether cause exists.<sup>96</sup> Consequently, courts have determined

---

<sup>87</sup> *Id.* at 50.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at 51.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.* (emphasis in original).

<sup>92</sup> *Id.*; but see *In re Palmetto Greens Golf & Country Club, LLC*, No. 09-04465-8-JRL, 2009 Bankr. LEXIS 3772, at \*5 (D.N.C. Nov. 18, 2009) (Denying creditor’s motion for relief from stay when debtor had a pending sales contract with a buyer who had the present ability to fund the entire purchase price and net sales proceeds were to be paid to the creditor to reduce the outstanding balance. Court reasoned that although the debtors could not commence monthly payments, they likely could propose a plan with a reasonable possibility of being confirmed within a reasonable time, dependent upon the pending sale and subsequent reduction of the outstanding debt. The motion for relief from stay was denied subject to two conditions: (1) the court required the debtors to file a joint plan within thirty days disclosing specifically how the debt would be paid down and how the debt would be reamortized and (2) the stay would be automatically lifted if the sales contract did not close within 90 days.

<sup>93</sup> Keith Aurzada, *United States: Single Asset Real Estate Cases—Enforcing the Stay May be Difficult Under the New Bankruptcy Code*, <http://www.mondaq.com/unitedstates/article.asp?articleid=48476> (last visited Jan. 10, 2010).

<sup>94</sup> *Id.*

<sup>95</sup> § 1112(b)(1).

<sup>96</sup> *In re R & G Props., Inc.*, No. 08-10876, 2008 Bankr. LEXIS 1320, at \*3 (D. Vt. Apr. 16, 2009) (citations omitted).

## SINGLE ASSET REAL ESTATE CASES

that bad faith constitutes cause under § 1112(b).<sup>97</sup> These same courts (and their respective circuit courts) consider several factors to determine whether bad faith exists.<sup>98</sup> The first factor on each court's list is whether the case involves a SARE debtor.

If the debtor satisfies the first factor, that in and of itself will not support a finding of bad faith filing. Indeed, such a finding likely has little weight in the court's analysis. "Chapter 11 offers distressed borrowers the opportunity to 'resolve' financial difficulties through reorganization rather than liquidation, and frustrated creditors must keep in mind that a debtor's availing itself of that opportunity is not *per se* bad faith or the kind of 'extraordinary circumstances' that justify a bad faith dismissal."<sup>99</sup> The court further commented that "if debtors in single asset real estate cases were deemed to have filed in bad faith due to the very nature of their business, § 362(d)(3) would never have the opportunity to provide relief from the automatic stay to creditors with an interest in single asset real estate cases."<sup>100</sup>

Rather, other considerations are more likely to persuade a court that a filing was or was not made in bad faith. For example, the court in *R & G Properties* concluded that the debtor had adequate cash flow to meet its current expenses<sup>101</sup> and a potentially viable business in place to protect and rehabilitate.<sup>102</sup> The court determined that the debtor's business possessed indicia of a viable enterprise because it had current operations and cash flow indicating the filing was not "the last gasp of a dying enterprise."<sup>103</sup> However, if "new debtor syndrome"<sup>104</sup> exists along with "factors such as having only one primary asset, few unsecured creditors, a pending foreclosure, and no employees or ongoing business," a bad faith filing is indicated.<sup>105</sup>

### IV. CHAPTER 11: CRAMDOWN

Even if a debtor is unable to acquire all of the required votes necessary for confirmation, the Code provides a method for implementing a plan over the objections of opposing creditors. Assuming all of the requirements of § 1129(a) have been met, a plan may be confirmed over the objection of a dissenting class of creditors, *i.e.*, *crammed down*, if it is fair and equitable and does not unfairly discriminate. The cramdown provision of the Bankruptcy Code provides in pertinent part:

. . . if all of the applicable requirements of subsection (a) of this section other than paragraph 8 [acceptance] are met with respect to a plan, the court . . . shall confirm the plan . . . if the plan does not discriminate unfairly and is fair and equitable with

---

<sup>97</sup> See, e.g., *id.*, at \*3; *In re Webb Mtn, LLC*, No. 3:07-CV-437, 2008 U.S. Dist. LEXIS 10030, at \*6 (E.D. Tenn. Feb. 8, 2008); *In re Vallambros Holdings, LLC*, No. 08-40791, 2009 Bankr. LEXIS 2583, at \*2 (S.D. Ga. May 21, 2009).

<sup>98</sup> *R & G Props.*, at \*3-4 (citations omitted); *Webb Mtn*, at \*8 (citations omitted); and *Vallambros Holdings*, at \*3 (citations omitted).

<sup>99</sup> *R & G Props.*, at \*10 (citation omitted).

<sup>100</sup> *Id.* at \*11.

<sup>101</sup> *Id.* at \*14.

<sup>102</sup> *Id.* at \*15.

<sup>103</sup> *Id.* at \*19.

<sup>104</sup> Occurs when a SARE debtor is created "on the eve of foreclosure to isolate a property and frustrate creditors." *Webb Mtn* at \*9.

<sup>105</sup> *Id.*

## SINGLE ASSET REAL ESTATE CASES

respect to each class of claims or interests that is impaired under, or has not accepted, the plan.<sup>106</sup>

### A. Unfair Discrimination

The Code does not define the term “unfair discrimination.” Several courts, however, have broadly construed the unfair discrimination requirement of § 1129(b).<sup>107</sup> These cases have held that a dissenting class must not only receive “fair and equitable” treatment, but must additionally receive treatment that allocates value to the dissenting class which is consistent with the manner in which other classes with similar legal claims are treated.<sup>108</sup>

### B. Fair and Equitable

Unlike the phrase “unfair discrimination,” the Code expressly defines “fair and equitable” as it relates to secured claims, unsecured claims and interests.<sup>109</sup>

#### 1. Secured Creditor Cramdown – 11 U.S.C. § 1129(b)(2)(A)

With respect to secured claims, a plan is fair and equitable and a secured creditor may be crammed down if: (1) the secured creditor (i) retains its lien in the collateral to the extent of the allowed amount of the secured claim, and (ii) receives *deferred cash payments* which total the allowed amount of the claim and which have a present value equal to the value of the collateral; (2) the plan provides for the sale of the collateral with the right of the secured creditor to credit bid; or (3) the secured creditor realizes the “indubitable equivalent” of its secured claim pursuant to the plan.<sup>110</sup>

The concept of secured creditor cramdown is simple. As to a dissenting secured creditor’s class, a certain basis or value must be established. The secured creditor must retain its lien in the property (or if the property is transferred under the plan, its lien must attach to the proceeds) *and* the creditor must receive deferred *cash* payments totaling at least the allowed amount of the creditor’s secured claim. The stream of deferred cash payments must have a present value as of the effective date of the plan in an amount at least equal to the value of the secured creditor’s claim. If the foregoing test is not met, then the secured creditor must realize under the plan the “indubitable equivalent” of its claim or the collateral must be sold subject to the credit bid rights of the secured creditor.

---

<sup>106</sup> 11 U.S.C. § 1129(b)(1).

<sup>107</sup> See *In re Meadow Glen, Ltd.*, 87 B.R. 421, 425-26 (Bankr. W.D. Tex. 1988); *In re Future Energy Corp.*, 83 B.R. 470, 492-93 (Bankr. S.D. Ohio 1988); *In re Wieberg*, 31 B.R. 782, 785 (Bankr. E.D. Mo. 1983).

<sup>108</sup> See *In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213, 226 (Bankr. D.N.J. 2000); *In re Mortgage Inv. Co. of El Paso*, 111 B.R. 604, 614 (Bankr. W.D. Tex. 1990).

<sup>109</sup> Fair and equitable treatment with regard to interest holders generally only comes into play if the interest holders are contending more than full value is being paid to the senior classes or alternatively, there are multiple classes of interest with some classes having liquidation preferences.

<sup>110</sup> See 11 U.S.C. § 1129(b)(2)(A).

## SINGLE ASSET REAL ESTATE CASES

With respect to a secured creditor, for example, one court has held that a debtor's plan to convert a five-year balloon note secured by commercial property into a twenty-year note is not fair and equitable to the secured creditor.<sup>111</sup>

In *In re Simons*, a case where the debtor proposed to return part of the secured creditor's collateral for a credit and pay the balance over time, the court gave the following example of fair and equitable:

For example, if a secured creditor held a lien on ten lots in a subdivision, it is possible that the plan would be fair and equitable to that creditor if it provided for the sale of three lots with the proceeds being applied to the secured claim, the return of four lots with the value thereof being applied to the secured claim, and the retention of three lots with a remaining secured claim being paid over time such that the present value of the income stream equaled the value of the secured creditors interest in the remaining lots.<sup>112</sup>

Secured creditor cramdown involves a variety of value and valuation issues including: (i) an analysis of § 506(a) with respect to whether the creditor is oversecured or undersecured (which involves a determination as to the value of the collateral securing the claim); (ii) an evaluation of the property to be distributed to the creditor under the plan; (iii) an evaluation and present value discount of the stream of payments to be received by the creditor under the plan; and (iv) the "indubitable equivalence" of the secured creditor's claim.

*In re Spacek*<sup>113</sup> held that secured lenders may not utilize liquidation values but should use fair market values which take into account lengthy marketing periods and even development of the property.<sup>114</sup>

### **2. Deferred Cash Payments – U.S.C. § 1129(b)(2)(A)(i); Value of Claim including discount rates and interest rates**

Rarely does a plan of reorganization contemplate full satisfaction in cash of the secured creditors claim on the confirmation date. Invariably the debtor proposes that the secured creditor receive a stream of payments over time while retaining its lien. Thus, for a plan to be "fair and equitable" to secured creditors pursuant to Bankruptcy Code § 1129(b)(2), subsection (A)(i)(II) requires a plan to provide that each holder of a secured claim receive "deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property."<sup>115</sup> Since the payments are to be deferred, Congress made it clear that this subsection requires a present value

---

<sup>111</sup> See *In re Manion*, 127 B.R. 887 (Bankr. N.D. Fla. 1991); see also *In re Hulen Park Place, Ltd.*, 130 B.R. 39 (N.D. Tex. 1991) (30-year term at 9% interest was not fair and equitable); *In re VIP Motor Lodge, Inc.*, 133 B.R. 41 (Bankr. D. Del. 1991); *In re Pelham Street Assoc.*, 131 B.R. 260 (Bankr. D. R.I. 1991) (5-year note was "pure pie in the sky"). But see *In re Dilts*, 126 B.R. 470 (Bankr. W.D. Pa. 1991) (court held that debtor's plan was fair and equitable even though the plan extended the original term over which the loan was to be repaid).

<sup>112</sup> *In re Simons* 113 B.R. 942, 946 (Bankr. W.D. Tex. 1990)

<sup>113</sup> 112 B.R. 162 (Bankr. W.D. Tex. 1990).

<sup>114</sup> See also *In re Raglin*, 110 B.R. 259 (Bankr. W.D. Tex. 1989); *In re Peerman*, 109 B.R. 718 (Bankr. W.D. Tex. 1989).

<sup>115</sup> 11 U.S.C. § 1129(b)(2)(A)(i)(II).

## SINGLE ASSET REAL ESTATE CASES

analysis to determine the current value of the future stream of payments.<sup>116</sup> The stream of payments must be discounted to present value, and the present value of the stream of future payments must not be less than the allowed amount of the creditor's claim.<sup>117</sup> Thus, the challenge for the bankruptcy court is to determine the present value as of the effective date of the plan of the property to be distributed, *i.e.*, the present value of the deferred cash payments.

Present values are a function of the principle that “a dollar today is worth more than a dollar tomorrow because the dollar today can be invested to start earning interest immediately.”<sup>118</sup> In calculating the present value, the court must first determine an appropriate discount rate, *i.e.*, the rate which will compensate the creditor for both the time value of its money and the risk of lending money to the debtor on the terms proposed in the plan. Risk, in turn, will be influenced by the postconfirmation capital structure, the debtor's need to borrow funds, plan covenants restricting future debt, and the timing of both future cash flow and payments under the plan. Although the mechanics of the present value calculation are fundamentally simple, the real issue is the rate to be applied to determine the discount factor.<sup>119</sup>

On appeal, the higher court will give great deference to the bankruptcy judge's findings regarding rates of return.<sup>120</sup> The bankruptcy judge's findings regarding whether the proposed cramdown rate satisfies the present value requirements of § 1129(b)(2)(A)(i)(II) are reviewed under the clearly erroneous standard.<sup>121</sup>

### 3. Figuring the Rate of Return

Before the United States Supreme Court's decision in *Till v. SCS Credit Corp.*, there were three prevailing approaches in cramdown interest rates: (1) the “cost of funds approach,” which sets the rate at the lender's cost of funds; (2) the formula method, which starts with the risk-free rate and then adjusts for risk; and (3) the “coerced loan” approach, which applies the market rate for loans made under similar circumstances.<sup>122</sup> Other courts, in response to the criticism that the coerced loan theory fails because there is no actual market for 100% loan-to-equity financing, employed a “Debt-Equity/Band of Investment Analysis.” Under this framework, courts (through expert testimony) determined the rate of return that would be required by the marketplace to provide the financing presented to the secured creditor in the plan. This financing usually consists of a debt component in the maximum loan-to-equity percentage generally accepted by the market and a second priority debt or equity component for the remaining percentage. This approach is consistent with the statutory language and economic reality. Still other courts held that, in the absence of special circumstances, the prepetition contract rate should be applied.

---

<sup>116</sup> See H.R. Rep. No. 95-595, 1st Sess. 414 (1977), reprinted in 1978 U.S.C.C.A.N. 5963.

<sup>117</sup> *In re Crosscreek Apartments, Ltd.*, 213 B.R. 521, (Bankr. E.D. Tenn. 1997).

<sup>118</sup> See *In re Neff*, 60 B.R. 448, 457 (Bankr. N.D. Tex. 1985), aff'd 785 F.2d 1033 (5th Cir. 1986) (citing *In re Fisher*, 29 B.R. 542, 543 (Bankr. D. Kansas 1983)).

<sup>119</sup> See also *In re Park Ave. Partners Ltd. P'ship*, 95 B.R. 605, 613 (Bankr. E.D. Wis. 1988); *In re Fi-Hi Pizza, Inc.*, 40 B.R. 258 (Bankr. D. Mass. 1984).

<sup>120</sup> *Corestates Bank, N.A. v. United Chem. Techs., Inc.*, 202 B.R. 33 (E.D. Pa. 1996), rev'd, 196 B.R. 716 (Bankr. E.D. Pa. 1996).

<sup>121</sup> *Id.*

<sup>122</sup> 541 U.S. 465 (2004).

## SINGLE ASSET REAL ESTATE CASES

On May 17, 2004, the Supreme Court announced its decision in *Till v. SCS Credit Corp.* In a plurality opinion authored by Justice Stevens, four of the justices rejected the cost of funds and coerced loan approaches to determining the rate of return on cramdown of a secured lender in a Chapter 13 case, and adopted the formula approach which starts with a base rate and then adds percentage points to compensate for risk. The court did note that in a Chapter 11 case it might be possible to determine a market rate of return. Although *Till* is a Chapter 13 consumer debtor case involving a \$4000 truck, the case interprets statutory provisions virtually identical to those in Chapter 11 business reorganizations. Unfortunately, *Till* did not so much smooth the road in Chapter 11 cases as much as create additional potholes.

Some argue, given that the cost of funds, coerced loan, and contract rate approaches were rejected in *Till*, each now has very limited, if any, application. But the real issue should be: “Did the secured creditor receive something worth \$100 for his \$100 claim?,” and not “What theoretical approach did the court take to get the result that the people in black robes wanted to obtain?” If appropriate evidence is presented to the court, the formula method should result in a rate that meets the statutory test, but the arbitrary caps that some courts have adopted do not comport with either the statute or the market reality. In commercial cases, 100% financing for businesses is available in the marketplace through a combination of senior financing, junior financing and equity financing and a blended rate can be determined for cramdown purposes.

The appropriate discount rate must be determined on the basis of the rate of return that is reasonable in light of the risks involved.<sup>123</sup> Thus, in determining the appropriate discount rate, the court must consider the prevailing market rate for a loan of a term equal to the payout period with due consideration for the quality of the security and the risk of subsequent default.<sup>124</sup> If the debtor and its business and the collateral are relocating from Boise to Baghdad the discount rate will increase considerably.<sup>125</sup>

Some courts have employed a “Debt-Equity/Band of Investment Analysis.”<sup>126</sup> Under this framework, courts (through the testimony of expert witnesses) determine the rate of return that would be required by the marketplace to provide the financing presented to the secured creditor in the plan. This financing usually consists of a debt component in the maximum loan-to-equity percentage generally accepted by the market and a second priority debt or equity component for the

---

<sup>123</sup> See *In re Monnier Bros. Inc.*, 755 F.2d 1336 (8th Cir. 1985).

<sup>124</sup> See *In re Monnier Bros. Inc.*, 755 F.2d at 1338 - 1340. See also *In re 360 Inns, Ltd.*, 76 B.R. 573, 587-88 (Bankr. N.D. Tex. 1987); *In re Neff*, 60 B.R. 448, 457 (Bankr. N.D. Tex. 1985), *aff'd without opinion*, 785 F.2d 1033 (5th Cir. 1986); *In re Gene Dunavant & Son Dairy*, 75 B.R. 328 (Bankr. N.D. Tenn. 1987).

<sup>125</sup> See *In re Crosscreek Apartments, Ltd.*, 213 B.R. 521, 544 (Bank. E.D. Tenn. 1997) (holding that a 2% spread over the essentially risk-free T-bill rate would adequately compensate the secured creditor for the risk of non-payment and the expected decrease in the dollar over time); *In re 360 Inns, Ltd.*, 76 B.R. 573, 593-94 (Bankr. N.D. Tex. 1987) (finding that a discount rate of 2.5% above prime was appropriate considering the prevailing rates of a loan for equal term, the quality of the security and the risk of the proposed loan); *In re S.E.T. Income Props., III*, 83 B.R. 791, 794 (Bankr. N.D. Okla. 1988) (using the prime rate as the best evidence of the market rate and then added 1.5% in recognition of the additional risk factors); *In re Computer Optics, Inc.*, 126 B.R. 664 (Bankr. D.N.H. 1991) (holding the primary emphasis for determining an appropriate rate is to determine the appropriate riskless rate to reach the present value of the deferred stream of payments to the secured creditor and provide an upward adjustment for any general risk attributed to the facility of the plan).

<sup>126</sup> See *In re Cellular Info. Sys., Inc.*, 171 B.R. 926 (Bankr. S.D.N.Y. 1994); *In re Deluca*, 1996 WL 910908 (Bankr. E.D. Va. 1996); *In re Birdneck Apartment. Assocs., II, L.P.*, 156 B.R. 499 (Bankr. E.D. Va. 1993).

## SINGLE ASSET REAL ESTATE CASES

remaining percentage. As an example of the investment band approach, in *In re Birdneck*, a secured lender to the single asset real estate debtor objected to a cram down rate of 8.25%. The lender's expert testified that although no market existed for a 100% loan to value ratio loan, he could construct a hypothetical financing for a 70% first priority debt portion and a 30% second priority equity portion. Accepting the expert's testimony that the market rates for the first and second priority portion were 8.66% and 14% respectively, the court denied confirmation, holding that a blended rate of over 10% would be required by section 1129(b).<sup>127</sup>

Judge Lifland applied the investment band technique in *In re Cellular Info. Sys., Inc.*<sup>128</sup> Based on expert testimony, Judge Lifland bifurcated the note into a \$46 million senior band to be paid at LIBOR plus 2.8% and a subordinated band of \$48.5 million to be paid at LIBOR plus 4.8% for a blended rate of LIBOR plus 3.82%. Since this blended rate exceeded the debtors' proposed rate by 82 basis points, Judge Lifland denied confirmation. This investment band approach most closely complies with both the statutory language and market reality in the context of a business Chapter 11 case.

Post-*Till*, it may be argued that judges believe that there are only two available methods for calculating a cramdown rate of interest in Chapter 11 - the "efficient market" approach or the formula approach. In applying *Till*, the majority of courts have held that, in the Chapter 11 context, courts must first evaluate whether an "efficient market" exists. If so, the rate of interest produced by that market is the rate that should be applied when the secured creditor's claim is crammed down. If no efficient market exists, default to the formula approach-produced rate is appropriate.<sup>129</sup> Unfortunately, many courts continue to misunderstand the holding in *Till* and market reality.<sup>130</sup>

### **a. Indubitable Equivalent and Give Back Plans**

In a feasible plan of reorganization, the debtor attempts to forecast cash flows that will provide periodic payments at market rates of return. Occasionally, the debtor will conclude that it simply cannot propose a feasible plan which would permit the court to conclude that the creditor is receiving a stream of payments with the present value of the allowed amount of its claim. In these circumstances, the debtor may attempt to convince the court that, despite the debtor's inability to make periodic payments in such an amount, the secured creditor is realizing the indubitable equivalent of its claim.

In the plan confirmation context, and stated simply, the question is whether the debtor can obtain a determination by the bankruptcy court that all or a part of the creditor's collateral has a certain value and then transfer the collateral, or something else of indubitable value, to the creditor for a partial or full credit on the debt. Several cases have addressed the issue of whether, in a

---

<sup>127</sup> See also *In re Deluca*, 1996 WL 910908 at \* 14 (concluding that 9% was an appropriate blended rate based on an 80% debt component at a market rate of 7.8% and a 20% equity component at a rate of 14%).

<sup>128</sup> *In re Cellular Info. Sys., Inc.*, 171 B.R. 926 (Bankr. S.D.N.Y. 1994).

<sup>129</sup> See *In re Sylvan I-30 Enters.*, No. 05-86709-HDH-11, 2006 WL 2539718 (Bankr. N.D. Tex. Sep. 1, 2006); *In re Nw. Timberline Enters., Inc.*, 348 B.R. 412 (Bankr. N.D. Tex. 2006).

<sup>130</sup> See *The contested Confirmation: Traps, Potholes and Strategies in a Cramdown*, by Phelan and Smith, American Bankruptcy Institute 17<sup>th</sup> Annual Southwest Bankruptcy Conference (2009) and cases cited therein.

## SINGLE ASSET REAL ESTATE CASES

cramdown reorganization plan, a debtor may convey property to a secured creditor in full or partial satisfaction of the secured claim.<sup>131</sup>

Bankruptcy courts generally support cramdown plans that provide a “dirt for debt” treatment for a secured creditor. Although “indubitable equivalent” has been interpreted to mean the cash equivalent of a claim, other courts have found that a plan need only provide a compensatory treatment to the secured creditor.<sup>132</sup> The issue often becomes one of valuation. The Court will conduct an evidentiary hearing to determine 1) if the collateral to be returned, or the indubitable property to be transferred to the secured creditor will be compensatory and 2) the risks involved to the secured creditor in accepting the treatment in lieu of retaining a lien on the full amount of the collateral. Plans that have been confirmed under the indubitable equivalent standard have provided for the transfer of combinations of land, cash, notes and other property.<sup>133</sup> It is hard to understand how treatment of a secured creditor that depends upon a contested valuation by a court can truly be “indubitable”. The very fact that the court has to make an educated guess as to value means that doubt exists.

### 4. Unsecured Creditor Cramdown – 11 U.S.C. §1129(b)(2)(B)

As disclosed above, a plan of reorganization is “fair and equitable”—allowing cramdown—if either: (i) the holders of claims in the unsecured class receive *property* under the plan having a present value equal to the amount of the claim; or (ii) no class junior to the dissenting class receives anything under the plan.<sup>134</sup> In a secured creditor cramdown, the creditor must receive deferred cash payments, but in the unsecured creditor cramdown, the creditor may receive property. Property in a bankruptcy case is used in its broadest sense (real, personal, tangible, intangible, pigs, bowling balls, synthetic derivatives).<sup>135</sup> As long as the present value of the property is equal to the allowed amount of the claims, cramdown of unsecured creditors is possible. Although certain types of properties may require difficult valuations, the court need only find a “reasonable likelihood” that the value of the property equals the required amount.<sup>136</sup>

---

<sup>131</sup> See e.g. *Sandy Ridge Dev. Corp. v. La. Nat'l Bank (In re Sandy Ridge Dev. Corp.)* 881 F.2d 1346 (5th Cir. 1989) (holding that transfer of all of a secured creditor's collateral back to the secured creditor constitutes the indubitable equivalent of the secured creditor's claim); but see *Arnold & Baker Farms v. U.S. (In re Arnold & Baker Farms)* 85 F.3d 1415 (9th Cir. 1996) (holding that a transfer of less than all of secured creditor's collateral did not constitute the indubitable equivalent of the creditor's claim).

<sup>132</sup> See *In re Hollanger*, 15 B.R. 35, 47 (Bankr. W.D. La. 1981).

<sup>133</sup> Some courts have found that the indubitable equivalent requirement was met under dubious circumstances. See e.g. *Brite v. Sun Country Dev. (In re Sun Country Dev.)*, 764 F.2d 406 (5th Cir. 1985) (finding that a creditor who was given notes for twenty one properties was given the indubitable equivalent of a prior lien on 200 acres, despite evidence that the debtors holding the 21 properties had a poor payment history which reduced the value of the notes, and the fact that to recover under the 21 notes, 21 separate foreclosure actions would be necessary); *Metro. Life Ins. Co. v. San Felipe@Voss, Ltd. (In re San Felipe@Voss)*, 115 B.R. 526 (S.D. Tex. 1990) (finding that restricted foreign securities were the indubitable equivalent of a first lien on the debtor's principle asset, an office building complex). See also, *In re Simons* 113 B.R. 942, 946 (Bankr. W.D. Tex. 1990), discussed above.

<sup>134</sup> See 11 U.S.C. §1129(b)(2)(B).

<sup>135</sup> See *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983).

<sup>136</sup> See Kenneth N. Klee, *All You Ever Wanted To Know About Cramdown Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133, 143-44 n. 87 (1979) (“There need only be a reasonable likelihood that the present value of the property equal the allowed amount of the unsecured claims.”)(citing 124 Cong. Rec. H. 11,104 (daily ed. Sept. 28, 1978 (remarks of Rep. Don Edwards); 124 Cong. Rec. S. 17,421 (daily ed. Oct. 6, 1978)).

## SINGLE ASSET REAL ESTATE CASES

For a debtor to cramdown a class of unsecured creditors who do not vote in favor of a plan of reorganization, that class of creditors must receive property of a value as of the effective date of the plan equal to the allowed amount of that class' claims, or no class junior to the class shall receive any property on account of its claim.<sup>137</sup>

Where the property to be received is in the form of deferred payments, questions of feasibility and questions concerning present value of those payments will arise. Similarly, where the unsecured class is to receive real property or payment from real property, valuation issues relating to appraisals and discounted cash flows will arise. Typically, unsecured classes are paid percentages of their overall claims in cash at confirmation, so the reported cases concerning valuation of that treatment are few.

### **5. Interest Holders – U.S.C. § 1129(b)(2)(C)**

Generally, cramdown of interest holders is an issue if the interest holders are contending that more than full value is being paid to the senior classes, the valuation of the reorganized debtor under the plan is too low, or there are multiple classes of interests with some classes having liquidation preferences and others not.

In order for prepetition equity security holders to receive or retain any property under a plan, the senior classes, including all classes of unsecured creditors, must be satisfied in full.

#### **C. Absolute Priority Rule**

The “absolute priority rule” requires that senior classes of claims or interests be paid in full before junior classes can receive anything under the plan on account of their claims or interests. The absolute priority rule also provides that a plan will be “fair and equitable” even if classes of creditors do not realize the full value of their claims, as long as no class junior to them receives or retains anything on account of their claims or interests.<sup>138</sup>

In some plans, the equity holders retain their interest. Any interest retained under a plan of reorganization must be considered property for purposes of § 1129(b)(2).<sup>139</sup> Moreover, the debtor has the burden of proof to establish the value of that retained interest.<sup>140</sup> Sometimes it is difficult to determine if an interest is given “on account of” the prior equity position of a party.

In *Bank of America National Trust & Savings Association v. 203 North LaSalle St. Partnership*,<sup>141</sup> the Supreme Court held that allowing junior interest holders the exclusive opportunity to obtain an interest in a reorganized entity by providing new value, free from competition and without market valuation, violates § 1129(b)(2)(B)(ii) because the exclusive

---

<sup>137</sup> 11 U.S.C. § 1129(b)(2)(B).

<sup>138</sup> See 11 U.S.C. § 1129(b)(2)(B)(ii).

<sup>139</sup> See *Norwest Bank Worthington v. Ahlers*, 108 S.Ct. 963, 969 (1988); *Kham & Nate's Shoes No. 2 v. First Banks*, 908 F.2d 1351 (7th Cir. 1990); *In re Modern Glass Specialist, Inc.*, 42 B.R. 139, 140-41 (Bankr. E.D. Wis. 1984).

<sup>140</sup> See *In re AG Consultants Grain Div., Inc.*, 77 B.R. 665, 678 (Bankr. M.D. Ind. 1987).

<sup>141</sup> *Bank of America National Trust & Savings Association v. 203 North LaSalle St. Partnership*, 526 U.S. 434 (1999).

## SINGLE ASSET REAL ESTATE CASES

opportunity to invest in the reorganized entity must be considered property received “on account of” the junior claim or interest.

A release of liability has some value under the Code.<sup>142</sup> In *In re PWS Holding Corp.*, the court stated that when the debtors extinguished claims arising out of recapitalization, the equity holder received something of value even though some creditors senior to the equity holder had not been paid in full. The court determined, however, that these releases were not made “on account of” the junior interest as had been the case in *LaSalle*. The *PWS* court noted that “[w]hat doomed the plan in *LaSalle* was not that old equity received property under the plan, but the ‘exclusivity’ that old equity enjoyed.”<sup>143</sup>

Courts have recognized an exception to the absolute priority rule denominated by the misnomer of the “substantial contribution exception.”<sup>144</sup> The substantial contribution exception was first discussed in *Case v. Los Angeles Lumber Products Co.*<sup>145</sup> In *Case*, the Supreme Court stated, *in dicta*, that, although an equity security holder usually will not be allowed to participate in a plan of reorganization when the unsecured creditors do not receive the full value of their claims, there are circumstances under which equity holders can participate. The court stated that if an equity holder were to participate, the “participation must be based on a contribution in money or in money’s worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.”<sup>146</sup> *Case* held that existing equity security holders can receive or retain interests in the reorganized debtor, even though claims of senior creditors are not paid in full, if the equity security holders make a substantial contribution or investment in the reorganized debtor which equals or exceeds the value of the interest which they retain. All this really means is that the equity security holder must pay for the new interest with new consideration and not receive the new interest on account of his old interest. Subsequent cases misinterpreted and expanded on the *Case* rule and permitted any variety of contributions of value to the reorganized debtor by old equity as a basis for old equity’s retention of an interest in the reorganized debtor. The analysis of these cases is questionable. Section 1129(b)(2)(C)(ii) provides that the holder of an equity interest will not receive property under the plan “on account of” his equity interest. The statute does not say that the interest holder cannot participate in the plan if he buys the new equity of the reorganized debtor under the plan. It just says that he cannot participate on account of his prior position as a holder of equity

In *Norwest Bank Worthington v. Ahlers*, the United States Supreme Court concluded that proposed contribution of services to the reorganized debtor did not qualify under the absolute priority rule.<sup>147</sup>

A case from 2009, *In re Charter Communications*,<sup>148</sup> presents an interesting example of an exception to the absolute priority rule. As part of the debtor’s plan, the debtor sought to reinstate

---

<sup>142</sup> *In re PWS Holding Corp.*, 228 F.3d 224, 239 (3<sup>rd</sup> Cir. 2000).

<sup>143</sup> *Id.* at 238-39.

<sup>144</sup> See *Norwest Bank Worthington v. Ahlers* 108 S.Ct. 963, 967, (1988); *In re Future Energy Corp.*, 83 B.R. 470, 497 (Bankr. S.D. Ohio 1988).

<sup>145</sup> 308 U.S. 106 (1939).

<sup>146</sup> *Id.* at 122.

<sup>147</sup> 108 S. Ct. 963, 99 L.Ed.2d 169 (1988).

<sup>148</sup> *JP Morgan Chase Bank, N.A., v. Charter Commc’ns Operating, LLC (In re Charter Commc’ns)* Case No. 09-11435, Adv. No. 09-01132 (Nov. 17, 2009).

## SINGLE ASSET REAL ESTATE CASES

\$11.8 billion in senior secured debt to preserve the favorable terms of the debt. To reinstate the debt, however, the debtor had to reinstate the original maturity date and cure any defaults.<sup>149</sup> Under the loan agreement, default would be triggered in the event of a change of control. Paul Allen, a major equity holder in the company, held substantial voting rights together with his equity. The court determined that a change of control would not result, even if Paul Allen's equity were wiped out, as long as he maintained at least 35% of the voting rights. To prevent a change in control the debtor's plan proposed a settlement with Paul Allen in which he would receive \$375 million in consideration for his continued voting participation, even though all equity was wiped out under the plan. The court confirmed the plan finding that the settlement was not paid on account of his equity position, but rather because of his concessions regarding his retention of voting rights and other agreements with the debtor.<sup>150</sup> The holding in this case is questionable since Allen's voting rights were derivative of his prior equity position.

### V. CREDIT BIDDING

The Bankruptcy Code permits credit bidding in the context of a § 363 sale. Section 363(k) states:

At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

Thus, a party with a lien on property sold pursuant to § 363 can bid at the sale using its allowed claim as part of the purchase amount. However, as noted in § 363(k), a court can, for cause, prohibit a secured creditor from credit bidding the amount of its claim as was recently done in *In re Fontainebleau Las Vegas Holdings, LLC*.<sup>151</sup>

*Fontainebleau* came on the heels of *In re Philadelphia Newspapers*<sup>152</sup> and *In re Pacific Lumber*.<sup>153</sup> In *Fontainebleau*, the court concluded that allowing the secured creditors, consisting of over 300 mechanics and materialmen lien claimants and dozens of bank mortgage lenders, to credit bid at the § 363 sale of an unfinished hotel and casino would delay the sale, deny all creditors the potential benefits of the sale process and continue the erosion of value of the property.

The court noted "Even if the lien claims could be adjudicated as to validity, priority and amount, prior to the § 363 sale scheduled for January 21, 2010, there is no feasible procedure to permit five (5) different groups, plus additional unrepresented lien claimants and the dozens of bank mortgage lenders to bid as single bidders against prospective cash bidders." Section 363(k) of the Bankruptcy Code gives the court the discretion to deny credit bidding.

---

<sup>149</sup> 11 U.S.C. § 1124

<sup>150</sup> JP Morgan Chase Bank, N.A., v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns) Case No. 09-11435, Adv. No. 09-01132 (Nov. 17, 2009).

<sup>151</sup> *In re Fontainebleau Las Vegas Holdings, LLC*, No. 09-2148-BKC-AJC (Bankr. S.D. Fla. Dec. 7, 2009).

<sup>152</sup> *In re Philadelphia Newspapers*, No. 09-11204 (Bankr. E.D. Pa. Nov. 10, 2009).

<sup>153</sup> *In re Pacific Lumber*, No. 08-40746 (5th Cir. Sept. 29, 2009).

## SINGLE ASSET REAL ESTATE CASES

In *In re Pacific Lumber* the plan of reorganization involved the sale of timberland and other property and the payment of the under secured creditors from the proceeds of their collateral at a value determined by the bankruptcy court under the “indubitable equivalent” provision of § 1129(b)(2)(A)(iii). Although § 1129(b)(2)(A)(ii) incorporates the § 363(k) provision for credit bidding, the court concluded that since the plan paid the secured creditors, in cash, the full value of their collateral, as the indubitable equivalent of the secured claim pursuant to § 1129(b)(2)(A)(iii), the plan was confirmable. Section 1129(b)(2)(A)(iii) does not mention § 363(k).

The bidding procedures order in *Philadelphia Newspapers* was approved by the District Court even though the order denied the secured creditor the right to credit bid at the auction of substantially all of the debtor’s assets. The court concluded that since the proposed plan contemplated the use of the indubitable equivalent provision of § 1129(b)(2)(A)(iii) that the prohibition against credit bidding was permitted. The court also noted that § 1111(b) could not be used if the property is being sold pursuant to a plan. These cases will be cited often by debtors attempting to circumvent the credit bidding rights of secured creditors.

### VI. RECENT CHAPTER 11 CASES

#### ***In re Reliant Energy Channelview LP*, No. 09-2074 (3d Cir. Jan. 15, 2010)**

*Is an award of a break-up fee necessary to preserve the estate’s value?*

Debtors in the Chapter 11 case entered into an Asset Purchase Agreement (“APA”) with an initial bidder, Kelson. The APA required the Debtors to seek an order approving certain “bid protections and procedures” in favor of Kelson if the Court required an auction of the plant before its sale. The bid protections and procedures provided: (1) that the Debtors could not accept a competing bid unless the bid exceeded Kelson’s by \$5 million; (2) that Kelson would receive a \$15 million break-up fee if the Debtors accepted a competing bid; and (3) that the Debtors would pay Kelson up to \$2 million as reimbursement for expenses incurred in the sale process. Before entering into the APA, the Debtors considered 11 other bids, including Fortistar’s, which was contingent on Fortistar obtaining financing. Because Fortistar lost its financing, the Debtors rejected its bid. Subsequently, the Debtors and Kelson entered into the APA.

The Debtors sought authorization to sell the plant to Kelson and approval of the bid protection measures. The Bankruptcy Court decided it would not approve the sale to Kelson without an auction for the plant. Further, Fortistar objected to the bid protection measures, indicating it would enter a higher and better bid but was deterred by the \$15 million break-up fee and the \$2 million expense reimbursement. At auction, Fortistar submitted the winning bid, which exceeded Kelson’s bid by \$32 million. Pursuant to the Bankruptcy Court’s decision, the Debtors did not pay Kelson the \$15 million break-up fee, but did pay its expenses.

The Third Circuit considered whether the Bankruptcy Court abused its discretion when it concluded that an award of a break-up fee was not necessary to preserve the estate’s value. The Third Circuit determined that the “the allowability of break-up fees, like that of other administrative expenses, depends upon the requesting party’s ability to show that the fees were actually necessary to preserve the value of the estate.” Thus, like the Bankruptcy Court, the Third Circuit focused on

## SINGLE ASSET REAL ESTATE CASES

whether approving the bid protections would enhance or chill bidding. The Court determined that the break-up fee was not necessary to preserve the value of the estate for two reasons. First, the opportunity to obtain a break-up fee did not induce Kelson to make its bid before the Bankruptcy Court ordered the auction because the offer only required that the Debtors seek, not actually obtain, approval of the break-up fee. Second, the break-up fee was not necessary to preserve Kelson's bid because bidders who have expended money, effort and time to make a bid will not necessarily withdraw a bid absent a break-up fee. Ultimately, the Court determined that any benefits of the break-up fee did not outweigh the potential harm to the estate of deterring other bidders from entering the bidding process.

### ***Ogle v. Fid. & Deposit Co. of Md.*, No. 09-0691-bk (2d Cir. Nov. 5, 2009)**

*Is an unsecured creditor entitled to recover post-petition attorneys' fees authorized by a pre-petition contract but contingent on post-petition events?*

The issue before the Second Circuit was whether an unsecured creditor is entitled to recover post-petition attorneys' fees authorized by a pre-petition contract but contingent on post-petition events. In *Ogle*, Fidelity & Deposit Company of Maryland ("Fidelity") and Agway, Inc. entered into several agreements. Agway agreed to indemnify Fidelity for any attorneys' fees Fidelity incurred in enforcing the agreements. After Agway filed a Chapter 11 petition, Fidelity paid Agway's creditors and made futile demands for indemnity pursuant to the agreements. Therefore, to collect from Agway, Fidelity incurred attorneys' fees.

The Bankruptcy Court held Fidelity could collect its post-petition attorneys' fees, and the district court affirmed. The Second Circuit also affirmed. The Second Circuit noted the issue implicated Sections 502(b) and 506(b) and that a Supreme Court case<sup>154</sup> addressed Section 502(b) while a Second Circuit case<sup>155</sup> addressed Section 506(b). The Second Circuit commented that under *Travelers*, Section 502(b) does not bar an unsecured creditor from recovering post-petition attorneys' fees. In *Travelers*, the Supreme Court interpreted Section 502(b) to mean unless a claim is unenforceable under state law or, alternatively, if one of the Section 502(b)(2)-(9) exceptions applies, courts must "presume" that the claim "will be allowed in bankruptcy unless [it is] expressly disallowed."<sup>156</sup> Moreover, the Second Circuit reasoned that although all fees in *Travelers* were incurred post-petition and, therefore, were unknown on the petition date, *Travelers* "suggest[s] that Section 502(b)'s requirement—that the court 'shall determine the amount of such claim... as of the date of the filing of the petition'—does not bar recovery of post-petition attorneys' fees." In applying Section 502(b) in *Ogle*, the Second Circuit concluded that the underlying contract was valid under state substantive law, no Section 502(b)(2)-(9) exception applied, and the Code is silent on the presented issue—"whether the Code allows unsecured claims for 'fees incurred while litigating issues of' contract law generally."<sup>157</sup> Therefore, the Second Circuit held that an unsecured

---

<sup>154</sup> *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007).

<sup>155</sup> *United Merchs. & Mfrs., Inc. v. Equitable Life Assurance Soc'y of the U.S.*, 674 F.2d 134 (2d Cir. 1982).

<sup>156</sup> *Travelers* at 452.

<sup>157</sup> The issue in *Travelers* was whether the Code allows unsecured claims for contractual attorney's fees incurred while litigating issues of bankruptcy law. *Id.* at 549. Here, the issue was whether such claims are allowable categorically.

## SINGLE ASSET REAL ESTATE CASES

claim for post-petition fees, authorized by a valid pre-petition contract, is allowable under Section 502(b) and is deemed to have arisen pre-petition.

*Does Section 506(b) bar recovery for unsecured claims?*

Unless a claim is expressly disallowed, if it is enforceable under applicable state law, it will be allowed in bankruptcy.<sup>158</sup> The Liquidating Trustee raised the following question: Should Section 506(b) be construed to expressly disallow Fidelity's claim by negative inference or otherwise? The court remarked that Section 506(b) states, "interest on [a] claim, *and any reasonable fees*, costs, or charges provided for under the agreement or State statute under which such claim arose" can be recovered if the creditor is *oversecured*.<sup>159</sup> The question in *Ogle*, then, was how should a similar, unsecured claim be treated under Section 506(b)?

In *United Merchants*, the Second Circuit observed that neither Section 506(b) nor its legislative history discussed the status of an unsecured creditor's contractual claims for attorney's fees.<sup>160</sup> The court then determined that *United Merchants* survived *Travelers* and was, therefore, dispositive. According to the Second Circuit, in *Travelers*, the Supreme Court considered whether the Code expressly *disallows* post-petition attorneys' fees. "It was therefore decisive in *Travelers* that 'the Code says *nothing* about unsecured claims for contractual attorney's fees incurred while litigating issues of bankruptcy law.'" <sup>161</sup> The Second Circuit then concluded "it is decisive here that the Code says nothing about such fees incurred litigating things *other* than issues of bankruptcy law." Therefore, the court held Section 506(b) does not implicate unsecured claims for post-petition attorneys' fees and does not bar recovery.

### ***In re DBSD N. Am., Inc., No. 09-13061 (REG) (Bankr. S.D.N.Y. Oct. 26, 2009)***

*How should a bankruptcy court rule (1) when, after a plan has been proposed, a creditor purchases all class votes to defeat the proposed plan and (2) when, if that creditor's vote is designated, no other creditor remains to assent to the plan?*

In *In re DBSD North America, Inc.*, the Bankruptcy Court considered an issue of first impression: How should a bankruptcy court rule (1) when, after a plan has been proposed, a creditor purchases all class votes to defeat the proposed plan and (2) when, if that creditor's vote is designated, no other creditor remains to assent to the plan? The court ruled that when an entity's vote has been disqualified because that entity bought all the claims in a class after a plan was announced, thereby making consent by that class impossible, the entity cannot indirectly secure the benefits of a dissenting class. Thus, that class will not be counted for Section 1129(a)(8) purposes.<sup>162</sup> The court reasoned, however, that the good faith requirement found in Section 1129(a)(3) protects a designated entity by "ensur[ing] that plan proponents do not abuse the benefits of a court's designation ruling."

---

<sup>158</sup> *Id.* at 452.

<sup>159</sup> § 506(b) (emphasis added).

<sup>160</sup> *United Merchs.* at 138.

<sup>161</sup> *Travelers* at 453 (emphasis in original).

<sup>162</sup> "The court shall confirm a plan only if . . . with respect to each class of claims or interests[,], such class has accepted the plan . . . ."

## SINGLE ASSET REAL ESTATE CASES

Under Section 1126(e)<sup>163</sup>, the court designated DISH Network's ("DISH") vote to reject the debtors' Chapter 11 plan by characterizing DISH as a "strategic investor" rather than a conventional creditor seeking to maximize its claim recovery. Further, Section 1126(c) discusses the "effects of voting within the class of a designation order."

A class of claims has accepted a plan if such plan has been accepted by creditors, *other than any entity designated under subsection (e) of this section*, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, *other than any entity designated under subsection (e) of this section*, that have accepted or rejected such plan.<sup>164</sup>

The court observed that no creditors remained other than DISH, the designated entity, because DISH purchased all the other creditors' claims. Therefore, the court determined that the class must be regarded as vacant. The question then became: How does a court handle a class with no members who may vote? This court offered two solutions. First, the court could disregard the class because to hold otherwise would make the designation ruling meaningless. DISH, although disqualified from rejecting, would essentially still be allowed to reject if the court held that the class effectively rejected. Second, the class "should be regarded as an accepting class" because "the Bankruptcy Code focuses on those who vote, not the total membership of classes." The court concluded that where at least one impaired class has consented, and a class has no votes, that lack of votes in the class does not constitute a failure to satisfy Section 1129(a)(8). In concluding, the court suggested that because DISH engaged in affirmative acts that precipitated its being designated, DISH's behavior strengthened the arguments that the class should be disregarded, and if not disregarded, deemed an accepting class. The effect of the court's ruling is that a class of creditors that rejects the plan is deemed to have affirmatively accepted the plan.

### ***In re Blake*, No. 07-12445-FJB (Bankr. D. Mass. Nov. 30, 2009)**

*For cram down purposes under § 1129(b)(2)(A)(i), in quantifying the value of property securing a claim, is the date of valuation the date on which the bankruptcy case commenced or the confirmation date?*

*In re Blake* presented the Bankruptcy Court with an issue of first impression in the Circuit: For cram down purposes under § 1129(b)(2)(A)(i), in quantifying the value of property securing a claim, is the date of valuation the date on which the bankruptcy case commenced or the confirmation date? The court held that under § 1129(b)(2)(A)(i), the valuation date is the confirmation date. Similarly, the court held that in quantifying the interest rate for the "stream of deferred payments" under the plan that would ensure present value as required under § 1129(b)(2)(A)(i), a debtor should use the base rate that exists on the confirmation date.

The debtors owned four mortgaged rental properties. In their plan, the debtors proposed the following: (1) each senior mortgagee would retain the mortgage securing its claim and (2) on

---

<sup>163</sup> "On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title."

<sup>164</sup> Emphasis added.

## SINGLE ASSET REAL ESTATE CASES

account of its secured claim, each mortgagee would receive a 30-year stream of equal monthly payments having a present value as of the confirmation date of an amount that the debtors contended was the fair market value of the property on the confirmation date. The creditors objected, contending that for purposes of cram down, the proper valuation date is the date on which the bankruptcy case commenced. The creditors also argued that the base rate applicable on the date the bankruptcy case commenced should determine the applicable interest rate to ensure they would receive present value for the 30-year stream of monthly payments.

The court concluded that the plan satisfied all § 1129(a) requirements except for paragraph (8). Under paragraph (8), each class must either accept the plan or be unimpaired by it. Here, each of the four secured claims were impaired and each had rejected the plan. Nevertheless, a court shall confirm a plan when all § 1129(a) requirements, except for paragraph (8), are met if the plan does not discriminate unfairly and is fair and equitable with respect to each class of claims or interests that is impaired under and has not accepted the plan.<sup>165</sup> The secured creditors argued that the plan was not fair and equitable. The court observed that § 1129(b)(2)(A) specified three requirements for fair and equitable treatment for secured claims but noted this case involved only the first requirement, which has two parts. First, a secured creditor must retain its lien, up to the allowed amount of the claim.<sup>166</sup> Second, a secured creditor must receive deferred cash payments that total at least the allowed amount of its claim, which must be of a value, *as of the effective date of the plan*, of at least the value of the secured creditor's interest in the estate's interest in the property.<sup>167</sup> The secured creditors conceded that the plan satisfied clause (I), lien retention but argued the plan failed to satisfy clause (II) because both the valuation date and determination date for the interest rate should have been the date bankruptcy commenced, not confirmation date.

More specifically, the creditors argued that the value of each creditor's interest in the estate's interest in each property was the value of the collateral as of the date bankruptcy commenced. The court determined that the Bankruptcy Code did not specify the date on which property securing a claim must be valued for Section 1129(b)(2)(A). Yet, the court did highlight two subsections that indicate congressional intent as to the date of valuation issue, and both favor valuation as of the confirmation date. First, under Section 1129(b)(2)(A)(ii), a plan satisfies the fair and equitable requirement if it provides for sale of the property free and clear of liens, with the liens attaching to the sale proceeds. The court reasoned that because "the sale would necessarily occur at or after confirmation, . . . the secured claim is necessarily valued as of the date of sale, because the sale itself quantifies the claim by converting the lien from one on the original collateral to one on the proceeds." According to the court, Congress must have anticipated that Section 1129(b)(2)(A), including clause (i), would require the value of a secured claim be determined as of the confirmation date.

Additionally, the court determined that the language in Section 1129(b)(2)(A)(i) reinforced its conclusion that Congress intended the confirmation date to be the date for determining value. That subsection requires that payments given for an allowed secured claim have a certain present value "as of the effective date of the plan." The court remarked that this language seems to indicate an intent to ensure that a secured creditor receives the same value it would receive if the collateral

---

<sup>165</sup> § 1129(b)(1).

<sup>166</sup> § 1129(b)(2)(A)(i)(I).

<sup>167</sup> § 1129(b)(2)(A)(ii) (II) (emphasis added).

## SINGLE ASSET REAL ESTATE CASES

(up to the value of the secured claim) were “simply handed over” to the secured creditor on the effective confirmation date. The court opined that had Congress intended to guarantee secured creditors the value of their secured claims as of case commencement, it would likely have written this clause to require that the stream of deferred payments have the required present value “as of the date of the bankruptcy petition.” The court noted that Congress made adequate protection available for secured creditors to protect their interest in their collateral from deterioration beginning from the commencement of the case up to confirmation. Thus, before the confirmation date, creditors should file a motion to seek adequate protection to prevent erosion of their collateral’s value. For the above reasons, the court concluded that the valuation date is the confirmation date.

Likewise, the secured creditors objected to confirmation based on the five percent interest rate that the debtors used to amortize their secured claims. The creditors argued that the proposed rate was lower than the rate applicable on the commencement date. The court, agreeing with the debtors, found that the stream of payments promised under Section 1129(b)(2)(A)(i)(II) must have a certain present value “as of the effective date of the plan.” Therefore, as the court noted, a cram down creates a situation similar to a “forced loan.” The date on which the “loan” is made and the risk is undertaken governs because that is the date the plan becomes effective.

The court overruled the secured creditors’ objections and confirmed the plan.

### ***Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), Case No. 07-1176 (9th Cir. BAP July 18, 2008).***

The debtor, PW, LLC, owned several parcels of real estate mortgaged to DW with junior liens held by Clear Channel Outdoor. Certain contractual obligations were not met by PW and DW set the parcels for foreclosure. On the eve of the foreclosure, PW filed for chapter 11 protection. In the bankruptcy, the chapter 11 trustee set the parcels for sale under section 363 of the bankruptcy code. DW was the stalking horse bidder with its credit bid, which was less than the secured claim amount. The auction failed to produce qualified bidders, and the properties were sold to DW for its credit bid amount. The bankruptcy court entered an order pursuant to section 363(f)(5) stripping the junior liens held by Clear Channel Outdoor. The bankruptcy court then confirmed the debtor’s plan which stripped Clear Channel Outdoor of its liens. Clear Channel Outdoor appealed and the district court affirmed. The Bankruptcy Appellate Panel affirmed in part and reversed in part.

The BAP concluded that the doctrine of equitable mootness and section 363(m) rendered Clear Channel Outdoor’s appeal of the validity of the sale to DW moot. However, the BAP held that the appeal of the lien-stripping ruling was not equitably moot because the court could fashion effective relief.

The BAP analyzed each of the five possible lien-stripping mechanisms under section 363(f), and held that the bankruptcy court applied an incorrect legal standard to strip Clear Channel Outdoor of its junior liens pursuant to section 363(f)(5). The BAP analyzed 363(f)(5) and found that the availability of cramdown under section 1129(b)(2) is not a “legal or equitable proceeding” to which section 363(f)(5) applies. The BAP remanded for the bankruptcy court to determine if there is a

## SINGLE ASSET REAL ESTATE CASES

qualified proceeding under non-bankruptcy law that would allow the court to strip Clear Channel Outdoor of its junior lien and allow the sale to DB to exist free and clear pursuant to section 363(f)(5). It has been suggested that state foreclosure and condemnation law, among others, will satisfy the requirements of section 363(f)(5) but it does not appear that the evidentiary record in *Clear Channel* supported such a ruling on the appeal.