Central States
Bankruptcy Workshop

Business Track

Decoding § 1111(b) Elections

Hon. David D. Cleary, Moderator
U.S. Bankruptcy Court (N.D. Ill.) | Chicago

Jonathan E. Aberman
Dykema Gossett PLLC | Chicago

Franklind D. Lea
Tactical Financial Consulting, LLC | Alpharetta, Ga.

Julie B. Teicher
Maddin Hauser Roth & Heller P.C. | Southfield, Mich.

CONCURRENT SESSION

2022

CENTRAL STATES BANKRUPTCY WORKSHOP

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JUNE 23-25, 2022

CENTRAL STATES BANKRUPTCY WORKSHOP

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Decoding § 1111(b) Elections

Statutory Review

DETERMINATION OF SECURED STATUS —§ 506(A)

- **An *Allowed* Claim . . .** is a ***secured claim*** to the extent of the value of creditor's security interest in the estate's property (i.e., its collateral value)

. . .

- and is an ***unsecured claim*** to the extent that the Allowed Claim exceeds the value of its security interest. See 11 U.S.C. § 506(a)

In other words, § 506(a) bifurcates claims into two parts:

- A secured claim equal to the value of the collateral, and
- An unsecured claim for the remaining amount

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Statutory Review

NON-RECOURSE TO RECOURSE—§ 1111(B)(1)

- Allows a non-recourse creditors to participate as a recourse creditor (and potentially control the unsecured vote)
  - Class vote, not an individual creditor election
  - Applies unless property is sold via 363 Sales or through the Plan

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Statutory Review

SECURE ENTIRE AMOUNT OF CLAIM—§ 1111(B)(2)

- Allows a Secured Creditor to elect to have its entire Allowed Claim treated as a single Secured Claim UNLESS:
  - Lien has Inconsequential Value
  - Property is being sold as part of a 363 sale or under a Plan

Bankruptcy Code Reference

Section 1111(b) - Treatment of Undersecured Claims

§ 1111(b)(1) - Converts Claim from Non-Recourse to Recourse

- Allows non-recourse secured creditor to participate as a recourse creditor per Bankruptcy Code Section 506(a) (i.e., undersecured creditors are entitled to a deficiency claim) unless:
  - The class of which such claim is a part elects to make the section 1111(b)(2) election
    - (*Generally, a secured creditor is placed in its own class*)
  - Collateral is sold via Bankruptcy Code section 363 sale ("363 Sale") or through the Plan
- By holding onto its unsecured deficiency claim, and not making the Section 1111(b) election, the undersecured creditor can vote and potentially control the unsecured creditor class

§ 1111(b)(2) - Allows an Undersecured Creditor to elect to have its entire Allowed Claim treated as a single Secured Claim UNLESS:

- Lien has Inconsequential Value
- Collateral is being sold as part of a 363 Sale or under a Plan

Bankruptcy Code Reference

Section 1129(b)(2)(A)(i)

- With respect to a class of secured claims, the plan provides:
  - (I) that the holders of such claims **retain the liens** securing such claim, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
  - (II) that each holder of a claim of such class **receive on account of such claim 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**.

The § 1111(b) Election – Key Considerations

- If no election is made, Bankruptcy Code section 1111(b)(1) permits a non-recourse creditor to participate as a recourse creditor by having an unsecured claim for its deficiency that potentially controls unsecured creditor class.
  - Practice point: Debtors often attempt to classify unsecured deficiency claims in their own class so that the creditor cannot control the unsecured class vote – Gerrymandering.
  - Courts disagree about whether a lender's unsecured deficiency claim can be separately classified from the general unsecured creditor class.
- The election gives an undersecured creditor the option to benefit from post-confirmation appreciation in value of its collateral.
- However, whenever a secured creditor makes the election it then abandons its unsecured (deficiency) claim.

The § 1111(b) Election – Key Considerations (cont'd)

- Timing of the Election - the election must be made no later than the conclusion of the Disclosure Statement hearing unless the Court orders otherwise (FRBP 3014).
- All liens must remain intact except in the case of a sale, where liens may be permitted to attach to substitute collateral such as the sale proceeds.
- The election cannot be made if the secured claim is of inconsequential value.
- The election decision is made by the class, not the individual creditor, although secured creditors are generally separately classified.
- Secured creditor retains right to object to the Plan on other grounds including feasibility.
- If the election is made and Plan treatment is then materially altered, secured creditor is not normally bound by its prior election.

The § 1111(b) Election – Subchapter V

- The Debtor or secured creditor should request a deadline by which to file the § 1111(b) election since there is no Disclosure Statement hearing.
- The Plan can get confirmed without any consenting class (§ 1191(b)) so this may affect one's case strategy.
- A Plan is bound by a statutory five-year plan term limit and this may affect the ability of a Debtor to propose a feasible plan.

Plan Must Satisfy Two *Independent* Mathematical Requirements

Present Value (§1129)

The discounted value of all future payments must equal the *present value* of the creditor's security interest in the debtor's property.

Aggregate Payment Amount (§1111(b))

Total amount of ALL plan payments (principal and interest) must total AT LEAST amount of the Allowed Claim.

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Section 1111(b) Election Effect on Plan Feasibility

If a Debtor passes the section **1129(b)(2)(A)(i)(II)** test, does this mean the Plan is feasible?

No. The Debtor must still meet all of the other Plan feasibility requirements.

In most cases, by making the section 1111(b) election, the secured creditor effectively "raises the bar" on the amount of payments required under the plan and can contest the Debtor's ability to made future payments.

Four Possible Scenarios

	Fails Present Value Test	Passes Present Value Test
Fails Aggregate Payment Test	PV = Fail AP = Fail	PV = Pass AP = Fail
Passes Aggregate Payment Test	PV = Fail AP = Pass	PV = Pass AP = Pass

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Strategy Example 1—The Secured Creditor Does Not Make The Election

Plan Terms

Allowed Claim: $110
Plan Term: One Year
Collateral Value: $100
Plan provides for:

- Interest on secured claim at 7%
- Principal and interest payments total $107 during the Plan Term
- Payments are also made to the unsecured class

Analysis

§ 506(A) bifurcates claim into a $100 secured claim and a $10 unsecured claim

§ 1111(b) is not applicable since the election was not made, however the creditor must still satisfy the present value requirements found in § 1129

Can the Plan be Confirmed?

Yes. Assuming Court finds the interest rate and other requirements are met, the Plan could be confirmed

The creditor will be receive a total of $107 ($100 principal plus interest of $7) and will receive its proportion of payments on its unsecured claim

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Strategy Example 2—The Secured Creditor Makes The Election

Plan Terms

Allowed Claim: $110
Plan Term: One Year
Collateral Value: $100
Plan provides for:

- Interest on secured claim at *10%*
- Principal and interest payments total $112 during the Plan Term
- Payments are made to the unsecured class

Analysis

§ 506(A) bifurcates claim into a $100 secured claim and a $10 unsecured claim

§ 1111(b) converts the entire allowed claim into a single secured claim

The creditor must satisfy the present value requirement of § 1129, AND the aggregate payment requirement of §1111(b)

Can the Plan be Confirmed?

Yes. Assuming Court finds the interest rate and other requirements are met, the Plan could be confirmed.

The creditor will receive a total of $110 on its secured claim ($100 plus interest of $10) and no distribution towards its prior unsecured claim

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Strategy Example 3—The Secured Creditor Makes The Election

Plan Terms

Allowed Claim: $110
Plan Term: One Year
Collateral Value: $100
Plan provides for:

- Interest on secured claim at *5%*
- Principal and interest payments total $105 during the Plan Term
- Payments are made to the unsecured class

Analysis

§ 506(A) bifurcates claim into a $100 secured claim and a $10 unsecured claim

§ 1111(b) converts the entire allowed claim into a single secured claim

The creditor must satisfy the present value requirement of § 1129, AND the aggregate payment requirement of §1111(b)

Can the Plan be Confirmed?

No, since the creditor will receive a total of $105 on its secured claim ($100 plus interest of $105) it fails to meet the § 1111(b) test of paying at least the amount of the allowed claim ($110).

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Strategy Example 4—— A Strategy to Remedy The Secured Creditor's Election in Example 3

Debtor Lengthens Plan Term to Pay More Interest

- Debtor amends its Plan by extending the Plan from one year to two years.
- This creates total payments to Secured Creditor of $110 (two years of interest $5 + $5 = $10) and the repayment of the principal $100
- Total payments now equal $110 meeting the section §1111(b) requirements

Debtor Increases Interest Rate to Pay More Interest

- Debtor amends its Plan by increasing the interest rate from 5% to 10%
- This creates total payments to Secured Creditor of $110 (one year of interest $10) and the repayment of the principal $100
- Total payments now equal $110 meeting the section §1111(b) requirements

Assuming Court finds the interest rate and other requirements are met, the Plan could be confirmed

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"Election vs. No Election" Strategy – Effect on Voting

Effect of Making the Election

- Secured Claim retains right to vote
- Unsecured Claim is merged into the Secured Claim; no unsecured creditor claim/vote

If you are a Secured Creditor and want to "block" the Debtor's Plan:

- You have two avenues to attack the Plan:
  - Make the election and challenge the Plan's feasibility by creating a higher payoff requirement.
  - Do not make the election and attempt to use your unsecured vote to control the General Unsecured Creditor Class.

Voting Strategy – Audience Question

Can Big Bank block the Plan with its unsecured vote or (assuming it was not in favor of the Plan) should it make the election have a potentially greater recovery?

Plan Terms

- Allowed Claim Amount of Big Bank, N.A.: $110
- Collateral Value: $50
- The Plan bifurcates the Big Bank's allowed claim into a secured claim of $50 and an unsecured claim of $60. Big Bank is the only creditor in its secured class
- There are 4 other unsecured creditors all in favor of the Plan whose claims total $20

SCENARIO	"Elect"	Don't "Elect"
Big Bank: Allowed Claim	$110	$110
Big Bank: Secured Claim	$110	$50
Big Bank: Unsecured Claim	$0	$60
Other Unsecured Creditors	$20	$20

Elect	# of Votes	$ Amount
Big Bank's Unsecured Vote	0	$0
Other Unsecured Creditors	4	$20
Total	4/4	$20/20
For "Votes"	100%	100%

Don't Elect	# of Votes	$ Amount
Big Bank's Unsecured Vote	1	$60
Other Unsecured Creditors	4	$20
Total	4/5	$20/$80
For "Votes"	80%	25%

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Elect	# of Votes	$ Amount
Big Bank's Unsecured Vote	0	$0
Other Unsecured Creditors	4	$20
Total	4/4	$20/20
For "Votes"	100%	100%

Don't Elect	# of Votes	$ Amount
Big Bank's Unsecured Vote	1	$60
Other Unsecured Creditors	4	$20
Total	4/5	$20/$80
For "Votes"	80%	25%

Secured Creditor holds no blocking position.

A blocking position would require a deficiency claim (i.e. unsecured claim) that is at least two-thirds in amount and more than one-half in number of the (voting) claims of the unsecured class

Secured Creditor holds a blocking position.

While its (number of) unsecured vote(s) is insufficient to block the plan, the size of its deficiency claim (i.e. unsecured claim) is more at least two-thirds in amount and more than one-half in number of the (voting) claims of the unsecured class

In this example, the Secured Creditor could have affirmatively "knocked out" the Plan by not making the election and casting its unsecured vote against the Plan. Had the Secured Creditor not controlled the unsecured class, it may have chosen to make the section 1111(b)(2) election and make feasibility more difficult for the Debtor.

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1111(b) Mathematical Strategy Plan Payments and Payoffs

Potential Mathematical Variables

Claims	Collateral	Repayment Terms
1. Allowed Claim	3. Collateral Value	4. Interest Rate
2. Secured Claim		5. Amortization
		6. Term
		7. Payment Frequency

6 unique variable creates *720 different possibilities* that can affect the outcome of the mathematical analysis!

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Amortization of the Outstanding Balance Under sections 1129 and 1111(b)

- Section 506(a) bifurcates a secured claim into two parts, a secured claim equal to the value of the collateral, and an unsecured claim for the remaining amount.
- If the section 1111(b) election is made, this raises the Secured Claim balance to equal the amount of the Allowed Claim.
- Section 1129 continues to require the payments under the Plan to total AT LEAST the amount of the (increased) Secured Claim over time.
- Section 1129 also requires the secured creditor receive payments equal to the net present value of its interest in the Debtor's property/collateral.

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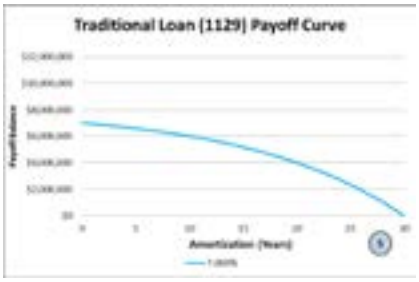
Payment/Payoff Calculations

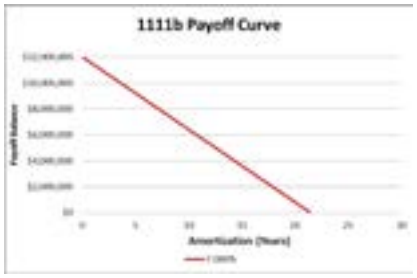
Section 1129

- Beginning Balance – Value of Creditor's Security Interest in its Collateral
- Payment – includes an interest payment which does not reduce amount owed under 1129
- Payoff – Beginning Balance less amount of principal paid at maturity



Section 1111(b)

- Beginning Balance – Amount of Allowed Claim
- Payment – specified by the terms of the Plan; all amounts paid to the secured creditor reduce the amount owed under 1111(b)
- Payoff = Beginning Balance less total payments paid at maturity



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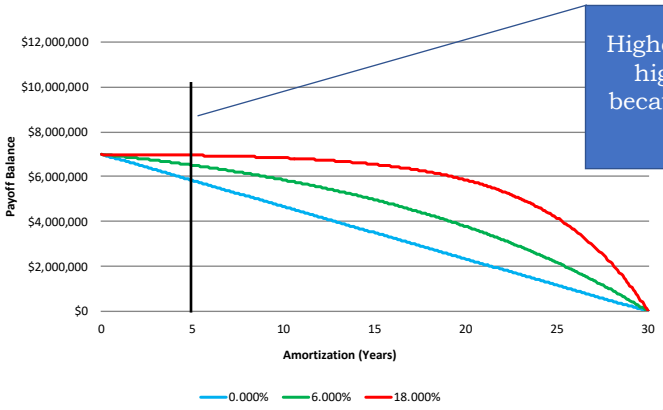
Traditional Loan (1129) Payoff Curve



Higher interest rates create higher payoff balances because less payment goes toward principal

Amortizing Balance	$ 7,000,000	$ 7,000,000	$ 7,000,000
Amortization (Years)	30	30	30
Interest Rate	0.000%	6.000%	18.000%
No. of Payments Per Year	12	12	12
Payment Amount	$ 19,444	$ 41,969	$ 105,496

Payment amount is higher for higher interest rate

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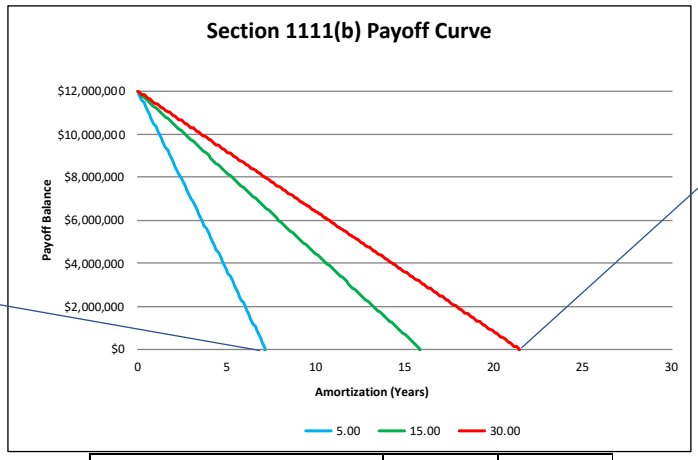

Note that with a 5 year amortization period, it takes longer (approximately 7 years) to pay off the 1111(b) balance

Note that with a 30 year amortization period, it takes less time (approximately 22 years) to pay off the 1111(b) balance

Allowed Claim	$ 12,000,000	$ 12,000,000	$ 12,000,000
Appraised/Present Value	$ 7,000,000	$ 7,000,000	$ 7,000,000
Amortizing Balance	$ 7,000,000	$ 7,000,000	$ 7,000,000
Amortization (Years)	5	15	30
Interest Rate	7.000%	7.000%	7.000%
No. of Payments Per Year	12	12	12
Payment Amount	$ 138,608	$ 62,918	$ 46,571

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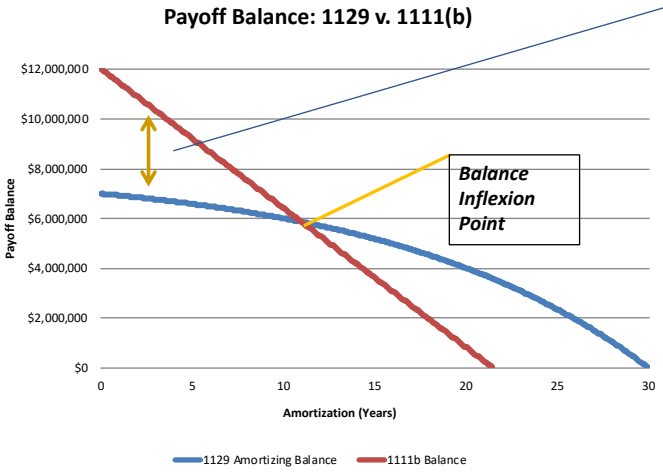
The intersection of the section 1129 and section 1111(b) Payoff Curves is the "*1111(b) Balance Inflexion Point*"



When the repayment term for the secured claim is to the left of the Balance Inflexion Point, the difference between the two values that the red line and blue line represent is referred to as the "1111(b) Premium"

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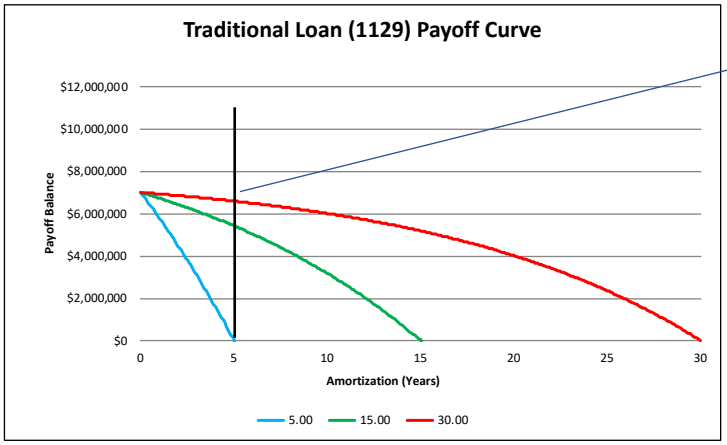

Shorter amortizations create lower payoff balances because the payment goes up

Amortizing Balance	$ 7,000,000	$ 7,000,000	$ 7,000,000
Amortization (Years)	5	15	30
Interest Rate	7.000%	7.000%	7.000%
No. of Payments Per Year	12	12	12
Payment Amount	$ 138,608	$ 62,918	$ 46,571

Payment amount is higher for shorter amortization

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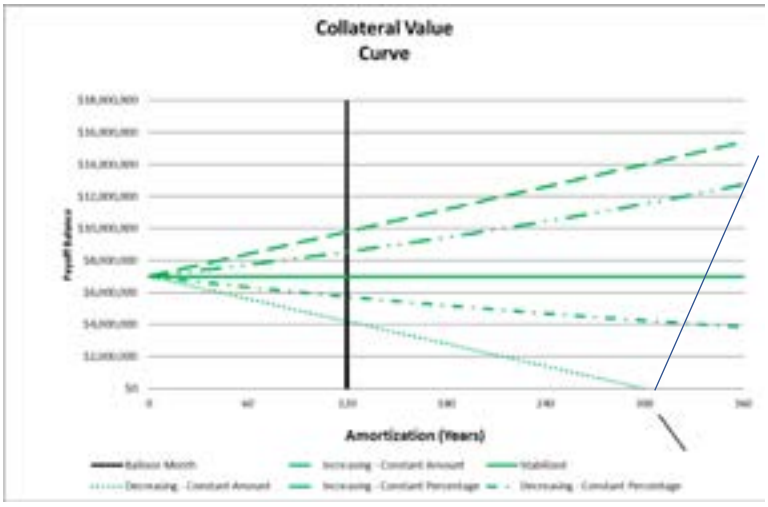
Collateral Value

Collateral can change in value during the term of the Plan or it can remain stable.



Collateral value often determines the feasibility of a Plan. Collateral values can behave in a myriad of ways often associated with the type of collateral and its economic life.

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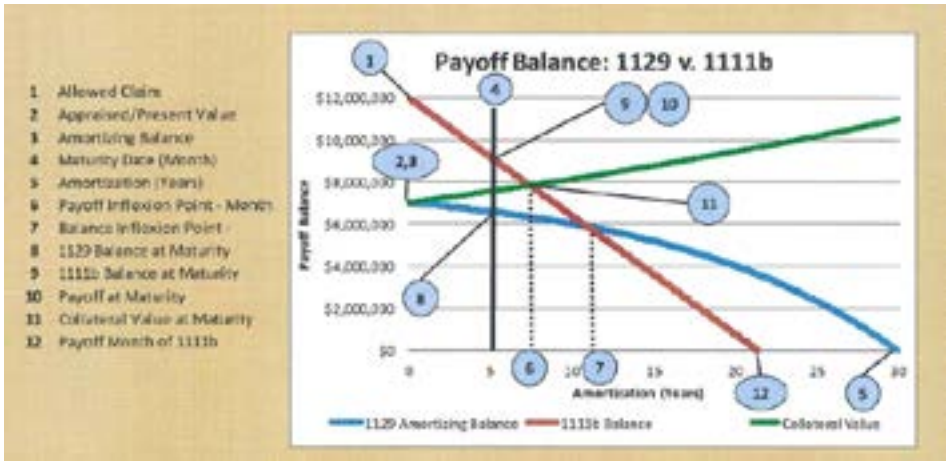
Elements of the Section 1111(b) Analysis



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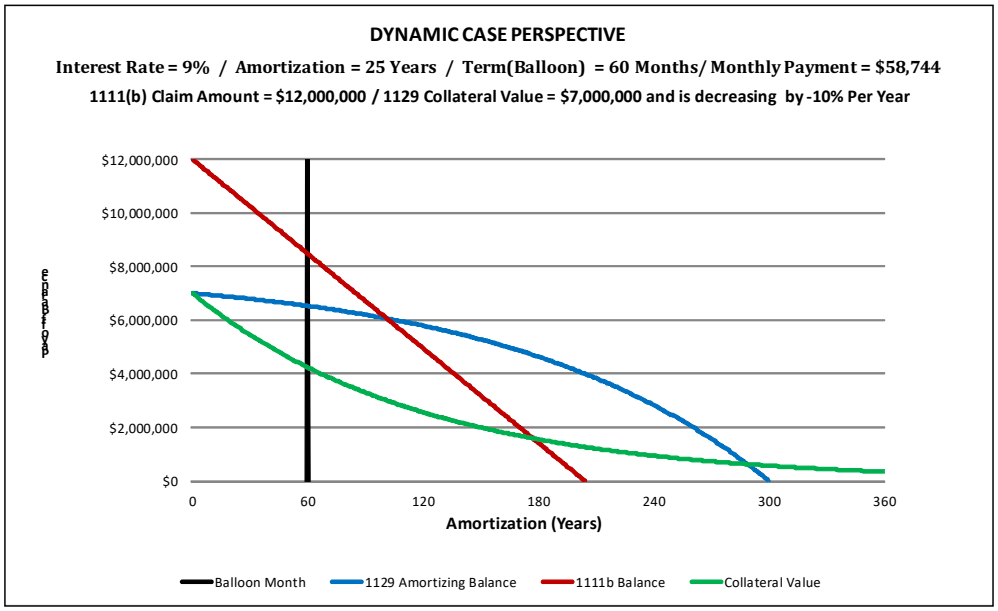

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Printing Company

- Debtor filed a Chapter 11 bankruptcy for a *Printing Company*
- The Secured Creditor has an *allowed claim of $1,200,000*
- The Secured Creditor and Debtor *disagree on the value* of the collateral
- The collateral is expected to remain *decreasing in value*
- The company has an expected *remaining economic life of 10 years*

Debtor's Position

Collateral Value: $600,000

Interest Rate: 6.0%

Term: 10 years

Amortization: 15 years

Monthly Payment: $5,063

Creditor's Position

Collateral Value: $900,000

Interest Rate: 12.0%

Term: 5 years

Amortization: 8 years

Monthly Payment: $14,628

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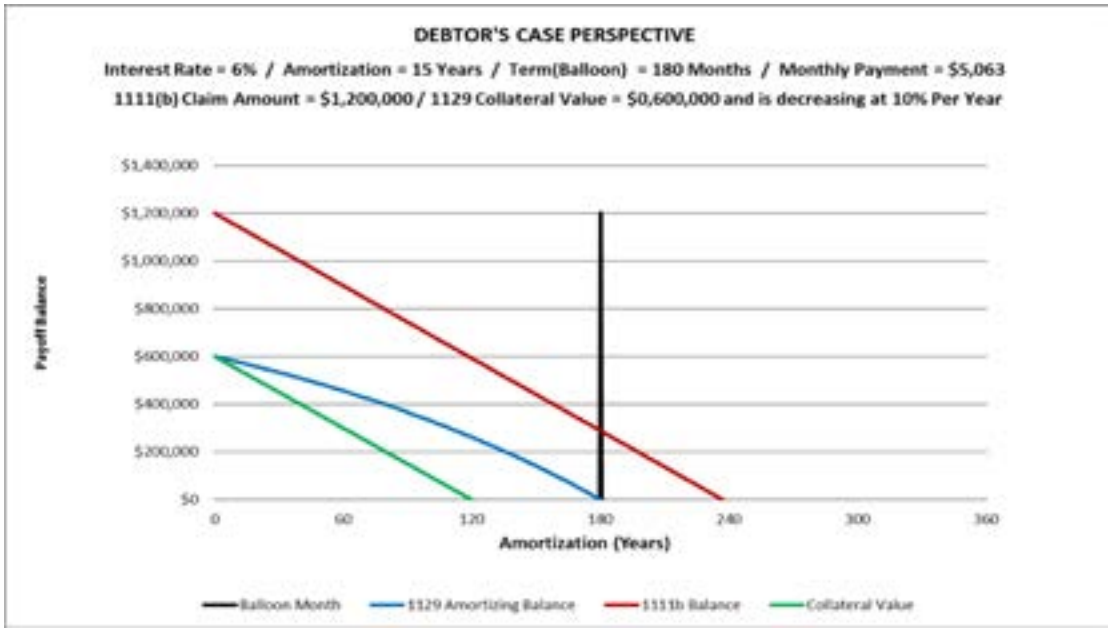

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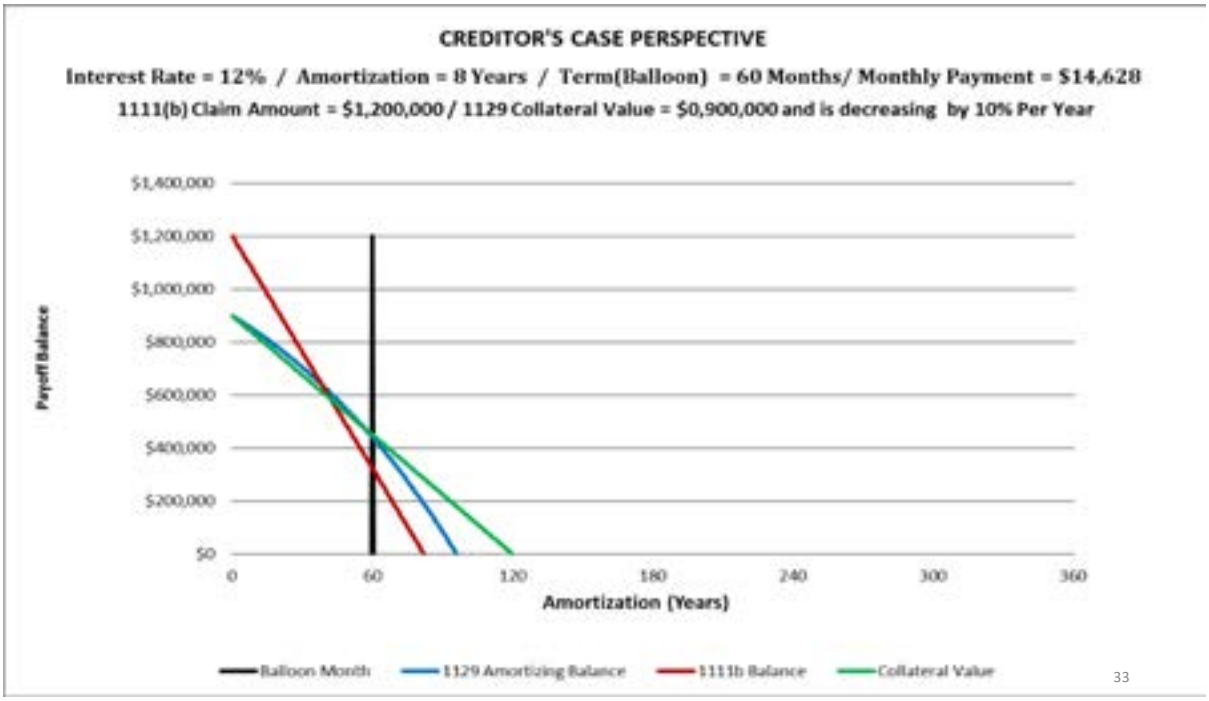

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Retail Center

- Debtor filed a Chapter 11 bankruptcy for a 20,000 s.f. unanchored retail center
- The Secured Creditor has an allowed claim of *$12,000,000*
- The Secured Creditor has a collateral interest valued at *$7,000,000*
- The Debtor believes the Value of the collateral is expected to *increase by 3% per year and the Secured Creditor expects the value to remain stable*
- The Center has an expected *remaining economic life of 30 years*

Debtor's Position	Creditor's Position
Interest Rate: 5.0%	Interest Rate: 9.0%
Term: 15 years	Term: 5 years
Amortization: 30 years	Amortization: 20 years
Monthly Payment: $37,578	Monthly Payment: $62,981

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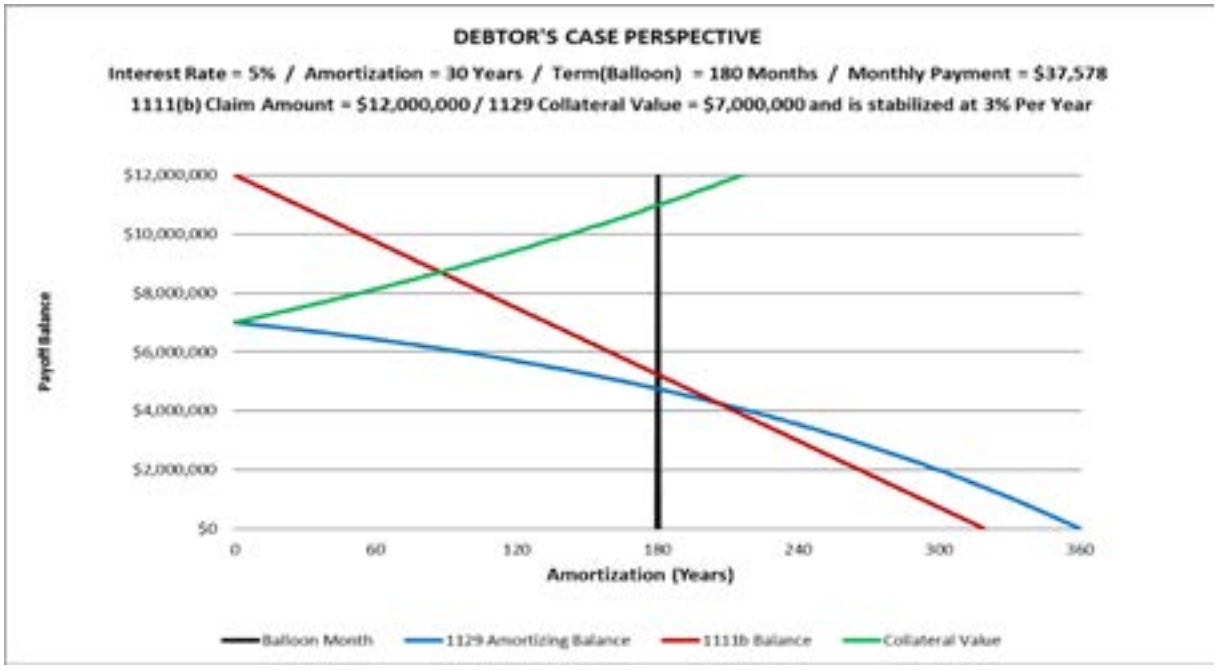
DEBTOR'S CASE PERSPECTIVE
Interest Rate = 5% / Amortization = 30 Years / Term(Balloon) = 180 Months / Monthly Payment = $37,578
1111(b) Claim Amount = $12,000,000 / 1129 Collateral Value = $7,000,000 and is stabilized at 3% Per Year
Payoff Balance
$12,000,000
$10,000,000
$8,000,000
$6,000,000
$4,000,000
$2,000,000
$0
0
60
120
180
240
300
360
Amortization (Years)
Balloon Month
1129 Amortizing Balance
1111b Balance
Collateral Value

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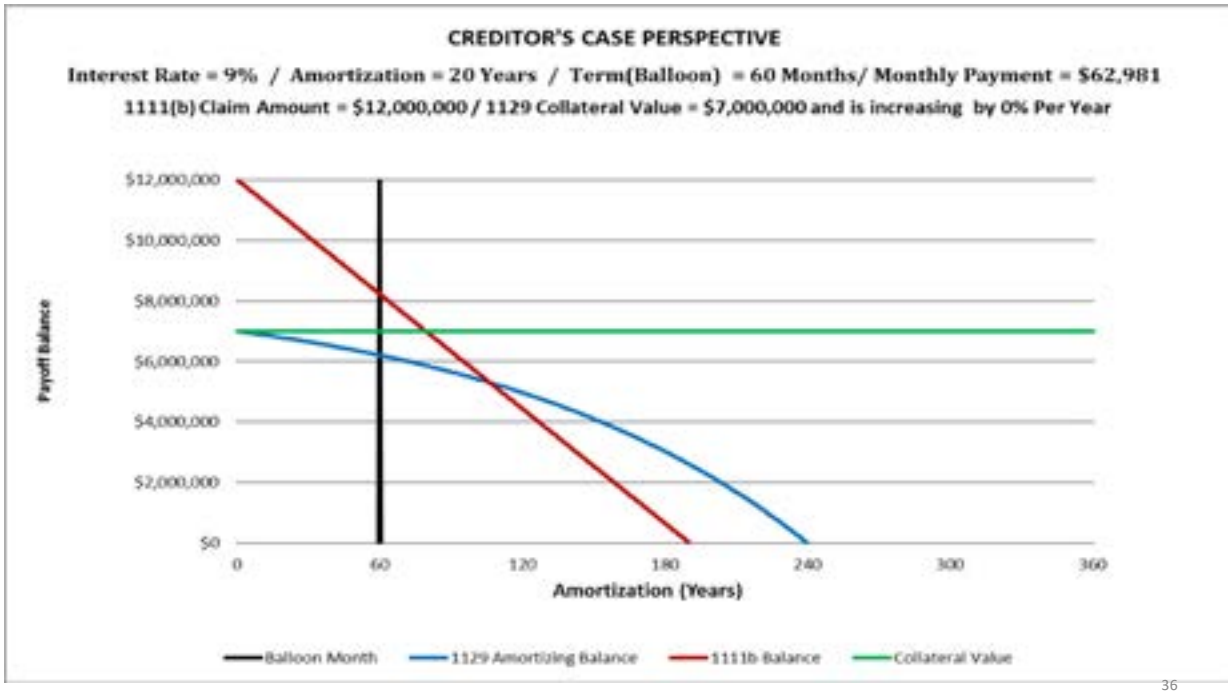
CREDITOR'S CASE PERSPECTIVE
Interest Rate = 9% / Amortization = 20 Years / Term(Balloon) = 60 Months/ Monthly Payment = $62,981
1111(b) Claim Amount = $12,000,000 / 1129 Collateral Value = $7,000,000 and is increasing by 0% Per Year
Payoff Balance
$12,000,000
$10,000,000
$8,000,000
$6,000,000
$4,000,000
$2,000,000
$0
0
60
120
180
240
300
360
Amortization (Years)
Balloon Month
1129 Amortizing Balance
1111b Balance
Collateral Value

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Section 1111(b) Considerations and Negotiating Points

1. Will collateral appreciate or depreciate over the life of the Plan?
2. Will collateral require additional cash to maintain or will collateral throw off cash that will support the business?
3. Has the collateral been over or under valued? Is that collateral worth more to the Debtor than to the market?
4. In the case of a strategic lender, is the collateral worth more to the lender than to the market?
5. What is the likelihood the Debtor will default?
6. Are there special turnover provisions in the Plan if the Debtor defaults?

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Section 1111(b) Considerations and Negotiating Points

7. What is the likelihood the Debtor can or will sell or refinance the collateral during the Plan?
8. What is the likelihood of receiving payments on the unsecured claim? Is it speculative, or guaranteed? Is it capped or a percent of returns?
9. Will the Secured Creditor's rejecting votes make it impossible for the Debtor to have an impaired accepting class at confirmation?
10. Will the election require the Debtor to have a plan term so long as to make the plan so speculative that feasibility is in doubt?
11. Will the election require the Debtor to have a plan term so long as to make the plan fail the "fair and equitable" standard?

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Potential Debtor Strategies

- Since the election is by class, creditors might be "gerrymandered" into classes to avoid/ minimize the liability created by the section 1111(b) election
- Negotiate a deal with Secured Creditor to become an accepting class
- Lengthen Plan term to enhance feasibility by increasing total amount paid under aggregate payment test
  - NOTE – Subchapter V limits the plan term to 5 years (§ 1191(c)(2))

Potential Secured Creditor Strategies

Willing Lender

- Attempt to negotiate a better payout through threat of section 1111(b)
- Use section 1111(b) and become the consenting impaired class

Unwilling Lender

- Block class via voting
- Block the Plan through feasibility challenge
  - Payments too high
  - High ending balance

Case Law – General Standard

- A court is allowed to confirm a plan under section 1129(b) if it determines that the plan does not discriminate unfairly, is fair and equitable with respect to each class of impaired claims or interests which have not accepted the plan, and all provisions of section 1129(a) except for paragraph (8) have been met.

- The consequence of an election is that a plan is required to "pay an amount equal to the greater of the present value of the secured portion of the creditor's claim or the full amount of the claim without interest, whichever is the larger amount." *In re Scruggs*, 342 B.R. 571, 575 (Bankr. E.D. Ark. 2006). When a creditor has made the election, a plan must provide for the following: (1) retention of electing secured creditor's lien on the property in the full amount of the claim, (2) deferred cash payments with a present value of the creditor's claim; and (3) deferred cash payments totaling at least the allowed amount of the total creditor's claim. *In re Brice Road Developments*, 392 B.R. 274, 285 (6th Cir. BAP 2008).

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Case Law – General Standard

- 11 U.S.C. § 1129(b)(2)(A)(i)(II) requires that the present value of the electing creditor's stream of payments need only equal the present value of the collateral, which is the same amount that must be received by the non-electing creditor, but the sum of the payments must be in an amount equal [to] at least the creditor's total claim. *In re Brice Road Developments*, 392 B.R. at 285; *see also In re Weinstein*, 227 B.R. 284, 295 (9th Cir. BAP 1998) ("the electing creditor receive its 'true' secured claim, i.e., the value of its collateral, in full at the time of plan confirmation or in deferred payments with interest so that the present value of the secured claim is provided . . . [t]he electing creditor should also receive payments on the unsecured portion of its claim without interest, if necessary, so that, at a minimum, the total payments received is equal the creditor's total claim").

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Case Law – Changing the § 1111(b) Election

- A secured creditor may change its decision regarding a § 1111(b)(2) election even after a court has approved a disclosure statement where the plan is subsequently modified in a manner which is materially adverse to the creditor. *In re Elmwood, Inc.*, 182 B.R. 845, 854 (D. Nev. 1995); *see also In re Scarsdale Realty Partners, L.P.*, 232 B.R. 300, 301 (Bankr.S.D.N.Y.1999); *In re Paradise Springs Associates*, 165 B.R. 913, 918 (Bankr. D. Ariz. 1993); *In re RBS Industries, Inc.*, 115 B.R. 419, 421 n. 2 (Bankr. D. Conn. 1990); *In re Century Glove, Inc.*, 74 B.R. 958, 961 (Bankr. D. Del. 1987); *In re Keller*, 47 B.R. 725, 730 (Bankr. N.D. Iowa 1985).

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"Inconsequential Value" Analyzed

- *In re McGarey*, 529 B.R. 277 (D. Ariz. 2015).
- In this case, the secured creditor had a total claim of approximately $2.335 million. The debtor and the secured creditor stipulated that the equity in the property subject to the lien was $80,000. The total property value was approximately $480,000. The secured creditor made the section 1111(b)(2) election. The debtor objected to the election on the grounds that the value was inconsequential pursuant to the terms of the statute. The Bankruptcy Court denied the debtor's motion and an appeal ensued. The District Court affirmed the Bankruptcy Court's denial of the debtor's motion, holding that in order to determine inconsequential value, section 1111(b) directs that the court compare the lien value to the asset value, not the lien value to the secured creditor's overall claim amount.

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Secured Creditor Can't Carve Out Claims From Election

- *In re Couture Hotel Corporation*, 536 B.R. 712 (N.D. Tex. 2015)
- Secured creditor filed a single secured proof of claim in the amount of $9.3 million. The creditor made the section 1111(b)(2) election. In its election notice, the secured creditor attempted to carve out a portion of its claim related to claims for alleged breach of a noncompete agreement. The Court noted that it could not locate any authority permitting a secured creditor to except portions of its secured claim from the election. The Court found that "section 1111(b)(2) specifically provides 'that if an election is made, notwithstanding section 506(a), such claim is a secured claim.'" As such, the Bankruptcy Court held that the election applied to the entirety of the claim, not just secured portion.

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Sale in Plan Defeats Election

- *In re R.L. Adkins Corp.*, 784 F. 3d 978 (5th Cir. 2015).
- A secured creditor by virtue of a prepetition mechanic's lien made the section 1111(b)(2) election. The plan recognized the secured creditor's lien on certain assets. The plan provided for the sale of the assets pursuant to section 363. The secured creditor did not participate in the confirmation hearing. The plan was confirmed. Thereafter, the secured creditor argued that it had either the right to credit bid at a sale or be granted its section 1111(b)(2) election. The Bankruptcy Court denied the election. That denial was affirmed by the District Court and by the Fifth Circuit Court of Appeals. The Fifth Circuit held that because the secured creditor had the right to credit bid for sale but failed to exercise that right and because section 1111 denies the election in that situation, the Bankruptcy Court and the District Court both correctly rejected the claim.

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Subchapter V Considerations and Case Law Regarding Section 1111(b) – Timing of Making the Election

- Some judges issue orders establishing deadlines and procedures in a Subchapter V case—this should be included as a deadline.
- Counsel should consider making sure that any Deadline Order that establishes such deadlines also include a deadline for the §1111(b) election
- This should be addressed at the initial status conference.
- If your court does not enter a scheduling order, counsel for either the debtor or secured creditor can request that the court establish a deadline by which to file the §1111(b) election.

Subchapter V Considerations and Case Law Regarding Section 1111(b) – Cases that Address Valuation and its Impact on SubChapter V Plans

- *In re VP Williams Trans, LLC*, 2020 WL 5806507 Bankr. S.D.N.Y. 2020). The court addressed (i) the Subchapter V requirements to confirm a plan over the objection of the secured creditors (*see* §1191(b)) and (ii) whether the value of the secured claim, i.e., the secured creditor's interest in the collateral, a taxi medallion, was "inconsequential". In this case, the taxi medallion was essential to the debtor's business. The debtor could not operate without it, and therefore, it was essential to the reorganization. The Court further noted that a secured creditor's right to elect §1111(b) is not limited by the impact that election has on feasibility of a plan, or stated another way, the Debtor's ability to pay a secured creditor because of the §1111(b) election is not a condition of the validity of the §1111(b) election. The opinion is also interesting for its analysis of the *In re Body Transit, Inc.* case, cited below, with regard to the issue of "inconsequential value". As for the timing of the §1111(b) election, the court stated that as a practical matter, the §1111(b) election cannot be made until a plan is filed, as classes of creditors are only determined based on the debtor's plan and classification of claims. The secured creditor made a timely election, as it was made before solicitation of votes or any other steps were taken toward confirmation.

Subchapter V Considerations and Case Law Regarding Section 1111(b) – Cases that Address Valuation and its Impact on SubChapter V Plans

- *In re Body Transit, Inc.*, 619 BR. 816 (Bankr. E.D. Pa. 2020). The debtor objected to the secured creditor's §1111(b) election on the basis that the collateral was of "inconsequential value" and also filed a valuation motion. This case is noteworthy for the court's analysis of the types of valuations and the legal standards for determining "inconsequential value". Ultimately, the court determined that the value of debtor's property, which was 8.2% of the secured creditor's total claim, was of inconsequential value. "The key point here is that the 'inconsequential value' determination is not a bean counting exercise; the determination cannot be based solely on a mechanical, numerical calculation. . . . In other words, while 'the numbers' provide an important starting point in deciding how much value is 'inconsequential,' the court also must consider other relevant circumstances presented in the case and make a holistic determination that takes into account the purpose and policy of the statutory provisions that govern the reorganization case." 619 B.R. at 836.
- *In re Caribbean Motel Corp.*, 2022 WL 50401 (Bankr., D. Puerto Rico, 2022). The court relied on VP Williams Trans, LLC, supra., and held that the subject collateral (a "by-the-hour motel") was essential to the debtor's reorganization, the proposed plan and all proposed scenarios, and that the collateral, which had a value of 15.6% of the total secured claim, was not inconsequential; therefore, debtor's objection to the §1111(b) election was denied.

Subchapter V Considerations and Case Law Regarding Section 1111(b) – Cases that Address Confirmation of a Subchapter V Plan

- *In the Matter of Topp's Mechanical, Inc.*, 2021 WL 5496560, (Bankr., D. Nebraska, 2021). The court sustained the Subchapter V Trustee's objection to confirmation, which asserted that the debtor's proposed treatment of its under-secured creditor pursuant to the §1111(b) election was "overly generous on the bank's deficiency claim at the expense of the other unsecured creditors." 2021 WL 5496560 at *1. The court agreed with the Subchapter V trustee that the payments to the bank were more than it was entitled to receive as a result of the §1111(b) election, the payments to unsecured creditors were artificially low as a result of the payments to the bank, and therefor the plan did not satisfy the "fair and equitable" requirements of 11 U.S.C. §1191(b)(2).

- *In re: S-Tek 1, LLC*, 2021 WL 5858906 (Bankr., D. New Mexico, 2021). The court held that a secured creditor who made a §1111(b) election was still impaired and entitled to vote to accept or reject the Plan.

Subchapter V Considerations and Case Law Regarding Section 1111(b) – Practical Considerations for Subchapter V Cases

- Set the date for the filing of the §1111(b) election.
- Address valuation of the collateral as early as possible in the case.
- Consider the impact of a §1111(b) election on the plan, taking into account the term limit of a plan (not to exceed 5 years), feasibility and whether the plan is fair and equitable.

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Julie Beth Teicher
Maddin, Hauser, Roth & Heller, P.C.
28400 Northwestern Hwy., 2nd Floor
Southfield, MI 48034
(248) 351-7059
jteicher@maddinhauser.com

CONSIDERATIONS OF §1111(b) AND SUBCHAPTER V CASES

A filing under Subchapter V (11 U.S.C. §1181 – 1195) requires some additional considerations when addressing the impact of an election under 11 U.S.C. §1111(b). There are a few reported cases, which address the following issues: (i) whether an under-secured creditor can make a §1111(b) election in a Subchapter V case; (ii) the timing of making the §1111(b) election; (iii) valuation of the collateral and its impact on the plan and payments; and (iv) the ability to confirm a plan under §1191(b) if you do not have a consensual plan.

I. Initial considerations:

A. Can an under-secured creditor make an election under §1111(b) in a Subchapter V case?

Yes. As you will see in the cases cited below, the courts have largely dispensed of this as an issue, and where relevant, followed precedent set in prior Chapter 11 cases.

B. Timing of making the election.

BR 3014 sets the time for making an election under §1111(b)(2):

> Rule 3014. **Election under §1111(b) by Secured Creditor in Chapter 9 Municipality or Chapter 11 Reorganization Case.**
>
> An election of application of §1111(b)(2) of the Code by a class of secured creditors in a chapter 9 or 11 case may be made at any time prior to the conclusion of the hearing on the disclosure statement or within such later time as the court may fix. If the disclosure statement is conditionally approved pursuant to Rule 3017.1, and a final hearing on the disclosure statement is not held, the election of application of §1111(b)(2) may be made not later than the date fixed pursuant to Rule 3017.1(a)(2) or another date the court may fix. The election shall be in writing and signed unless made at the hearing on the disclosure statement. The election, if made by the majorities required by §1111(b)(1)(A)(i), shall be binding on all members of the class with respect to the plan.

Since there is no Disclosure Statement in a Subchapter V, what is the deadline for a secured creditor's 1111(b) election?

Some judges issue orders establishing deadlines and procedures in a Subchapter V case. In the Eastern District of Michigan, certain judges issue a form of Order Establishing Deadlines and Procedures in a Subchapter V case (the "Deadline Order), which does not address the §1111(b) election, but provides for a deadline to object to the dates set forth in the Deadline Order. To avoid confusion, counsel should consider making sure that any Deadline Order that establishes such deadlines also include a deadline for the §1111(b) election, and this should be addressed at the initial status conference. (The Deadline Order may be followed by a Notice of the Deadline Order (the "Notice"). In the Eastern District of Michigan, the Notice has a specific line item: "Deadline for creditors to make an election of application of 11 U.S.C. §1111(b)(2) is." However, in many cases, this date is not filled in. Both debtor's and creditor's counsel should pay attention to the Deadline Order, the Notice and this date, and it should be clearly established.)

If your court does not enter a scheduling order, counsel for either the debtor or secured creditor can request that the court establish a deadline by which to file the §1111(b) election.

II. Considerations of valuation and impact on a Subchapter V plan:

A. *In re VP Williams Trans, LLC*, 2020 WL 5806507 (Bankr. S.D.N.Y. 2020). The court addressed issues regarding collateral value's impact and the timing on the creditor's §1111(b) election in this Subchapter V case. The property at issue was a taxi medallion (a right issued by a governmental authority to operate a taxi operation), which was collateral for a secured loan. The secured creditor's claim was $576,927.58. The secured creditor asserted in its proof of claim that the value of the collateral was $200,000, leaving a deficiency (unsecured) claim of $376,927.58. The plan was filed on May 19, 2020, and proposed to bifurcate the creditor's claim into a secured

and unsecured claim, paying the secured claim of $200,000 in full, and paying approximately 3% on the unsecured portion of the claim.

The secured creditor filed its §1111(b) election on Sept. 4, 2020. Debtor objected on 2 grounds: 1) that the value of the collateral, the taxi medallion, was "inconsequential", and 2) the election was too late and that the secured creditor was bound by its proof of claim.

The court engaged in a thorough analysis, addressing Subchapter V requirements to confirm a plan over the objection of a secured creditor (see §1191(b)—the plan must be "fair and equitable" with respect to the secured claim; looking to §1129(b)(2)(A), which sets forth the tests for "fair and equitable").

The court then addressed whether the value of the secured claim, i.e., the secured creditor's interest in the collateral, was "inconsequential". In this case, the taxi medallion was essential to the debtor's business. The debtor could not operate without it, and therefore, it was essential to the reorganization. The Court further noted that a secured creditor's right to elect §1111(b) is not limited by the impact that election has on feasibility of a plan, or stated another way, the Debtor's ability to pay a secured creditor because of the §1111(b) election is not a condition of the validity of the §1111(b) election.[1] The opinion is also interesting for its analysis of the *In re Body Transit, Inc.* case, cited below, with regard to the issue of "inconsequential value".

As for the timing of the §1111(b) election, the court stated that as a practical matter, the §1111(b) election cannot be made until a plan is filed, as classes of creditors are only determined based on the debtor's plan and classification of claims. As there was no preliminary or final hearing on a disclosure statement in this case, the secured creditor made a timely election, as it was made before solicitation of votes or any other steps were taken toward confirmation. The court

[1] The reader is reminded that (although uncommon) a creditor can make the election and also vote affirmatively for the plan.

noted that the parties did not ask for a deadline to be set for making the §1111(b) election, and the court never set one.

B. *In re Body Transit, Inc.*, 619 BR. 816 (Bankr. E.D. Pa. 2020). This case involved a Subchapter V debtor that operated 3 fitness centers at the time of filing the case, and at the time of the chapter 11 plan, had one remaining location. Debtor filed its proposed plan on April 11, 2020, and an amended plan on April 22, 2020. Secured creditor, First Bank, filed its §1111(b)(2) election on April 19, 2020. Debtor filed a Valuation Motion in response. First Bank had a total claim of $944,364.00, of which the Plan proposed to pay $317,578.82 as a secured claim, to be paid over 60 months, with graduated payments of principle and interest. The debtor objected to the §1111(b) election on the basis that the collateral was of "inconsequential value", along with its valuation motion. The court engaged is a very detailed review of the arguments and the underlying facts, including a review of the testimony of the parties' experts, the various types of valuations of collateral, an example and analysis of how §1111(b) works, and the legal standard for determining "inconsequential value". Ultimately, the court determined that First Bank's interest in the collateral was of inconsequential value, finding that the value of the debtor's property was $80,000.00, which was 8.2% of First Bank's total claim of $970,233.13.

However, the court stated:

> The key point here is that the 'inconsequential value' determination is not a bean counting exercise; the determination cannot be based solely on a mechanical, numerical calculation. Some consideration must be given to the policies underlying both the right to make the §1111(b) election and the exception to that statutory right. In other words, while 'the numbers' provide an important starting point in deciding how much value is 'inconsequential,' the court also must consider other relevant circumstances presented in the case and make a holistic determination that takes into account the purpose and policy of the statutory provisions that govern the reorganization case.
> 619 B.R. at 836.

The court concluded with the following:

> The point here – and it is one that the Debtor has acknowledged – is that defeating a §1111(b) election on the ground that the creditor's interest in the debtor's property is of inconsequential value may render confirmation of a chapter 11 plan very difficult. Perhaps there is a 'Goldilocks zone,' a narrow path that a debtor can navigate between the inconsequential value left in the business and the feasibility of a proposed chapter 11 plan; perhaps not.
> 619 B.R at 838.

C. *In the Matter of Topp's Mechanical, Inc.*, 2021 WL 5496560 (Bankr., D. Nebraska, 2021): The court sustained the Subchapter V Trustee's objection to confirmation, which asserted that the debtor's proposed treatment of its under-secured creditor pursuant to the §1111(b) election was "overly generous on the bank's deficiency claim at the expense of the other unsecured creditors." 2021 WL 5496560 at *1 The court agreed with the Subchapter V trustee that the payments to the bank were more than it was entitled to receive as a result of the §1111(b) election, the payments to unsecured creditors were artificially low as a result of the payments to the bank, and therefor the plan did not satisfy the "fair and equitable" requirements of 11 U.S.C. §1191(b)(2).

D. *In re: S-Tek 1, LLC*, 2021 WL 5858906 (Bankr., D. New Mexico, 2021), the court held that a secured creditor who made a §1111(b) election was still impaired and entitled to vote to accept or reject the Plan.

> Even if a creditor makes the §1111(b) election, the creditor's secured claim is impaired by the plan if, for example, the plan changes contract rates of interest, provides for deferred payments different from the terms of the original contract, or alters the maturity date or noneconomic terms of the original contract. There is no §1111(b) election exception to impairment under the terms of §1124.
> WL 5858906 at *3.

The court analyzed the requirements of §1129(b)(2)(A) vis-à-vis §1129(a)(8)—which does not apply in Subchapter V cases:

> In chapter 11 cases not governed by subchapter V, §1129(b)(2)(A) applies to a class of secured claims only if the requirements of §1129(a)(8) are not met. Section § 1129(a)(8) requires either a) acceptance by the class; or (b) unimpairment of the class. If making the §1111(b) election automatically rendered the secured claims in the class unimpaired, §1129(a)(8) would be satisfied because the class would not

> be impaired and, by operation of §1126(f), the class would be conclusively presumed to have accepted the plan. Creditors in the class making the §1111(b) election therefore could not invoke the cramdown provisions.
>
> Similarly, under subchapter V, secured claims in a class are entitled to the protections of §1129(b)(2)(A) only if the class of secured claims is impaired under and has not accepted the plan. See §§1191(b) and (c)(1). If a class of secured creditors making the §1111(b) election is deemed unimpaired, the creditors in the class would not be protected by §1129(b)(2)(A).
>
> Section § 1111(b) does not operate to defeat its very purpose by rendering a claim unimpaired to deprive electing creditors of the protections of §1129(b)(2)(A) while taking away the creditors' unsecured deficiency claim. No creditor would knowingly make the §1111(b) election if that were the result.
> WL 5858906 at *5 – 6. Footnotes omitted.

E. *In re Caribbean Motel Corp.*, 2022 WL 50401(Bankr., D. Puerto Rico, 2022), the court relied on *VP Williams Trans, LLC, supra.,* and held that the subject collateral (a "by-the-hour motel") was essential to the debtor's reorganization, the proposed plan and all proposed scenarios, and that the collateral, which had a value of 15.6% of the total secured claim, was not inconsequential; therefore, debtor's objection to the §1111(b) election was denied.

III. Practical considerations for Subchapter V cases

A. Set the date for the filing of the §1111(b) election. The debtor and secured creditor should ask the court to set the §1111(b) election filing date so that there is appropriate time for the parties to address issues related to the election, which could include resolution of debtor's objection to same, preparation and filing of an amended plan, timing relative to submission of ballots and objections to the plan, and plan confirmation.

B. Valuation of collateral. One of the points of Subchapter V is to keep costs down, in part by reducing the time frame in which to file a plan and by encouraging the parties to negotiate the plan terms prior to filing the plan and the confirmation hearing. (See §1188(c) and §1189(b).) In order to facilitate negotiation with creditors, and in particular with the secured creditor,

valuation of the collateral should be done as early in the case as possible, so that any valuation disputes can be addressed during the plan formulation process.

C. Scenarios for payment. Debtor's counsel should consider the impact of a §1111(b) election as they are developing the plan, in order to prepare for this contingency. Can a plan still be feasible? Is it still fair and equitable? Can the Plan be completed within a maximum 5 year term?[2] As the *Topp's Mechanical* case points out, even with the agreement of the debtor and the secured creditor, and without a consenting class (*see* §1191(b)), the Subchapter V trustee may object to the plan.

[2] 11 U.S.C. §1191(c) Rule of Construction—For Purposes of this section, the condition that a plan be fair and equitable with respect to each class of claims or interests includes the following requirements:
…
(2) As of the effective date of the plan –
(A) the plan provides that all of the projected disposable income of the debtor to be received in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or
(B) the value of the property to be distributed under the plan in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date on which the first distribution is due under the plan is not less than the projected disposable income of the debtor.

Faculty

Jonathan E. Aberman is a member of Dykema Gossett PLLC in Chicago and leads the firm's Chicago bankruptcy, insolvency and creditors' rights practice. He represents clients nationwide to solve complex challenges arising from distressed situations. He has helped businesses, banks and nonbank lenders, finance companies, special servicers, and other secured and unsecured creditors enforce their rights and protect their assets and interests in bankruptcy cases, workouts and restructurings, foreclosures, receiverships and assignments for the benefit of creditors. He also has represented buyers and sellers of assets in the distressed marketplace, including § 363 sales and Article 9 sales. For more than 20 years, Mr. Aberman has handled all aspects of complex chapter 11 cases in bankruptcy courts across the country, including debtor-in-possession financing and cash-collateral disputes, auctions and asset sales, plan formation and confirmation, claims and objections, preference actions and fraudulent-transfer suits. He also negotiates and structures the bankruptcy-related aspects of commercial loan transactions, including intercreditor and subordination agreements and unitranche and agreements among lenders. Mr. Aberman has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law (2021), named a Leading Lawyer in Bankruptcy & Workout Law: Commercial by The Leading Lawyers Network (2015-18), and named in *Illinois Super Lawyers* for Bankruptcy: Business Law annually since 2018. He received his B.A. *cum laude* in 1995 from Duke University and his J.D. in 1998 from Northwestern University School of Law.

Hon. David D. Cleary is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, appointed in December 2019. Previously, he chaired Greenberg Traurig LLP's Business Reorganization & Financial Restructuring Practice in Phoenix, where he focused his practice on business restructuring and reorganizations, distressed-asset dispositions and financings, debt restructurings and workouts, and litigation. He regularly represented distressed companies, financial institutions, secured and significant creditors, noteholders and bondholders, hotel/resort owner/operators, boards of directors, debtors, official and ad hoc committees, and insurance and surety portfolios. Judge Cleary is a Master with the Arizona Inns of Court, past co-chair of the American Bar Association's Litigation Section of its Bankruptcy and Insolvency Committee, past chair of the Chicago Bar Association's Rules Sub-Committee of its Bankruptcy Committee, and past co-chair of ABI's Asset Sales and Health Care Committees. He was listed in *The Best Lawyers in America* and in *Southwest Super Lawyers*, and he was a member of the winning team for The M&A Advisor's "Restructuring of the Year (Over $500mm to $1 Billion)" award in 2015 for the restructuring of FriendFinder Networks. He is also rated AV-Preeminent by Martindale-Hubbell. Judge Cleary was admitted to practice in Arizona and Illinois, before the U.S. Courts of Appeals for the Ninth and Seventh Circuits, and before the U.S. District Courts for the District of Arizona and the Northern District of Illinois. He received his B.A. *cum laude* from Arizona State University in 1984 and his J.D. with honors from DePaul University College of Law in 1987, where he was an article and note editor for the *DePaul Law Review*.

Franklind D. Lea, CIRA is the president of Tactical Financial Consulting, LLC in Alpharetta, Ga., and has more than 30 years of professional experience and education in complex business and financial matters. He has broad expertise in commercial finance, insolvency, real estate, real estate

finance and valuation. His experiences encompass business and project evaluation, damage claims and lost profits, debt and equity structuring and restructuring, feasibility analysis, financial analysis, investment management, lending and leasing, and valuation. His professional roles have been as an appraiser, commercial lender, credit officer, financial consultant and workout officer. Since the creation of Tactical Financial, Mr. Lea has provided services to companies, investors, lenders and secured creditors, unsecured creditors' committees and law firms. He has acted as an advisor and litigation consultant, and has provided expert witness reports and expert testimony for a number of matters related to damage claims, feasibility, financing, real estate and specialized bankruptcy issues such as the § 1111(b) election, § 1129 confirmation requirements, the indubitable equivalent and *Till* cramdown interest rates. Within these roles, he has participated in more than 200 court hearings and provided testimony through affidavits, depositions and direct examination within the courtroom. Prior to forming Tactical Financial, Mr. Lea was a senior lender at Textron Financial Corp. for 11 years, where he focused on specialty real estate lending and large account workouts for real estate, equipment leasing and commercial lending. During his tenure at Textron Financial, he held several senior roles within its specialty lending divisions and risk-management department. He completed approximately 50 multi-million dollar specialty loan transactions and conducted several multi-year complex workouts and financial restructurings. Mr. Lea sits on ABI's Board of Directors and is an At-Large member of its Executive Committee. He also is a former co-chair of ABI's Asset Sales Committee and sits on the advisory board of ABI's Judge Alexander L. Paskay Memorial Bankruptcy Seminar. Mr. Lea received his B.S. in management and his M.B.A. from Florida State University, and a Master's degree in real estate and urban analysis from the University of Florida.

Julie B. Teicher is a shareholder with Maddin, Hauser, Roth & Heller P.C. in Southfield, Mich., and a member of the firm's Bankruptcy, Restructuring and Debtor-Creditor Rights Practice Group and the its Financial Services and Real Property Litigation Group. She concentrates her practice on business-related insolvency and bankruptcy matters, handling cases in bankruptcy, district and state court proceedings. Her clients include debtors, creditors, receivers, purchasers and parties in interest in bankruptcy and receivership matters in both state and federal courts. Ms. Teicher has served as a court-appointed receiver and as the trustee of a liquidating trust established pursuant to Delaware law. She has worked on many hospital bankruptcy matters over the years, representing a variety of clients in various cases. Ms. Teicher has experience representing creditors in consumer chapter 11, 13 and 7 cases, including various financial institutions, real estate companies, title companies, landlords and trustees. She also has represented clients in bankruptcy matters in Michigan, New York, Pennsylvania, Delaware, Texas and Ohio, and she serves as local counsel for out-of-state attorneys who have matters in Michigan courts, including state, federal and bankruptcy courts. Ms. Teicher is AV-rated by Martindale-Hubbell, is listed in *DBusiness* magazine as a Top Lawyer in bankruptcy, and she has been recognized as a Michigan Leading Lawyer in *Bankruptcy & Workout Law: Commercial and Creditor's Rights/Commercial Collections Law*. She also has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law and Litigation-Bankruptcy since 2010, and since 2018 for her work in Commercial Litigation. In 2019, she was inducted as a Fellow of the American College of Bankruptcy. A Certified Bankruptcy Court Mediator, Ms. Teicher has been an adjunct professor at the University of Detroit Mercy School of Law at various times since 2006. She also has been a presenter at many seminars, including ABI's Central States Bankruptcy Workshop and Hon. Steven W. Rhodes Consumer Bankruptcy Conference. Ms. Teicher received her B.A. with honors in 1978 from James Madison College, Michigan State University and her J.D. in 1982 from the University of Detroit.