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Chapter 11 Plan-Confirmation Issues

CONCURRENT SESSION

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CHAPTER 11 PLAN CONFIRMATION ISSUES

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One Man's Fish is Another Man's Poison: Third Party Releases

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> [E]ven if a bankruptcy court has both the subject matter jurisdiction under 28 U.S.C. § 1334(a) and the general legal authority under 11 U.S.C. § 105(a) to confirm a plan that includes a third party release, it is an [sic] nonetheless an extraordinary act. The Bankruptcy Code does not lightly authorize the bankruptcy court to deprive one non-debtor of its legal remedies against another non-debtor (if it does at all). The goal of a debtor's reorganization, while worthy, is not a societal value that necessarily trumps all others. Restricting the exercise of a non-debtor's legal remedies against another non-debtor against that creditor's will is supported by equity only after the court has considered, in a comprehensive fashion, the impact that confirmation will have on all of the parties affected. Courts may approve third party releases only when the reorganization plan is widely supported by the creditor constituency that includes the parties being restrained, accords significant benefits to that constituency and the court is satisfied that the creditors being restrained are also being treated fairly. It is a very narrow legal realm in which a party's legal rights may be restricted because the needs of the many outweigh the rights of the few.
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> *In re Saxby's Coffee Worldwide, LLC*, 436 B.R. 331, 337-38 (Bankr. E.D. Penn. 2010).

I. *ONE FISH, TWO FISH, RED FISH, BLUE FISH*: SPECTRUM OF PLAN RELEASES.

A. *Not All Fish Are the Same*: Not Every Plan Release is a Third Party Release.

1.) *Not a Fish*: Debtor or Estate Releases.

a. Definition: Release by the debtor of a non-debtor.

b. 11 U.S.C. § 1123(b)(3)(A): "[A] plan may provide for the settlement or adjustment of any claim or interest belonging to the debtor or to the estate."

c. Some litigants have successfully convinced courts that the third party release standard should be applied to debtor estate releases

(i) *In re rue21, Inc.*, 575 B.R. 314 (2017).

(ii) Why this matters - A more stringent confirmation standard applies to third party releases, which initially may make it more difficult to confirm a plan, but could also dull the standard for approval of third party releases over time and add a new factor (whether the released claim is colorable) to the consideration of third party releases.

- Compare the standards for the approval of a settlement pursuant to Rule 9019 and approval of a third party release.
    - Settlement: The key inquiry is whether the proposed settlement falls within the reasonable range of litigation possibilities, and a "settlement fails this test only if it 'fall[s] below the lowest point in the range of reasonableness.'" *In re Energy Co-op Inc.*, 886 F.2d 921, 929 (7th Cir. 1989).
    - Third Party Release: Third party releases are permissible if they are narrowly tailored and essential to the debtor's reorganization.

2.) *Easy Fishing*: Exculpation Clauses.

a. Definition: debtor and/or non-debtor releases professionals and other fiduciaries of the estate, such as officers and directors, often for activities connected to the bankruptcy proceeding.

b. Different than a third party release in terms of the parties covered and the time period involved.

3.) *The Big Fish*: Third Party Releases.

a. Definition: Forced or consensual release by non-debtors of non-debtors.

B. *All the Fish in the Sea*: The Typical Released Parties.

1.) Insiders.

2.) Guarantors.

3.) Affiliates.

4.) Insurers.

5.) Plan Sponsors/Funders.

6.)  Third Party Releases in the Archdiocese of Milwaukee Chapter 11 proceeding.

C. *Catch and Release or Dinner*: Temporary v. Permanent Third Party Releases.

1.) Instead of releasing a claim, a plan may temporarily enjoin litigation while the debtor performs the plan. For example, a secured creditor may be prohibited from pursuing collection against a guarantor as long as the debtor has not defaulted under the plan.

2.) Some courts require a showing that, among other things, the proposed injunction satisfies the standards for obtaining an injunction.

II. *GONE FISHIN'*: GETTING APPROVAL OF A THIRD PARTY RELEASE.

A. *Fishing Without a License*: *Law v. Siegel*.

1.) Except in asbestos cases (11 U.S.C. § 524(g)), no provision in the Bankruptcy Code permits third party releases.

2.) There are several provisions in the Rules that appear to assume that a release may be included in a plan even if the Bankruptcy Code does not expressly provide for such a release.

a. Rule 2002(c)(3): "If a plan provides for an injunction against conduct not otherwise enjoined under the [Bankruptcy] Code . . .."

b. Rule 3016(c): "If a plan provides for an injunction against conduct not otherwise enjoined under the [Bankruptcy] Code . . .."

c. Rule 3017(f): "If a plan provides for an injunction against conduct not otherwise enjoined under the [Bankruptcy] Code . . .."

d. Rule 3020(c)(1): "If the plan provides for an injunction against conduct not otherwise enjoined under the [Bankruptcy] Code . . .."

3.) Depending on the jurisdiction, no provision of the Bankruptcy Code prohibits third party releases. Some courts hold that § 524(e) of the Bankruptcy Code prohibits third party releases.

a. 11 U.S.C. § 524(e): "[D]ischarge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

4.) In 2014, the Supreme Court issued its decision in *Law v. Siegel*, 134 S.Ct. 1188 (2014). The Supreme Court held that bankruptcy courts could not override express provisions in the Bankruptcy Code either by using their inherent powers or the statutory authority under § 105 to override the express provisions of the Bankruptcy Code.

a. At least one court has held that *Law v. Siegel* does not prevent bankruptcy courts from granting third party releases. *See*, *e.g.*, *In re City of San Bernardino, California*, 566 B.R. 46, 63 (Bankr. C.D. Cal. 2017).

B. *We WILL Catch Fish Today.*

1.) *The Hook and the Bait*: §§ 105(a) and 1123(b)(6).

a. To catch a fish (the third party release), you need both the hook (§ 105(a)), and the bait (§1123(b)(6)). The strongest statutory support for third party releases is § 105(a) of the Bankruptcy Code. However, courts can be reluctant to use § 105 on its own. Instead, many courts use § 105 to implement another section of the Bankruptcy Code. With respect third party releases, the most commonly cited provision is § 1123(b)(6).

b. The Hook: "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a).

c. The Bait: "[A] plan may . . . include any other appropriate provision not consistent with the applicable provisions of this title." 11 U.S.C. § 1123(b)(6).

2.) *Even a Blind Fisherman Can Catch a Fish*: Third Party Releases are Not Permissible But May Still be Possible.

a. The Fifth, Ninth , and Tenth Circuits do not allow for third party releases.

(i) *Bank of NY Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

(ii) *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394 (9th Cir. 1995).

(iii) *Landsign Diversified Props.-II v. First Nat'l Bank & Trust Co. of Tulsa (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592 (10th Cir. 1990).

b. That does not mean debtors cannot and do not get third party releases approved if/when a release is included in the plan and no objections are filed. However, even when all the parties are in agreement, the Office of the United States Trustee can and has objected to confirmation of plans containing third party releases and exculpation clauses.

c. Dispute between the circuits is based on the impact of § 524(e):

> The nub of the circuit's disagreement concerns to interrelated questions . . .. The first is whether § 524(e) of the bankruptcy code bars a bankruptcy court from releasing non-debtors from liability to a creditor without the creditor's consent. Section 524(e) provides that "the discharge of a debt of the debtor does not affect the liability of another on, or the property of any other entity for, such debt." The natural reading of this provision does not foreclose a third-party release from a creditor's claims. Section 524(e) is a saving clause; it limits the operation of other

> parts of the bankruptcy code and preserves rights that might otherwise be construed as lost after the reorganization. Thus, for example, because of § 524, a creditor can still seek to collect a debtor from a co-debtor who did not participate in the reorganization-even if that debt was discharged as to the debtor in the plan. Or a third party could proceed against the debtor's insurer or guarantor for liabilities incurred by the debtor even if the debtor cannot be held liable.
>
> In any event, § 524(e) does not purport to limit the bankruptcy court's powers to release a non-debtor from a creditor's claims. If Congress meant to include such a limit, it would have used the mandatory terms "shall" or "will" rather than the definitional term "does." And it would have omitted the propositional phrase "on, or . . . for, such debt," ensuring that the "discharge of a debtor of the debtor shall not affect the liability of another entity"-whether related to a debt or not. Also, where Congress has limited the powers of the bankruptcy court, it has done so clearly . . ..
>
> The second related question dividing the courts is whether Congress affirmatively gave the bankruptcy court power to release third parties from a creditor's claims without the creditor's consent, even if § 524(e) does not expressly preclude the releases. A bankruptcy court applies principles and rules of equity jurisprudence, and its equitable powers are traditionally broad. Section 105(a) codifies this understanding of the bankruptcy court's power by giving it the authority to effect any "necessary or appropriate" order to carry out the provisions of the bankruptcy code. And a bankruptcy court is also able to exercise these broad equitable powers within the plans of reorganization themselves. Section 1123(b)(6) permits a court to "include any other appropriate provision not inconsistent with the applicable provisions of this title." In light of these provisions, we hold that this "residual authority" permits the bankruptcy court to release third parties from liability to participating creditors if the release is "appropriate" and not inconsistent with any provision of the bankruptcy code.
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> *Airadigm Commc'ns, Inc. v. Federal Commc'ns Comm'n (In re Airadigm Commc'ns, Inc.)*, 519 F.3d 640, 656-57 (7th Cir. 2008).

C. *The Necessary Fishing Equipment*.

1.) *Just a Net*: Consensual Releases.

a. Consensual third party releases are generally permissible; may be evaluated as a matter of contract law.

b. Courts can vary on what is considered consent to a third party release – voting in favor of the plan, failure to vote on the plan, or a separate and specific assent to the release.

2.) *All the Equipment*: Non-consensual Releases.

a. There is no uniform standard for determining whether a third party release is permissible.

b. *Master Mortgage* Test: The *Master Mortgage* Test is a five factor test for determining the propriety of a third party release. It comes from a decision by the United States Bankruptcy Court for the Western District of Missouri. *In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994).

(i) The Factors:

- Identity of interests between the debtor and the third party (usually an indemnity relationship) where a suit against the third party is, in essence, a suit against the debtor or will deplete the assets of the estate.

- Third party has contributed substantial assets to the reorganization.

- The release is essential to the reorganization, and without it there is limited likelihood of success.

- A substantial majority of the creditors agree to the release; specifically, the impacted class or classes have overwhelmingly voted to accept the proposed plan treatment.

- The plan provides a mechanism to pay all, or substantially all, of the affected claims.

c. Second Circuit:

(i) Key Cases: *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir. 2005).

(ii) "A nondebtor release in a plan should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the plan, focusing on" whether the released party made a substantial contribution to the plan, the enjoined claims are channeled to a settlement fund rather than extinguished, the enjoined claims directly impact the debtor's reorganization by way of indemnity or contribution, and whether the plan otherwise provides for the full payment of the enjoined claims.

d. Third Circuit:

(i) Key Cases: *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203 (3d Cir. 2000).

(ii) Permissible third party releases require "fairness, necessity to the reorganization, and specific, factual findings to support these conclusions" and "adequate consideration to the claimholder being forced to release claims against non-debtors."

e. Fourth Circuit:

(i) Key Cases: *National Heritage Foundation, Inc. v. Highbourne Foundation*, 760 F.3d 344 (4th Cir. 2014); *Menard-Sanford v. Mabey (In re A.H. Robins Co., Inc.)*, 880 F.2d 694 (4th Cir. 1989).

(ii) Recommends use of the test from the Sixth Circuit in *In re Dow Corning Corp.*

f. Sixth Circuit:

(i) Key Cases: *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002).

(ii) Factors (taken from *Master Mortgage*):

- Identity of interests between the debtor and the third party (usually an indemnity relationship) where a suit against the third party is, in essence, a suit against the debtor or will deplete the assets of the estate.
- Released party has contributed substantial assets to the reorganization.
- Release is essential the reorganization, meaning that the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor.
- Plan provides a mechanism to pay all, or substantially, all of the affected claims.
- Plan provides an opportunity for those claimants who choose not to settle to recover in full.
- Bankruptcy Court made a record of specific factual findings that support its conclusion.

g. Seventh Circuit:

(i) Key cases: *In re Specialty Equip Cos., Inc.*, 3 F.3d 1043 (7th Cir. 1993); *Airadigm Commc'ns, Inc. v. Federal Commc'ns Comm'n (In re Airadigm*

Commc'ns, Inc.), 519 F.3d 640 (7th Cir. 2008); *In re Ingersoll, Inc.*, 562 F.3d 856 (7th Cir. 2009).

- *Union Carbide* (per curiam): "A bankruptcy discharge arises by operation of federal bankruptcy law, not by contractual consent of the creditors. A creditor's approval of the plan cannot be deemed an act of assent having significance beyond the confines of the bankruptcy proceedings, simply because the gamesmanship imported from state contract law into the bankruptcy proceedings would be intolerable. . . . In the case that a single creditor's vote is determinative, imputing extra-bankruptcy significance to it for that reason violates the specific command of Section 16 that the liability of a guarantor shall not be altered by the discharge of the bankrupt. The import of Section 16 is that the mechanics of administering the federal bankruptcy laws no matter how suggestive, do not operate as a private contract to relieve co-debtors of the bankrupt of their liabilities."

    - Section 16 of the Bankruptcy Act: "The liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankruptcy shall not be altered by the discharge of such bankrupt."

    - Compare to 11 U.S.C. § 524(e): "The discharge of a debtor of the debtor does not affect the liability of another entity on, or the property of any other entity for, such debt."

    - *See also In re Diversey Bldg. Corp.*, 86 F.2d 456, 458 (7th Cir. 1936) ("It is quite true that a continuation of appellants'activities might have frustrated the approved plan, but if so, it was because it was too extensive in its scope. It not only purported to reorganize the debtor's estate by reducing the amount of its debt and interest and extending the time of payment, but it also essayed to reduce the indebtedness of Becklenberg and extend his time for payment. His estate is not subject to reorganization under section 77B, and he cannot modify his obligations by the reorganization of other insolvents. The only relief which he may seek under the Bankruptcy Act, with respect to his debts, is to be found under section 74 as amended on June 7, 1934 (11 U.S.C.A. § 202), and the provisions of the act as it existed before that amendment; and he is not entitled to relief under those provisions until he tenders his estate to the bankruptcy court for administration, and establishes the fact that he is insolvent, or is unable to meet his debts as they mature. None of these facts appear, hence the court was without jurisdiction to make the order complained of insofar as it affected the original guaranty of Becklenberg.").

- *Specialty Equipment* (Flaum):

    - "While a third-party release, like the one in *Union Carbide* releasing a co-debtor from liability, may be unwarranted in some circumstances, a

per se rule disfavoring all releases in a reorganization plan would be similarly unwarranted, if not a misreading of the statute [§524(e)]."

- Distinguishes *Union Carbide*.

- Addresses the approval of consensual third party releases: "According to the terms of the Plan, each creditor could choose to grant, or not to grant, the release irrespective of the vote of the class of creditors or interest holders of which he or she is a member. As a consequence, a creditor who votes to reject the Plan or abstains from voting may still pursue any claims against third-party nondebtors."

- Holds that the appeal is moot because the plan had been substantially consummated which precludes challenge of the releases because they were an integral element of the bargain represented by the plan.

- *Airadigm* (Flaum): "'[R]esidual authority" permits the bankruptcy court to release third parties from liability to participating creditors if the release is "appropriate" and not inconsistent with any provision of the Bankruptcy Code.

  - Exculpation clause or third party release: "TDS shall not have or incur any liability for any act or omission arising out of or in connection with the Case, the confirmation of this Plan, the consummation of this Plan, or the administration of this Plan or property to be distributed under this Plan, except for willful misconduct."

  - Release in question was "necessary for the reorganization and appropriately tailored."

- Ingersoll (Evans): "[T]he case before us is one step removed—the Gaylords are nondebtors, but Miller is not a creditor of Ingersoll. But we don't think that is dispositive when the party whose claim was extinguished received fair notice and an opportunity to object. And there is nothing in the bankruptcy code that tells us otherwise. Yet, it is important to note in all of this what we are not saying. We are not saying that a bankruptcy plan purporting to release a claim like Miller's is always—or even normally—valid. In the unique circumstances of this case, however, we believe it is. We go no further than to apply the rule we adopted in *Airadigm* to the facts at hand. In most instances, releases like the one here will not pass muster under that rule. Bankruptcy litigants should keep that in mind when they sit down at the negotiating table."

- Fish At Your Own Risk: Seventh Circuit precedent may not support approval of many traditional third party releases.

h. Eleventh Circuit:

(i) Key Cases: *SE Property Holdings, LLC v. Seaside Engineering & Surveying, Inc. (In re Seaside Engineering & Surveying, Inc.)*, 780 F.3d 1070 (11th Cir. 2015).

- Recommends use of the test from the Sixth Circuit in *In re Dow Corning Corp.*

D. The Universal Lure: ABI Commission Recommendations on Third Party Releases.

1.) Exculpation Clauses: "A debtor or plan proponent should be permitted to include an exculpatory clause in the chapter 11 plan that covers parties participating in the chapter 11 case and identified in the chapter 11 plan, including estate representatives, subject to customary exclusions consistent with public policy, that provides for exculpation with respect to acts or omissions during the case and prior to the effective date of the plan, including in connection with the negotiation, drafting, and solicitation of the plan."

a. Acknowledged that other estate representatives and their professionals can be included in an exculpation clause based on their participation in the reorganization or plan process, but did not provide a standard for determining who.

b. Agreement that simple negligence could be covered by an exculpation clause, but no agreement for conduct beyond simple negligence.

2.) Third Party Releases: "A debtor or plan proponent should be permitted to seek approval of third-party release in connection with the solicitation and confirmation of the chapter 11 plan."

a. Recommended a standard based on the *Master Mortgage* test and rejected application of the *Dow Corning* factors.

III. *FISHING AT DAYBREAK*: A COMPARISON OF NON-DEBTOR STAYS AND THIRD PARTY RELEASES

A. Differences:

1.) Non-debtor stays are pre-confirmation and often temporary.

2.) Third party releases are entered pursuant to confirmation orders and typically permanent.

B. *In re Caesars Entm't Operating Co., Inc.*, 808 F.3d 1186 (7th Cir. 2015).

1.) The Seventh Circuit held that, pursuant to § 105(a), a bankruptcy court could stay a separate case if the stay is "likely to enhance the prospects for a successful resolution of the disputes attending the [debtor's] bankruptcy."

C. *McCartney v. Integra Nat'l Bank N.*, 106 F.3d 506 (3d Cir. 1997).

1.) The Third Circuit held that the automatic stay can be extended to situations involving non-debtors, but only in the most extreme and unusual circumstances.

2.) The Third Circuit further stated that "unusual circumstances" can be found where "there is such an identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor."

IV. *WHERE TO FISH*: "JURISDICTIONAL" ISSUES UNDER *STERN*.

A. As it applies to third party releases, *Stern v. Marshall*, 564 U.S. 462 (2011), concerns the issue of who ultimately decides the issue of the third party release, not whether a third party release is permissible.

B. *In re Millennium Lab Holdings II, LLC*, 2017 WL 4417562 (Bankr. D. Del. Oct. 3, 2017).

1.) Held that *Stern* does not prohibit a bankruptcy court from considering and granting a third party release.

2.) Rationale:

a. The "narrow interpretation" of *Stern* (*"Stern* stands for the sole proposition that a bankruptcy judge 'lacked constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim.'") is the correct interpretation of *Stern*.

b. Operative proceeding is confirmation of a plan.

c. That a bankruptcy court's order may have some preclusive effect on a third party lawsuit does not violate *Stern*.

d. An alternative reading of *Stern* would change the division of labor between the bankruptcy court and the district court.

3.) Adjudication: "The legal process of resolving a dispute; the process of judicially deciding a case." ADJUDICATION, Black's Law Dictionary (10th ed. 2014).

C. Fishing in the Lake vs. the Pond: Why Parties Litigate *Stern* Issues with Respect to Third Party Releases.

1.) Litigating in bankruptcy court is probably better for debtors, while litigating in district court is probably better for creditors.

a. Bankruptcy court is familiar with the case and the parties, no learning curve.

b. Bankruptcy court may feel pressure to confirm the plan.

c. Moving to district court will likely slow the case down, providing potential leverage.

d. Bankruptcy court is familiar with third party releases and the Bankruptcy Code.

e. District court is likely unfamiliar with third party releases and the Bankruptcy Code, and therefore, may be more skeptical of the propriety of granting a third party release.

V. *FISHING SEASON CLOSED*: JURISDICTION TO GRANT A THIRD PARTY RELEASES.

A. Subject Matter Jurisdiction Generally: "The district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b).

1.) "Related to" jurisdiction:

> The usual articulation of the test for determining whether a civil proceeding is related to the bankruptcy is whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy. Thus, the proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to the bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankruptcy estate.

Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984).

2.) "In short, our recently reaffirmed precedent dictates that a bankruptcy court lacks subject matter jurisdiction over a third-party action if the only way in which the third party action could have an impact on the debtor's estate is through the intervention of yet another lawsuit." *In re W.R Grace & Co.*, 591 F.3d 164, 173 (3d Cir. 2009).

B. "[B]efore considering the merits of any § 105(a) injunction, a bankruptcy court must establish that it has subject matter jurisdiction to enter the injunction." *In re WR Grace & Co.*, 591 F.3d 164, 170 (3d Cir. 2009); *see also In re Johns-Manville Corp.*, 517 F.3d 52, 60-65 (2d. Cir. 2008); *see also In re Airadigm Commcn's, Inc.*, 519 F.3d at 657; *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746 (5th Cir. 1995).

C. *In re Digital Impact, Inc.*, 223 B.R. 1 (Bankr. N.D. Oklahoma 1998).

1.) Holding that bankruptcy court did not have subject matter jurisdiction to approve third party releases.

2.) "If proceedings over which the Court has no independent jurisdiction could be metamorphisized into proceedings within the Court's jurisdiction simply by including their release in a proposed plan, this Court could acquire infinite jurisdiction."

3.) "A permanent injunction prohibiting certain legal action against a non-debtor is a final adjudication of such anticipated legal action in favor of the non-debtor, and all jurisdictional and due process prerequisites for such a final adjudication must be satisfied. Further, persons or entities who have not subjected themselves and all their assets to the bankruptcy process have not earned the protection of the bankruptcy court's power to terminate claims by permanent injunction. Finally, a court cannot assume jurisdiction in order to enjoin actions to protect a third party who is capitalizing a plan, even though such an injunction appears to be a critical pre-requisite to the adoption of a successful plan."

D. *In re Midway Gold US, Inc.*, 575 B.R. 475 (Bankr. D. Colo. 2017).

1.) Held that the bankruptcy court did not have subject matter jurisdiction to approve third party releases.

2.) "It is true the Court has subject matter jurisdiction over these Chapter 11 Cases pursuant to 28 U.S.C. § 157(a) and 'confirmations of plans' are expressly made core proceedings under 28 U.S.C. § 157(b)(2)(L) which the Court may hear and determine on a final basis. However, the Court cannot permit third-party non-debtors to bootstrap their disputes into a bankruptcy case in this fashion. There must be some independent statutory basis for the Court to exercise jurisdiction over the third parties' disputes before the Court may adjudicate them."

VI. *YOU CANNOT THROW THE FISH BACK*: POST-CONFIRMATION CHALLENGES.

A. Failure to request and/or obtain a stay pending appeal may moot a party's ability to challenge a confirmation order containing a third party release. *See*, *e.g.*, *In re Specialty Equip Cos., Inc.*, 3 F.3d 1043 (7th Cir. 1993).

B. Failure to object to a plan containing a third party release may prevent a subsequent challenge, even if the creditor did not vote in favor of the plan. *See*, *e.g.*, *Corbett v. MacDonald Moving Servs., Inc.*, 124 F.3d 82 (2d Cir. 1997).

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Chapter 11 Plan Confirmation Issues – Accepting Rejection After Confirmation

I. Executory Contracts Generally

A. Definition: A contract between a debtor and another party "under which the obligation[s] of both the bankruptcy and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *In re Terrell,* 892 F.2d 469 (6th Cir. 1989); *In re Pesce Baking Co., Inc.*, 43 B.R. 949 (Bankr. N.D. Ohio 1984); *In re AutoStyle Plastics, Inc.*, 227 B.R. 797 (Bankr. W.D. Mich. 1998); *see also In re StarNet Inc.*, 355 F.3d 634, 635 (7th Cir. 2004) ("Bankruptcy law allows debtor to reject the executory portions of their contracts."); *Sharon Steel Corp v. Nat'l Fuel Gas Distr.*, 872 F. 2d 36, 40 (3d Cir. 1989)("The language of [section 365] is clear: the trustee may assume or reject any executory contract of the debtor.").

B. A Debtor in bankruptcy may (a) assume, (b) reject, or (c) assume and assign executory contracts. 11 U.S.C. §§ 365(a)(1) and (f). The business judgment standard governs the decision to assume or reject an executory contract. *See, e.g., Phar-Mor, Inc. v. Strouss Bldg. Assocs.*, 204 B.R. 948 (N.D. Ohio 1997); *Allied Tech., Inc. v. R.B. Brunemann & Sons, Inc.*, 25 B.R. 484 (Bankr. S.D. Ohio 1982); *In re Penn Traffic Co.*, 524 F.3d 373 (2d Cir. 2008). Under the business judgment test, the debtor need demonstrate only that the assumption and rejection of the executory contract or unexpired lease will benefit the estate. *Granada Investments, Inc. v. DWG Corp.*, 823 F. Supp. 448, 454 (N.D. Ohio 1993) ("The business judgment rule presumes that in making a business decision, actions have been taken on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the company") (citations omitted); *In re Goodyear Tire & Rubber Co. Deriv Litig.*, No. 5:03-cv-2180, 2007 WL 43557, *10 (N.D. Ohio Jan. 5 2007) (holding there is a presumption in making business decisions that the directors exercised duties "with due care, without self-dealing, and in good faith").

C. Assumption. To assume an executory contract, a debtor must satisfy the requirements of section 365(b) of the Bankruptcy Code, including curing defaults and providing adequate assurance of future performance. Section 365(b)(1) provides:

1. If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee:

(a) cures, or provides adequate assurance that the trustee will promptly cure, such default….

(b) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any ancillary pecuniary loss to such party resulting from such default; and

(c) provides adequate assurance of future performance under such contract or lease.

D. Assumption and Assignment. If a debtor chooses to assume and assign an executory contract, the proposed assignee must establish it can provide adequate assurance of future performance. 11 U.S.C. § 365(c). The inability to assign a contract under nonbankruptcy law may prevent assumption and assignment. *In re Catapult Entertainment, Inc.*, 165 F.3d 747 (9th Cir.), *cert dismissed*, 528 U.S. 924, 120 S. Ct. 369, 145 L. Ed. 2d 248 (1999).

E. Rejection. Alternatively, a debtor or trustee may choose to reject an executory contract. Rejection constitutes a material breach of such contract entitling the non-debtor counterparty to file a claim for rejection damages but without the benefit of specific performance. 11 U.S.C. § 365(g). Rejection does not necessarily terminate the contract, but excuses remaining parties from performing, at least with respect to the debtor. Generally, rejection is *nunc pro tunc* the entry of the order granting the rejection. 11 U.S.C. §

II. Rejecting Prepetition Contracts After Confirmation (*In re Triangle USA Petroleum)*

A. **They did what?** In a recent groundbreaking decision, Hon. Mary F. Walrath confirmed a plan that permitted the debtor to reject a pre-bankruptcy contract well after its case ended, despite concerns that the decision would encourage other post-confirmation activities. Judge Walrath held that the debtors' plan sufficiently provided for the rejection of certain pipeline contracts, even though the rejection was conditioned upon the occurrence of future post-confirmation events. *See* Order Confirming Third Amended Joint Chapter 11 Plan of Reorganization of Triangle USA Petroleum Cor. And its Subsidiary Debtors, Case No. 16-11566 (MFW) (Bankr. D. Del. March 10, 2017) [Docket No. 825], pg. 22 (the "***Confirmation Order***").

B. **How Did They Do That?** Section 1123 of the Bankruptcy Code provides that a plan may, "subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section." 11 U.S.C. § 1123(b)(2).

C. **Just The Facts, Ma' ma.** Triangle USA Petroleum Corp ("***TUSA***") and its affiliates (collectively, the "***Debtors***") are an oil and gas exploration and development company focused on the acquisition and development of shale oil and natural gas in the Williston Basin located in North Dakota and Montana. The Debtors and certain nondebtor affiliates created a joint venture called Caliber Midstream Partners LP (with the joint venture's affiliates, "***Caliber***") for the purpose of constructing a pipeline in the Williston Basin. Caliber provided services to TUSA pursuant to several midstream service agreements (collectively, the "***Caliber Contracts***"), which provided that Caliber was to be the exclusive provider of midstream services for certain TUSA drilling units. When gas prices tanked, TUSA intended to use the bankruptcy process to renegotiate the above-market Caliber Contracts.

D. **Of Course, Lawsuits Were Involved.** On May 27, 2016, prior to the bankruptcy filing, Caliber attempted to enforce the Caliber Contracts by commencing a lawsuit (the "***Caliber Declaratory Judgment Action***") against TUSA in the District Court for the Northwest Judicial District of North Dakota (the "***North Dakota State Court***"), seeking, among other things, a declaratory judgment that specific dedications of oil and gas interests contained in certain Caliber Contracts constitute valid and enforceable covenants running with the land under North Dakota Law. On June 29, 2016, TUSA and its affiliated debtors commenced their chapter 11 cases in the United States Bankruptcy Court for the District of Delaware (the "***Bankruptcy Court***"). On July 5, 2016, TUSA filed an adversary proceeding (the "***Caliber Adversary Proceeding***") against Caliber seeking a declaratory judgment that the Caliber Contracts do not contain or constitute valid and enforceable covenants running with the land under North Dakota Law. On November 23, 2016, the Bankruptcy Court entered orders (i) dismissing the Caliber Adversary Proceeding and (ii) modifying the automatic stay to permit the Caliber Declaratory Judgment Action to continue in the North Dakota State Court. *See* TUSA Bankruptcy Docket 469.

E. **Bankruptcy Filing and Proposed Plan Treatment of the Caliber Contracts.** The Debtors were unable to reject the Caliber Contracts during the court of the case because it required a ruling in the Caliber Declaratory Judgment Action by the North Dakota State Court. As a workaround, the Debtors bankruptcy plan contained a "provisional rejection" of the Caliber Contracts that were accompanied by a "toggle" provision that would make the rejection permanent based on the outcome of the Caliber Declaratory Judgment Action.[1] The plan provided that,

[1] Specifically, the plan provided, among other things, that the Caliber Contracts would be deemed automatically rejected pursuant to §§ 365 and 1123 of the Bankruptcy Code as of the effective date of the plan, *subject only to the*

pending a determination whether the conditions had been satisfied, the reorganized debtors would perform under the Caliber Contracts in accordance with their terms.

F. **Caliber Objected.** It argued that the toggle provision would "eviscerate" the statutory protections afforded to Caliber under §§ 1123(b)(2) and 365 of the Bankruptcy Code by allowing the debtors to have an unlimited post-confirmation extension of time to assume or reject to the Caliber Contracts[2]. Caliber focused on the economic argument that the toggle provision allowed the Debtors to delay for years the decision to assume or reject the Caliber Contracts and thereby force Caliber to bear the uncertainty of not knowing whether customers and potential financiers will continue to do business with a company whose primary source of revenue could be rejected at an unknown date. By extending the deadline to assume or reject an executory contract, a debtor also would have the option to wait out market conditions post-effective date, and determine then, with full information, whether rejection or assumption inures to the debtor's benefit.

Caliber also argued that assumption/rejection through section 1123 required compliance with section 365, which (it argued) prohibits a post-confirmation assumption/rejection decision. Section 365 provides in relevant part that "the trustee may assume or reject an executory contract… at any time before the confirmation of the plan." 11 U.S.C § 365(d)(2). According to Caliber, the Bankruptcy Court should have followed *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 529 (1984) ("In a Chapter 11 reorganization, a debtor-in-possession has until a reorganization plan is confirmed to decide whether to accept or reject an executory contract, although a creditor may request the Bankruptcy Court to make such a determination within a particular time."); *see also Fla Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 46 (2008) ("We agree with *Bildisco's* commonsense observation that the *decision* whether to reject a contract or lease must be made before confirmation.)

G. **You Already Know the Plan Was Confirmed.** Clearly, Judge Walrath agreed with the Debtors. At the confirmation hearing, the Debtors argued that section 1123 "provided for" the rejection of the Caliber Contracts. The Debtors also asserted that the toggle provision was appropriate because (1) it enabled the Debtors, which

satisfaction of each of the following conditions: (1) the entry of a final order or judgment in the Caliber Declaratory Judgment Action determining that the Caliber Contracts do not constitute or contain a covenant running with the land; and (2) final order by the Bankruptcy Court determining or estimated the allowed amount of Caliber's rejection damages claims at less than $75 million (the "toggle provision"). The failure of either or both of these conditions to be satisfied would result in the assumption of the Caliber Contracts and the payment of any cure amounts associated with such assumption.

[2] *See Caliber's Objection to the Second Amended Joint Chapter 11 Plan of Reorganization of Triangle USA Petroleum Corporation and Its Affiliated Debtors*, at ¶ 2.

were Caliber's customers, to complete their restructuring; (2) allowed the Caliber Declaratory Judgment Action to be litigated sequentially; (3) allowed Caliber to vote on the plan to the fullest extent of its potential rejection claim and participate in the rights offering provided for under the plan; and (4) provided for the debtors to continue to honor their obligations under the Caliber Contracts during the litigation of the Caliber Declaratory Judgment Action.

In her bench ruling, Judge Walrath agreed that the language of §§ 1123 and 365(d)(2) was permissive, stating that "Congress knowns when to set an absolute deadline, and I don't think the language used by Congress in these two provisions is that." *See Tr. of Hearing*, Case No. 16-11566 (MFW) (Bankr. D. Del. March 10, 2017) at 111-12. The Bankruptcy Court continued to explain that "the debtor simply has to provide in the plan whether a contract is going to be assumed or rejected and the debtor has done so." *Id*. at 112. While Judge Walrath tried to limit the scope of when a debtor could reject an executory contract, she appeared more persuaded by the proposition that "the absolute decision made by the debtor to assume or reject can be conditioned on a future event" *Id.* She also rejected Caliber's market argument because, in large part, the debtors would continue to perform their obligations under the Caliber Contracts pending the resolution of the Caliber Declaratory Judgment Action.

H. **So What Does This Mean?** So long as a debtor can articulate in its plan what treatment in intends to give to an executory contract, and such treatment is not subjective, it appears that such treatment is confirmable… regardless of when the actual rejection or assumption would occur.

PERKINSCOIE

COUNSEL TO GREAT COMPANIES

In re Transwest – How Many Impaired Classes of Creditors is Required to Confirm a Joint Chapter 11 Plan?

Presented by:
Eric E. Walker, Partner at Perkins Coie LLP

Perkins Coie LLP

11 U.S.C. § 1129(a)(10)

- **11 U.S.C. § 1129(a)** – Statutory Requirements for Confirmation of Chapter 11 Plan
  - § 1129(a)(10) – "If a class of claims is impaired under the plan, ***at least one class of claims that is impaired under the plan has accepted the plan***, determined without including any acceptance of the plan by any insider."
- Question arises in a joint chapter 11 plan covering multiple related debtors
- Is the requirement for at least one accepting impaired class of claims applied for each debtor covered by the joint plan ("per debtor") or applied just to the one joint plan ("per plan")

11 U.S.C. § 1129(a)(10)

- Courts adopting the "per plan" rule
  - ***Morgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns, LLC)*, 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009)**
    - Adopting a "per-plan" approach where "the evidence supports a finding that the business of Charter is managed by CCI on an integrated basis making it ***reasonable and administratively convenient*** to propose a joint plan." (emphasis added)
- Courts adopting the "per debtor" rule
  - ***In re Tribune Co.*, 464 B.R. 126, 180 (Bankr. D. Del. 2011)**
    - Adopting a "per debtor" approach because ***each debtor*** in a joint chapter 11 plan must satisfy the requirements under § 1129(a) to confirm a plan
    - Finding that "convenience alone is not sufficient reason to disturb the rights of impaired creditors of a debtor not meeting confirmation standards."

PERKINSCOIE

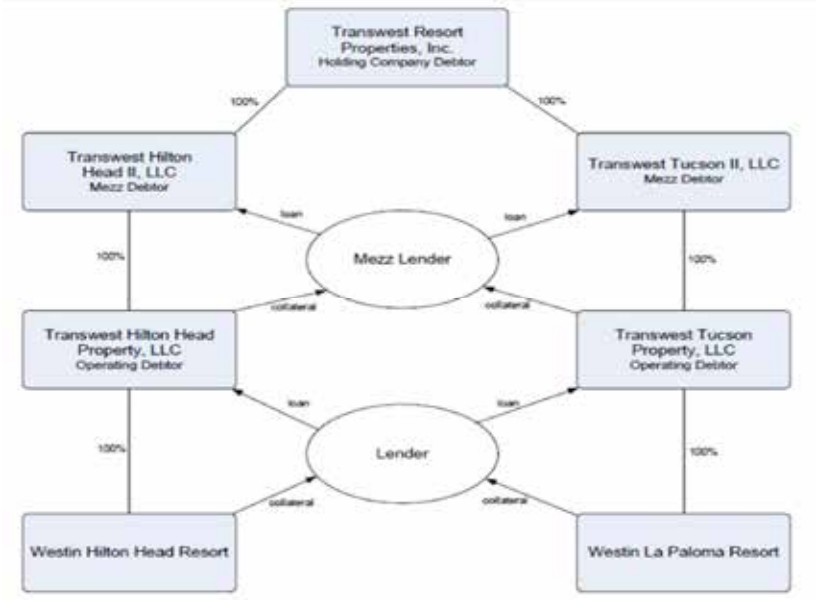
In re Transwest Resort Properties, Inc.

In re Transwest Resort Properties, Inc., 881 F.3d 724 (9th Cir. 2018)

- Involved two resort hotel properties
  - Westin La Paloma in Tucson, Arizona
  - Westin Hilton Head Island Resort and Spa on Hilton Head Island in South Carolina
- Acquisition financed in December 2007 with mortgage debt and mezzanine financing
  - SPE financing structure with Operating Entities, which owned resorts, and Mezzanine Entities, which owned equity interests in Operating Entities
  - Mortgage loan and other trade debt held by Operating Entities
  - Mezzanine loan held by Mezzanine Entities, which had no other creditors
- Debtors defaulted on loans less than a year later during 2008 financial crisis

PERKINSCOIE

In re Transwest – Organizational Structure



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In re Transwest Resort Properties, Inc.

Background Facts

- Operating Entities and Mezzanine Entities filed bankruptcy petitions and cases jointly administered under Fed. R. Bankr. P. 1015(b)
- Debtors filed one joint chapter 11 plan of reorganization for all debtors, but did ***not*** move for substantive consolidation
- Mortgage lender purchase mezzanine claim and voted against chapter 11 plan
- Lender objected to confirmation of joint plan
  - § 1129(a)(10) requires an accepting impaired class of claims for ***each debtor*** in joint chapter 11 plan – *In re Tribune*
  - Mezzanine Debtors had no accepting impaired class
  - Only creditor of Mezzanine Debtors (mezzanine lender) voted against plan

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In re Transwest Resort Properties, Inc.

Bankruptcy Court Decision

- Bankruptcy Court overruled Lender's objection and confirmed the joint chapter 11 plan
- Bankruptcy Court rejected the holding of *In re Tribune* and instead found that the plan reading of the statutory text in §1129(a)(10) only required one accepting impaired class ***per plan***
- Lenders appealed to the District Court
  - District Court dismisses appeal as equitably moot
  - Ninth Circuit reverses and remands to District court
- District Court addresses merits and affirms the Bankruptcy Court's decision relying on the plain language of the statute
- Lenders appealed to the Ninth Circuit Court of Appeals

PERKINSCOIE

In re Transwest Resort Properties, Inc.

Ninth Circuit Opinion

- Ninth Circuit affirms District Court ruling
- Plain language of §1129(a)(10) supports the "per plan" interpretation
- Statutory text does not distinguish between single-debtor and multi-debtor plans
- Court rejected Lender's argument that interpretation of §1129(a)(10) on a "per plan" basis incorrectly permits *de facto* substantive consolidation of a joint plan
- **J. Friedland Concurrence**
  - Acknowledges unfairness in depriving mezzanine lender of ability to effectively object to a joint chapter 11 plan
  - Better addressed through objection to substantive consolidation than through blanket statutory interpretation of §1129(a)(10)

PERKINSCOIE

In re Transwest Resort Properties, Inc.

Implications of *Transwest* Opinion

- Only one accepting impaired class of claims is required for joint Chapter 11 plans
  - Even joint plans involving *hundreds* of different debtors
  - Potential for "drag along" joint chapter 11 plans – ability to join debtors unable satisfy 11 U.S.C. § 1129(a)(10)
- Impact on Substantive Consolidation
  - Potential for *de facto* substantive consolidation
  - Friedland Concurrence suggests potential for objecting on this ground
- Market impacts on availability and pricing of mezzanine financing

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN THE MATTER OF TRANSWEST RESORT PROPERTIES, INC., *Debtor*,	No. 16-16221
JPMCC 2007-C1 GRASSLAWN LODGING, LLC, *Appellant*, v. TRANSWEST RESORT PROPERTIES INCORPORATED; SWVP LA PALOMA LLC; SWVP HILTON HEAD LLC, *Appellees*.	D.C. Nos. 4:12-cv-00024-RCC 4:12-cv-00121-RCC OPINION

Appeal from the United States District Court
for the District of Arizona
Raner C. Collins, Chief District Judge, Presiding

Argued and Submitted October 25, 2017
San Francisco, California

Filed January 25, 2018

Before: J. CLIFFORD WALLACE, MILAN D. SMITH, JR., and MICHELLE T. FRIEDLAND, Circuit Judges.

Opinion by Judge Milan D. Smith, Jr.;
Concurrence by Judge Friedland

SUMMARY*

Bankruptcy

The panel affirmed the district court's affirmance of the bankruptcy court's order approving a Chapter 11 "cramdown" reorganization plan of five related debtors.

The debtors had previously acquired two resorts. A lender, whose claim was undersecured, elected to have its entire claim treated as secured pursuant to 11 U.S.C. § 1111(b)(2). The plan restructured the lender's loan to a term of 21 years and included a due-on-sale clause requiring the debtors to pay the lender the outstanding balance of the loan if the resorts were sold. The due-on-sale clause did not apply if the debtors were to sell the resorts between years five and fifteen.

The panel held that an election under § 1111(b)(2) does not require that a due-on-sale clause be included in a reorganization plan.

* This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

The panel also held that § 1129(a)(10), which requires that at least one impaired class accept a "cramdown" plan, applies on a "per plan" basis, rather than a "per debtor" basis.

Concurring, Judge Friedland agreed that § 1111(b)(2) does not require that a bankruptcy plan include complete due-on-sale protection for the creditor and that § 1129(a)(10) applies on a "per plan" basis. She wrote separately to acknowledge the argument of the lender that it was unfairly deprived of the ability to object effectively to reorganization of two of the debtors, despite being their only creditor. Judge Friedland wrote that any unfairness resulted not from the interpretation of § 1129 challenged by the lender, but instead from the fact that the reorganization treated the five debtor entities as if they had been substantively consolidated—something the lender did not object to in the bankruptcy court.

COUNSEL

David M. Neff (argued) and Eric E. Walker, Perkins Coie LLP, Chicago, Illinois; Dean C. Waldt, Ballard Spahr LLP, Phoenix, Arizona; for Appellant.

Donald A. English (argued) and Christy I. Yee, English & Gloven APC, San Diego, California; Susan G. Boswell and Brad D. Terry, Quarles & Brady LLP, Tucson, Arizona; for Appellees.

OPINION

M. SMITH, Circuit Judge:

JPMCC 2007-C1 Grasslawn Lodging, LLC (Lender) objected to the Chapter 11 plan of five related entities (collectively, Debtors) who previously acquired two hotels. Despite these objections, the bankruptcy court approved a "cramdown" reorganization plan. The Lender appealed to the district court, but the district court concluded that the Lender's appeal was equitably moot. In 2015, we reversed the district court's equitable mootness determination, and remanded to the district court for consideration of the Lender's appeal on the merits. *See In re Transwest Resort Props., Inc.*, 801 F.3d 1161 (9th Cir. 2015) (*Transwest I*).

On remand, the district court evaluated the merits of the Lender's appeal, and concluded that (1) an election under 11 U.S.C. § 1111(b)(2) does not require that a Chapter 11 plan contain a due-on-sale clause; and (2) 11 U.S.C. § 1129(a)(10) applies on a "per plan," not a "per debtor," basis. This appeal is limited to the construction of 11 U.S.C. § 1111(b)(2) and 11 U.S.C. § 1129(a)(10).[1] Based on the plain language of both statutory sections, we affirm.

FACTUAL AND PROCEDURAL BACKGROUND

In 2007, the Debtors acquired the Westin Hilton Head Resort and Spa and the Westin La Paloma Resort and Country Club (collectively, the Resorts). The Debtors were composed of: Transwest Hilton Head Property, LLC, and Transwest Tucson Property, LLC (Operating Debtors);

[1] Unless otherwise noted, subsequent statutory references are to Title 11 of the United States Code.

Transwest Hilton Head II, LLC, and Transwest Tucson II, LLC (Mezzanine Debtors); and Transwest Resort Properties, Inc. (Holding Company Debtor). The Holding Company Debtor was the sole owner of the Mezzanine Debtors. The Mezzanine Debtors were, in turn, the sole owners of the two Operating Debtors, who owned and operated the Resorts. The acquisitions were financed by (1) a $209 million mortgage loan to the Operating Debtors from the Lender, secured by the Resorts (the Operating Loan); and (2) a $21.5 million loan from Ashford Hospitality Finance, LP (Mezzanine Lender), secured by the Mezzanine Debtors' interests in the Operating Debtors (the Mezzanine Loan).

In 2010, the Debtors filed for Chapter 11 bankruptcy. The five cases involved were jointly administered, but not substantively consolidated.[2] The Lender filed a claim in the bankruptcy proceeding for $298 million, based on the Operating Loan. The Mezzanine Lender filed a $39 million claim based on the Mezzanine Loan. The Lender subsequently acquired this claim from the Mezzanine Lender.

The Debtors filed a joint Chapter 11 reorganization plan (the Plan), whereby third-party investor Southwest Value Partners would acquire the Operating Debtors for $30 million, thereby extinguishing the Mezzanine Debtors' ownership interest in the Operating Debtors.

The Lender, whose claim was undersecured, elected to have its entire claim treated as secured pursuant to 11 U.S.C. § 1111(b)(2). The Plan restructured the Lender's loan to a term of 21 years, and required monthly interest payments,

[2] The Lender never objected to or argued that the bankruptcy court was treating the case as if substantive consolidation had occurred.

and a balloon principal payment at the end of the term. The Plan included a due-on-sale clause requiring the Debtors to pay the Lender the outstanding balance of the restructured loan in the event the Resorts were sold. However, the due-on-sale clause did not apply if the Debtors were to sell the Resorts between Plan years five and fifteen. The Lender voted against the Plan. Several other impaired classes voted to approve the Plan.

The Lender objected to two aspects of the Plan.[3] First, the Lender objected to the ten-year exception in the due-on-sale clause. It contended that the exception in the due-on-sale clause would allow the Debtors to partially negate the benefit of the Lender's section 1111(b)(2) election. Second, the Lender asserted that section 1129(a)(10), which requires that at least one impaired class accept the Plan, applies on a "per debtor," not a "per plan," basis. Because the Lender is the only class member for the Mezzanine Debtors and did not vote to approve the Plan, the Lender argued that the Plan did not satisfy section 1129(a)(10). Despite the Lender's objections, the bankruptcy court approved the Plan.

Following an unsuccessful emergency motion for a stay pending appeal, the district court dismissed the Lender's appeal as equitably moot. In 2015, we reversed this dismissal and remanded to the district court with instructions to evaluate the Lender's objections on the merits. *Transwest I*, 801 F.3d at 1173. On remand, the district court ruled that an election under section 1111(b)(2) does not require that a due-on-sale clause be included in the Plan, and that section 1129(a)(10) applies on a "per plan" basis. The district court

[3] The Lender raised other objections to the Plan, but the parties previously resolved those objections.

thereby affirmed the bankruptcy court's confirmation of the Plan. The Lender timely appealed to our court.

JURISDICTION AND STANDARD OF REVIEW

We have jurisdiction over this appeal pursuant to 28 U.S.C. § 158(d)(1). Because the Lender appeals from the district court's conclusions of law and interpretations of the Bankruptcy Code, we review *de novo*. *See Smith v. Arthur Andersen LLP*, 421 F.3d 989, 1006 (9th Cir. 2005); *In re Barakat*, 99 F.3d 1520, 1523 (9th Cir. 1996).

ANALYSIS

I. 11 U.S.C. § 1111(b)

The Lender first challenges the district court's conclusion that a due-on-sale clause need not be included in the Plan when an undersecured creditor elects to have its claim treated as secured pursuant to section 1111(b)(2). This section must be read in context. Pursuant to section 506(a), an undersecured creditor's claim is bifurcated into: (1) "a secured claim equal to the value of the collateral" and (2) "an unsecured claim equal to the remainder of the obligation owing to the creditor as of the petition date." *In re Weinstein*, 227 B.R. 284, 291–92 (B.A.P. 9th Cir. 1998). The undersecured creditor may elect to have its entire claim treated as secured pursuant to section 1111(b)(2). *Id.* at 293; *see* 11 U.S.C. § 1111(b)(2). The effect of such an election is that the undersecured creditor obtains certain benefits reserved for secured, but not unsecured, creditors. *See, e.g.*, 11 U.S.C. § 1129(b)(2)(A)–(B) (distinguishing between the "fair and equitable" requirements for secured and unsecured claims). The Lender contends that the absence of a due-on-sale clause covering sales of the Resorts occurring between years five and fifteen of the loan term partially diminishes

the benefits of its section 1111(b)(2) election, thereby violating section 1111(b)(2).

"The starting point for our interpretation of a statute is always its language." *United States v. Fei Ye*, 436 F.3d 1117, 1120 (9th Cir. 2006) (quoting *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989)). We must consider "the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997); *see also King v. Burwell*, 135 S. Ct. 2480, 2489 (2015) ("[W]hen deciding whether the language is plain, we must read the words 'in their context and with a view to their place in the overall statutory scheme.'" (citation omitted)). Only where the statutory text is ambiguous do we "look to other interpretive tools, including the legislative history," in order to determine the statute's meaning. *See Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 567 (2005).

Section 1111(b) provides, in pertinent part:

> (1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless—
>
> > (i) the class of which such claim is a party elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection;

. . . .

> (2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

11 U.S.C. § 1111(b). The Lender's position that section 1111(b)(2) requires a due-on-sale clause to be included in the Plan finds no support in the text of the statute, nor does the language of the statute implicitly require the inclusion of such a clause.

The broader statutory context of Chapter 11 further undermines the Lender's position. Section 1123 describes the required contents of a Chapter 11 plan. *See* 11 U.S.C. § 1123. Nothing in section 1123 requires the inclusion of a due-on-sale clause in a plan, let alone following a section 1111(b)(2) election. Instead, section 1123(b)(5) indicates that a plan may "modify the rights of holders of secured claims." This would include the ability to determine whether to include a due-on-sale clause in the documentation of any secured creditors' claims. Further, section 1129(b)(2)(A)(i)(I) requires that in order for a plan to be fair and equitable, the holder of a claim must retain the lien securing that claim even when "the property subject to such liens is . . . transferred to another entity." Thus, the statute expressly allows a debtor to sell the collateral to another entity so long as the creditor retains the lien securing its claim, yet the statute does not mention any due-on-sale requirement, further undermining the Lender's position that a due-on-sale clause must be included in the Plan.

Our conclusion is consistent with the reasoning of the Seventh Circuit in *In re Airadigm Commc'ns, Inc.*, 519 F.3d

640 (7th Cir. 2008). There, FCC regulations required that, under certain circumstances, a due-on-sale clause be included in the documentation when a licensee transfers a license to a non-qualifying entity. *Id.* at 653. A licensee filed a reorganization plan, which a bankruptcy court approved even though it did not contain a due-on-sale clause. *Id.* at 646. The FCC objected to the plan because it "did not keep the FCC's due-on-sale rights." *Id.* at 646, 653. While the FCC did not make an election under section 1111(b), the Seventh Circuit concluded that a due-on-sale provision was not a "lien that the bankruptcy court had to 'retain' in order to approve the plan pursuant to § 1129." *Id.* at 654. Instead, the provision is merely a mechanism "regarding the terms of payment for the debt." *Id.* at 655. The same reasoning applies in this case—a due-on-sale clause is a mechanism regarding the terms of payment of a debt, not a substantive right of creditors making an election pursuant to section 1111(b)(2).

Neither the plain language of section 1111(b)(2) nor the broader context of Chapter 11 requires that a plan involving an electing creditor contain a due-on-sale clause. We need not address the Lender's remaining arguments because the statutory text renders the Lender's other arguments meritless. *See Satterfield v. Simon & Schuster, Inc.*, 569 F.3d 946, 951 (9th Cir. 2009). We therefore hold that section 1111(b)(2) does not require that a plan involving an electing creditor contain a due-on-sale clause.[4]

[4] This holding does not imply that "due-on-sale" protection is irrelevant to whether a plan is "fair and equitable" under section 1129(b). Although the Lender here waived any argument that the Plan was not "fair and equitable," the availability of due-on-sale protection may inform whether a plan is confirmable in other reorganizations. *Cf. In re*

II. 11 U.S.C. § 1129(a)(10)

The Lender next challenges the district court's conclusion that section 1129(a)(10) applies on a "per plan" basis. Generally, a bankruptcy court may confirm a plan only if each class of impaired creditors consents. 11 U.S.C. § 1129(a)(8). However, in certain instances, a plan proponent can confirm a "cramdown" Chapter 11 plan over the objections of one or more of the creditors. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 641–42 (2012); *see* 11 U.S.C. § 1129(b). Section 1129 lists the requirements for approval of a cramdown plan, and "contains a number of safeguards for secured creditors who could be negatively impacted by a debtor's reorganization plan." *In re The Vill. at Lakeridge, LLC*, 814 F.3d 993, 1000 (9th Cir. 2016). One such safeguard is in section 1129(a)(10), which requires that at least one impaired creditor has accepted the plan. *See* 11 U.S.C. § 1129(a)(10).

According to the Lender, a complication arises when there is a jointly administered plan consisting of multiple debtors. The Lender argues that in such a situation, a "per debtor" approach that requires plan approval from at least one impaired creditor for each debtor involved in the plan is necessary. In contrast, the Debtors argue that the plain language of the statute contemplates a "per plan" approach in which a plan only requires approval from one impaired creditor for any debtor involved. As a matter of first impression among the circuit courts, we hold that section 1129(a)(10) applies on a "per plan" basis.

Monarch Beach Venture, Ltd., 166 B.R. 428, 436 (Bankr. C.D. Cal. 1993) ("[T]o be fair and equitable, a plan of reorganization cannot unfairly shift the risk of a plan's failure to the creditor.").

As with section 1111(b)(2), we begin our analysis of section 1129(a)(10) with its plain language. *See In re HP Inkjet Printer Litig.*, 716 F.3d 1173, 1180 (9th Cir. 2013). Section 1129(a) provides that a court may confirm a plan only if a number of requirements are met. Section 1129(a)(10) details one such requirement: "If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." 11 U.S.C. § 1129(a)(10).

The plain language of the statute supports the "per plan" approach. Section 1129(a)(10) requires that one impaired class "under the plan" approve "the plan." It makes no distinction concerning or reference to the creditors of different debtors under "the plan," nor does it distinguish between single-debtor and multi-debtor plans. Under its plain language, once a single impaired class accepts a plan, section 1129(a)(10) is satisfied as to the entire plan. Obviously, Congress could have required plan approval from an impaired class for each debtor involved in a plan, but it did not do so. It is not our role to modify the plain language of a statute by interpretation. *See King*, 135 S. Ct. at 2489 ("If the statutory language is plain, we must enforce it according to its terms.").

The statutory context of section 1129(a)(10) does not aid the Lender's argument. The Lender, citing the only court that has applied the "per debtor" approach, argues that section 102(7) requires that section 1129(a)(10) apply on a "per debtor" basis. *See In re Tribune Co.*, 464 B.R. 126, 182–83 (Bankr. D. Del. 2011). We disagree. Section 102(7), a rule of statutory construction, provides that "the singular includes the plural." 11 U.S.C. § 102(7). This rule of construction does not change our analysis. Section 102(7)

effectively amends section 1129(a)(10) to read: "at least one class of claims that is impaired under the plans has accepted the plans." The "per plan" approach is still consistent with this reading. Therefore, section 102(7) does not undermine our view that section 1129(a)(10) applies on a "per plan" basis.

Nor do other subsections in section 1129(a) indicate that section 1129(a)(10) must apply on a "per debtor" basis. The court in *Tribune* concluded that section 1129(a)(10) must apply on a "per debtor" basis because other subsections apply on a "per debtor" basis. 464 B.R. at 182–83. For example, section 1129(a)(3) requires that "[t]he plan has been proposed in good faith." 11 U.S.C. § 1129(a)(3). This argument fails for two reasons. First, as with subsection ten, nothing in the plain text of subsection three indicates that it applies on a "per debtor" basis. *See BedRoc Ltd. v. United States*, 541 U.S. 176, 183 (2004) (holding a court presumes that Congress says in the statute what it means). Second, while a statute must be "read as a whole," *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991), the Lender provides no support for its position that all subsections must uniformly apply on a "per debtor" basis, especially when the Bankruptcy Code phrases each subsection differently. Instead, the Lender's argument is essentially a regurgitation of a summary of the *Tribune* decision unsupported by argument or other case law. These deficiencies defeat the Lender's argument that section 1129(a)(10) unambiguously applies on a "per debtor" basis based on other subsections in section 1129(a).

The Lender also argues that while the Plan states it is a jointly administered plan, it was, in effect, a substantive consolidation. The Lender's argument faces two hurdles. First, the Lender never objected to the Plan on this basis. As

the Lender's counsel concedes, the only issue before us is the construction of sections 1111(b)(2) and 1129(a)(10). These are the objections the Lender raised before the bankruptcy court, the objections it appealed to the district court, and the issues we previously identified. *See Transwest I*, 801 F.3d at 1166–67. Therefore, whether the parties and the bankruptcy court dealt with the Plan approval as if it were a substantive consolidation is not properly before us on appeal. Second, to the extent the Lender argues that the "per plan" approach would result in a parade of horribles for mezzanine lenders, such hypothetical concerns are policy considerations best left for Congress to resolve. *See Henson v. Santander Consumer USA Inc.*, 137 S. Ct. 1718, 1726 (2017) (stating that "the proper role of the judiciary" in statutory interpretation is "to apply, not amend, the work of the People's representatives").

Because the plain language of section 1129(a)(10) indicates that Congress intended a "per plan" approach, we need not to look to the statute's legislative history or address the Lender's remaining policy concerns. *See Tahara v. Matson Terminals, Inc.*, 511 F.3d 950, 953 (9th Cir. 2007) (citing *SEC v. McCarthy*, 322 F.3d 650, 655 (9th Cir. 2003)). We therefore hold that section 1129(a)(10) applies on a "per plan" basis.

CONCLUSION

For the foregoing reasons, we affirm the district court's conclusions that 11 U.S.C. § 1111(b) does not require the inclusion of a due-on-sale clause in the Plan, and that 11 U.S.C. § 1129(a)(10) applies on a "per plan" basis.

AFFIRMED.

FRIEDLAND, Circuit Judge, concurring:

I agree that 11 U.S.C. § 1111(b)(2) does not require that a bankruptcy plan include complete due-on-sale protection for the creditor. And although I think the statutory language is somewhat ambiguous, I further agree that the better reading of 11 U.S.C. § 1129(a)(10) is that it applies on a "per plan," rather than "per debtor," basis. I write separately, however, to acknowledge the argument advanced by JPMCC 2007-C1 Grasslawn Lodging, LLC ("Lender") that it was unfairly deprived of the ability to object effectively to reorganization of the Mezzanine Debtors, despite being their only creditor. While Lender's concern is not unfounded, I believe any unfairness resulted not from the interpretation of § 1129 that Lender challenged in this appeal, but instead from the fact that this particular reorganization treated the five Debtor entities as if they had been substantively consolidated—something Lender did not object to in the bankruptcy court.

Joint administration and substantive consolidation are both mechanisms to facilitate multi-debtor reorganizations. Joint administration is a tool of convenience; "[t]here is no merging of assets and liabilities of the debtors," and "[c]reditors of each debtor continue to look to that debtor for payment of their claims." *In re Parkway Calabasas Ltd.*, 89 B.R. 832, 836 (Bankr. C.D. Cal. 1988). By contrast, substantive consolidation replaces "two or more debtors, each with its own estate and body of creditors," with "a single debtor, a single estate with a common fund of assets, and a single body of creditors." *Id.* at 836–37*; see also In re Bonham*, 229 F.3d 750, 764 (9th Cir. 2000). Accordingly, "consolidation depends on substantive considerations and affects the substantive rights of the creditors of the different estates." *In re Bonham*, 229 F.3d at 762 (quoting Fed. R.

Bankr. P. 1015 advisory committee's note). Here, the cases of the five Debtors were jointly administered pursuant to Federal Rule of Bankruptcy Procedure 1015, but neither party moved for substantive consolidation.

Nevertheless, I think Lender is correct that the distribution scheme adopted by the Plan involved a degree of substantive consolidation. Debtors' respective bankruptcy estates may technically have remained separate, but the Plan treated Debtors as a single entity. Specifically, by subordinating the Mezzanine Loan claims to the Operating Loan claims, the creditors for different Debtors all drew from the same pool of assets. And had the Mezzanine Lender voted to accept the Plan, its claims would have been paid from the assets of the reorganized Operating Debtors, demonstrating that the Plan did not differentiate based on the recipient of a particular creditor's loan. As the bankruptcy court itself explained, this arrangement treated the Mezzanine Lender's claims as if the cases had been substantively consolidated.

In many cases involving a reorganization plan that effectively merges the assets and liabilities of multiple debtors, "the constituents in the chapter 11 proceeding either reach this result by consensus, or, no objection is made by any creditor or party in interest." *In re Tribune*, 464 B.R. 126, 183 (Bankr. D. Del. 2011). The plan can thus proceed under a "de facto" substantive consolidation, absent a formal assessment of whether substantive consolidation is appropriate. Here, however, two classes of creditors objected to the Plan: (1) the class consisting of Lender's secured claim, which arose from the mortgage loan secured by the resorts, and (2) the class consisting of the secured and unsecured mezzanine claims, which arose from the mezzanine loan originally provided by Ashford Hospitality

Finance, LP, and subsequently purchased by Lender. Because there was no consensus over these bankruptcy proceedings, there should have been an evaluation of whether substantive consolidation was appropriate before it (effectively) occurred.

To determine whether substantive consolidation is appropriate, a bankruptcy court evaluates "(i) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit; or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors." *FDIC v. Colonial Realty Co.*, 966 F.2d 57, 61 (2d Cir. 1992) (quoting *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2d Cir. 1988)) (internal quotation marks omitted); *see also In re Bonham*, 229 F.3d at 766 (adopting the Second Circuit's test for substantive consolidation). The "sole aim" of this analysis is "fairness to all creditors." *In re Bonham*, 229 F.3d at 765 (quoting *Colonial Realty*, 966 F.2d at 61). Assessing whether substantive consolidation was appropriate here would thus have required the bankruptcy court to consider whether consolidation was fair to Lender, among other creditors.

According to Lender, its treatment under the Plan was unfair, and the root of the potential unfairness is that § 1129(a)(10) was interpreted as applying on a "per plan," rather than a "per debtor," basis. Section 1129(a)(10) requires that at least one impaired class of creditors accept a plan in order for it to be confirmed. Under the "per plan" approach, this provision was satisfied here as soon as any one impaired class from any of the five Debtors accepted the Plan. But if this provision had been applied on a "per debtor" basis, then one impaired class for *each* of the five Debtors would have had to accept the Plan. Because Lender was the

only creditor for the Mezzanine Debtors following its purchase of the mezzanine claims, under the "per debtor" interpretation of § 1129(a)(10) Lender's objection would have prevented the Plan from being confirmed. Lender argues that use of the "per plan" approach had the same effect as substantive consolidation because one impaired class of creditors for one Debtor was able to bind all of the involved creditors, nullifying the leverage Lender would have otherwise had in the confirmation process under the "per debtor" approach.

Lender thus characterizes the "per plan" approach as "de facto" substantive consolidation. But this characterization is correct only to the extent that the "per plan" approach allowed for confirmation of a Plan that effectively merged the Debtor entities. The root of Lender's objection is that the reorganization here was governed by a single plan that did not delineate among separate debtor-creditor relationships. Had the Debtors—and thus their reorganization plans—remained separate, there would have been no need to invoke the "per debtor" approach to preserve the effectiveness of any objection Lender had.

Although Lender's "per debtor" interpretation would have allowed Lender to object and thereby block confirmation of the Plan, the problem in my view is not the interpretation of the statute, but rather that the Plan effectively merged the Debtors without an assessment of whether consolidation was appropriate. Such an assessment would have required the bankruptcy court to evaluate whether it was fair to proceed on a consolidated basis. *In re Bonham*, 229 F.3d at 765. Had the court taken this step of "balanc[ing] the benefits that substantive consolidation would bring against the harms that it would cause," *id.*, it

might have alleviated concerns about whether consolidation of the proceedings was in fact unfair.

Given that Lender asserts now that de facto substantive consolidation was inappropriate, it is unclear why Lender did not challenge the Plan on that basis prior to confirmation. It is possible that, if there had been an objection raising the question, Debtors' single-purpose entity structure would have defeated any request for substantive consolidation. The original loan documents required maintaining the Operating Debtors and the Mezzanine Debtors as separate entities. As a result, the bankruptcy court might have concluded that creditors treated Debtors as separate entities, and further that the special-purpose entity structure prevented their assets from becoming entangled—thus rendering substantive consolidation unavailable under this circuit's test. *See id.* at 765–66. If so, the court could have required altering the distribution scheme to maintain entity separateness, thus preserving Lender's leverage over the Plan.

If, however, the bankruptcy court had instead determined that this case was a candidate for substantive consolidation, then an appeal of that determination would have involved an evaluation of this particular Plan on its facts and resulting equities—rather than a challenge to the interpretation of a statute that governs all Chapter 11 reorganizations. But because Lender focused solely on the statute, the substantive consolidation objection is now waived.

In sum, I am not unsympathetic to Lender's argument that it was deprived of an opportunity to object to confirmation of the Plan, and I have concerns that entangling various estates in a complex, multi-debtor reorganization diminishes the protections afforded to creditors by the Bankruptcy Code. But I do not believe bolstering these

protections requires the blanket statutory solution that Lender proposes. Rather, if a creditor believes that a reorganization improperly intermingles different estates, the creditor can and should object that the plan—rather than the requirements for confirming the plan—results in de facto substantive consolidation. Such an approach would allow this issue to be assessed on a case-by-case basis, which would be appropriate given the fact-intensive nature of the substantive consolidation inquiry. *See In re Bonham*, 229 F.3d at 765 ("[O]nly through a searching review of the record, on a case-by-case basis, can a court ensure that substantive consolidation effects its sole aim: fairness to all creditors." (quoting *Colonial Realty*, 966 F.2d at 61)).

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Update Regarding Cram down Valuation (Yes, you can do that to a secured lender)

I. General Overview of Cram Down Concept

A. Bankruptcy Code Section 506(a)(1) governs the extent to which a creditor has a secured claim in property of the bankruptcy estate. The value of such secured claim is "determined in light of the purpose of the valuation and of the proposed disposition or use of such property."

B. Courts have employed several different valuation methods for collateral in the context of a chapter 11 plan:

1. **Foreclosure Value**: is determined by the net amount the creditor would receive upon foreclosure and a subsequent sale of the asset.

2. **Replacement Value**: is determined by how much the debtor would have to pay to purchase a "like" asset. *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 965, 117 S. Ct. 1879, 1886, 138 L.Ed.2d 148 (1997) ("*Rash*").

3. **"Split the Difference**" – certain courts use the mid-points of both valuations.

C. **What Applies in Chapter 11?** Some experts argue that *Rash* is limited to Chapter 13 cram down cases and/or to personal property valuation. Rash involved a chapter 13 plan and the proposed retention of a truck, so foreclosure value was significantly lower than replacement value. But other courts have not conceded that *Rash* applies in Chapter 11 cases or in cases involving real property. For example, in *United Air Lines, Inc. v. Reg'l Airports Imp. Corp*., 564 F.3d 873 (7th Cir. 2009), in valuing airline terminal gates that the debtor had improved, the United States Court of Appeals for the Seventh Circuit determined that foreclosure value operates to set a floor on the secured creditor's recovery. The Seventh Circuit stated: "[i]f the Lender foreclosed and took over the space, it could rent the gates to United or some other airline at more than $17 a square foot- at perhaps four times that much, to go

by prices at the airport's one terminal that leases fully built-out gates." *Id*. at 876-77.

Yet, the Third Circuit Court of Appeals has articulated a somewhat different standard. In *In re Heritage Highgate, Inc*., 679 F.3d 132 (3d Cir. 2012), the court adopted the replacement value standard identified in Rash, and applied it in a case that involved real property. However, that court equated replacement value with the asset's fair market value, as "most respectful of a property's anticipated use." Id. at 142.

D. The variation in approaches leads to a lack of uniformity in the bankruptcy process and calls into question what valuation standard applies to confirmation of a cram down plan. When a debtor chooses to retain the collateral rather than to return it to the secured creditor, the Bankruptcy Code requires the plan to provide the creditor "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." § 1129(b)(2)(A)(i)(II).

II. In re Sunnyslope, 859 F.3d 637 (9th Cir. 2017).

A. This is a noteworthy case for secured lenders involving the confirmation of a cram down plan proposed by Sunnyslope Housing Limited Partnership in its chapter 11 bankruptcy case. The disputed raised in this case concerns what value a debtor must pay under a plan if the debtor proposed to keep real property over the objection of a secured lender.

B. **Facts**: The Debtor owned an apartment complex in Arizona. To secure financing and tax benefits, the debtor agreed to covenants which required that the property be used for affordable housing. These restrictive covenants were terminated upon foreclosure. After the debtor defaulted, First Southern National Bank began foreclosure proceedings. A receiver was appointed and ultimately agreed to sell the property to a third party for $7.65 million. Before the sale closed, Sunnyslope filed a chapter 11 petition and sought to retain the complex by exercising the cram down option over First Southern's objection.

C. **Valuation Issue**: The chief dispute at confirmation was the value of the apartment complex, and specifically whether the property should be valued with or without the restrictive covenants. A valuation of the property that contemplated continued use of the complex for low-income housing (in accordance with the restrictive covenants) resulted in a valuation of $3.9 million with interest at 4% (a lower rate than in the original loan), over 40 years, with a balloon at the end. Conversely, if the covenants were rejected, the property may be worth more than $7 million.

D. **Lower Court Decisions**: Relying on 11 U.S.C. § 1129(b)(2)(A)(i)(II), the bankruptcy court confirmed the plan at the $3.9 million valuation and the district court affirmed because the plan provides for payment of "at least the value of the creditor's interest in the estate's interest" in the collateral securing the claim. On

appeal, the United States Court of Appeals for the Ninth Circuit reserved the lower court's decision. The panel held that the apartment complex should have been valued without regard to the covenants. Ultimately, the case was granted a rehearing *en banc*.

E. **Ninth Circuit's Decision**: The United States Court of Appeals for the Ninth Circuit, sitting *en banc*, created a split with the Seventh Circuit and lower courts in finding that *Rash* mandated the application of the replacement value standard for real property under § 506(a)(1) for the purposes of a cram down under § 1129(b)(2)(A)(i)(II). Section 506(a) says that the value of the property is "determined in light of the purpose of the valuation and of the proposed disposition or use of such property." The difficulty here is that the Supreme Court in *Rash* said "that the value of collateral under § 506(a)(1) is 'the cost the debtor would incur to obtain a like asset for the same 'proposed . . . use.'" The bank argued that that means the cost of building that building for use as affordable housing. But the court here responded that it's the value of that building as proposed to be used by the debtor. "[T]he proposed disposition and use is for low-income housing; indeed, no other use is possible without foreclosure."

As to the remainder of the cram down issues, the 9th Circuit said there is no clear error. As to the interest rate, "[t]he bankruptcy court conducted a hearing at which it heard expert testimony, applied the *Till* test, and found that the 4.4% interest rate on the plan payments would result in [the bank's] receiving the present value of its $3.9 million security over the term of the reorganization plan. The relevant national prime rate was 3.25%, and the bankruptcy court adjusted that rate upward to account for the risk of non-payment."

In his dissent, Judge Kozinski insists that *Rash* mandates the higher value. He says, "Rash never adopted today's strict 'particular use' interpretation of replacement value." In a footnote he comments, "I make no effort to defend Rash, which has been subject to abundant criticism along these lines. But I also see no reason to step beyond it, as today's majority does."

F. **What is *Really* Going On Here?** Dissenters would argue that this case is not really about valuation at all. It is about lien priority, an issue not involved in *Rash*. There were two relevant encumbrances (*i.e.*, property interests) attached to the debtor's property: the senior lien of the secured creditor, and the subordinate right of the housing authority to enforce its covenants. The covenants were expressly subordinated to the lien of the mortgage, pursuant to an agreement. Under §510(a), that subordination agreement is *per se* enforceable:

> (a) A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law.

In holding that the property would remain subject to the covenants, the Ninth Circuit necessarily reversed the priorities of those two encumbrances, stripping the senior lien of its senior status. The Ninth Circuit failed to mention §510(a).

G. **Fight! Fight! Fight!** There aren't many issues in the bankruptcy arena that actually get people's dander up but cram down valuation may be one of them. A group of eight retired bankruptcy judges and law professors, led by retired bankruptcy judge Judith K. Fitzgerald, filed an *Amici Curiae* brief in support of Writ of Certiorari (but not in support of either party). On January 8, 2018, the Supreme Court denied certiorari.

Although three circuits may have split on the question of whether a secured creditor can recover foreclosure value when foreclosure will bring a higher price than the debtor's continuing use of the property, the justices might believe the split is not yet broad enough to warrant review. A split may be slow to broaden because questions arising from confirmation valuations seldom reach even the courts of appeals because consummation of chapter 11 plans often renders the appeals moot.

H. **So What Now?** Does Rash mandate the use of replacement value even when that valuation method returns less to the secured creditor than it could obtain on its own using its state law rights? Can Debtors manipulate cram down valuation by stating a less than genuine basis for use of the property moving forward? How does 11 U.S.C. § 1111(b) play into the decision of a secured lender moving forward? Until the Supreme Court decides these issues, debtors and secured creditors are in limbo and may face the uncertainty associated with valuations in a chapter 11 cram down plan.