The World of SARE Cases

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The 1111(b) Election: A Graphical Interpretation

March 24, 2015

Presented By:

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Franklind Lea is the President of Tactical Financial Consulting. Mr. Lea has over 25 years of professional experience and education in complex financial matters encompassing evaluation, valuation and appraisal; investment management; financial analysis; debt structuring; and financial restructuring, bankruptcy and workouts. During his career, he has developed broad experience in commercial finance including leasing, lending, real estate, valuation, restructuring, bankruptcy and workouts. He has been designated as one of only approximately 1,000 Certified Insolvency and Restructuring Advisor's in the United States by the Association of Insolvency and Restructuring Advisors.

Experience and Education

Mr. Lea has been a financial consultant since late 2005 when he formed Tactical Financial. Since the creation of Tactical Financial, Mr. Lea has served as a financial advisor to investors, debtor companies, secured creditors, unsecured creditors' committees, law firms, and as an expert witness. As an advisor, he has provided due diligence services and financial consulting as well as litigation consulting and expert testimony for a number of matters related to damage claims, feasibility, financing, and specialized bankruptcy issues such as Till interest rates, the 1111(b) election, indubitable equivalent, and 1129 confirmation requirements.

Prior to forming Tactical Financial, he was a senior lender at Textron Financial Corporation 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, Mr. Lea held several senior roles within its specialty lending divisions and risk management department. He completed approximately 50 specialty loan transactions and conducted several multi-year, complex workouts and financial restructurings. His other professional experiences include roles as a commercial real estate appraiser with national and regional appraisal firms and various positions at First Florida Bank, including Vice President of Commercial Lending and Regional Commercial Credit Manager. His experiences include direct lending of approximately $500 million to businesses and commercial real estate ventures and credit review and approval of approximately $1.5 billion. He has also led numerous workouts and financial restructurings recouping over $250 million of potential losses while working with companies with market capitalization ranged from $2 million to in excess of $1 billion.

Mr. Lea graduated with a Bachelor of Science degree in Management from Florida State University in 1986, a Master of Business Administration from Florida State University in 1987 and a Master's Degree in Real Estate and Urban Analysis from the University of Florida in 1994.

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

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

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Potential Mathematical Variables

Claims

1. Allowed Claim
2. Secured Claim

Collateral

3. Collateral Value

Repayment Terms

4. Interest Rate
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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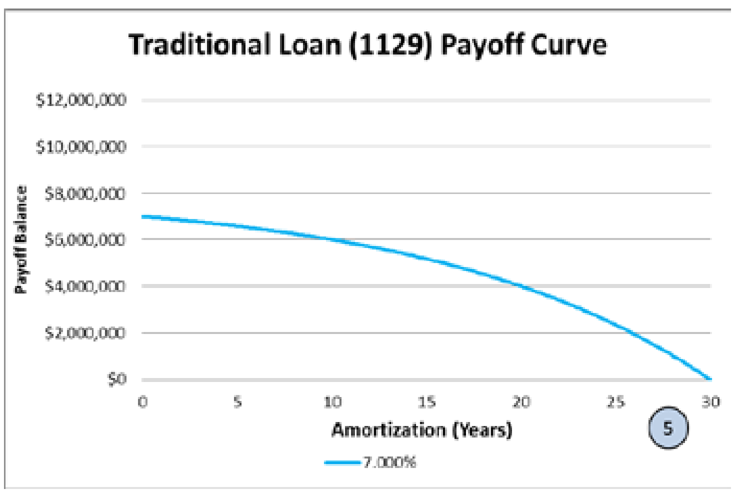
Payment/Payoff Calculations

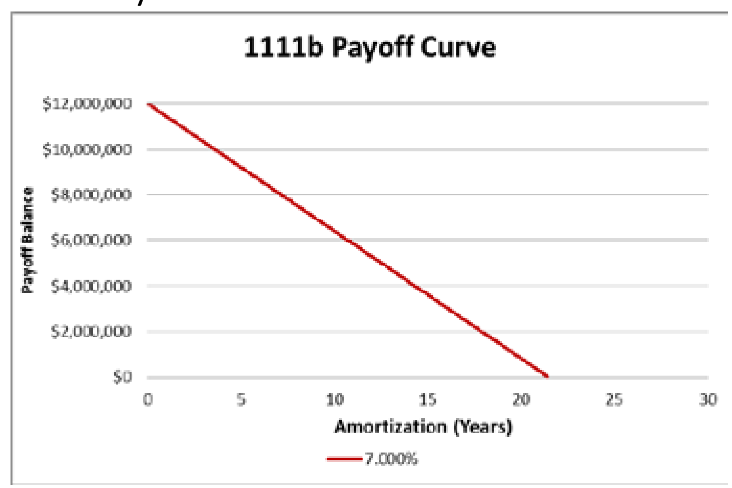
1129

- Balance – Value of Creditor's Security Interest in its Collateral
- Payment –
  - includes an interest payment
- Payoff – Prior Period balance less amount of principal paid



1111(b)

- Beginning Balance – Amount of Allowed Claim
- Payment – specified by the terms of the Plan; all amounts paid to the secured creditor
- Payoff = Prior Period Balance less (total) Payment



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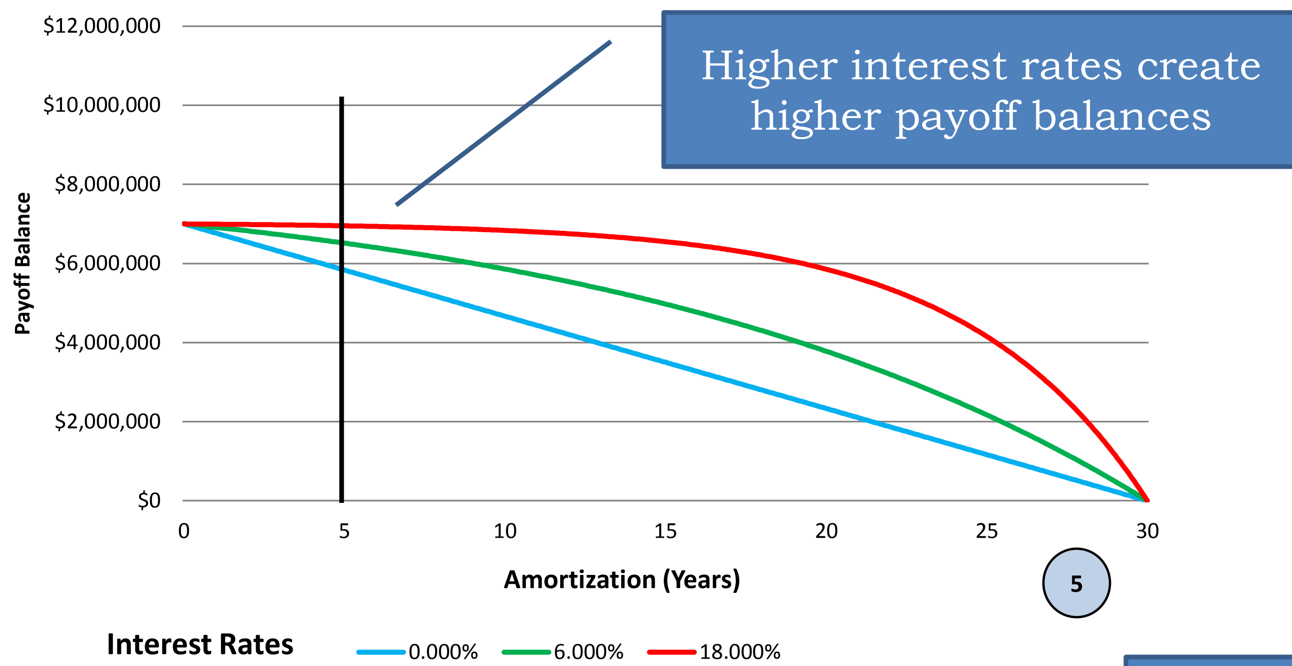
Amortization Schedule with Payoff Inflexion Point Highlighted

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

Upper half of page

Month	Payment	Interest	Principal	1129 Amortizing Balance	1111b Balance
0				7,000,000	12,000,000
1	46,571	40,833	5,738	6,994,262	11,953,429
2	46,571	40,800	5,771	6,988,491	11,906,858
3	46,571	40,766	5,805	6,982,686	11,860,286
4	46,571	40,732	5,839	6,976,847	11,813,715
5	46,571	40,698	5,873	6,970,974	11,767,144
6	46,571	40,664	5,907	6,965,067	11,720,573
7	46,571	40,630	5,942	6,959,125	11,674,002
8	46,571	40,595	5,976	6,953,149	11,627,431
9	46,571	40,560	6,011	6,947,138	11,580,859
10	46,571	40,525	6,046	6,941,092	11,534,288
11	46,571	40,490	6,081	6,935,010	11,487,717
12	46,571	40,454	6,117	6,928,893	11,441,146

Traditional Loan (1129) Payoff Curve



Calculated via the Prior Formula

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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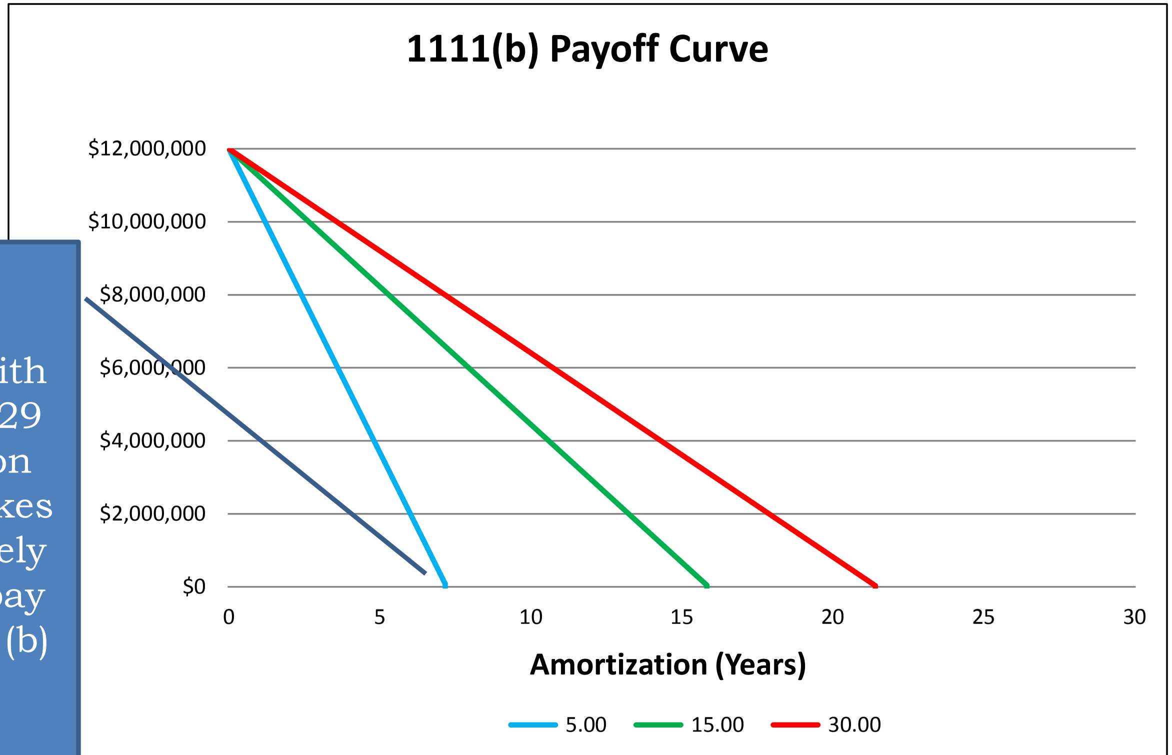

Note that with a 5 year 1129 amortization period, it takes approximately 7 years to pay off the 1111(b) balance

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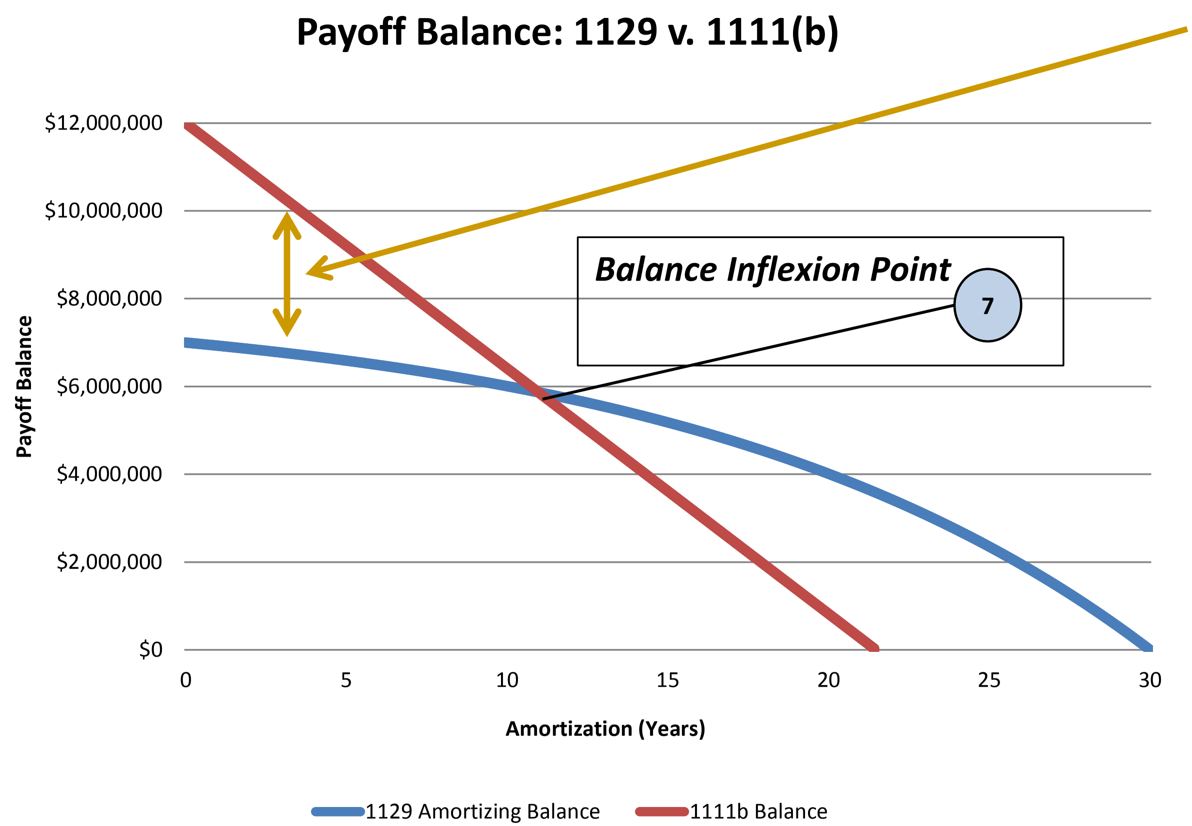
The intersection of the 1129 and 1111(b) Payoff Curves is the ***"1111(b) Balance Inflexion Point"***



When the repayment term for the secured claim is to the left of the 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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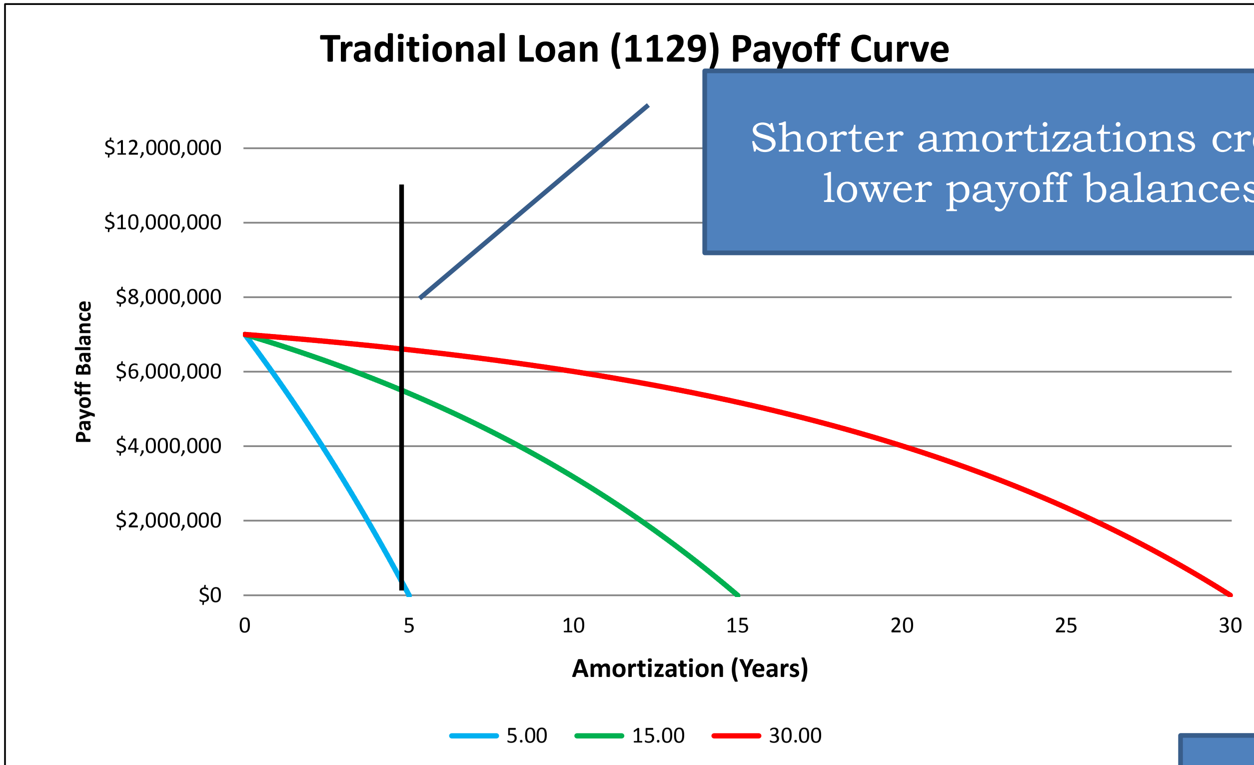


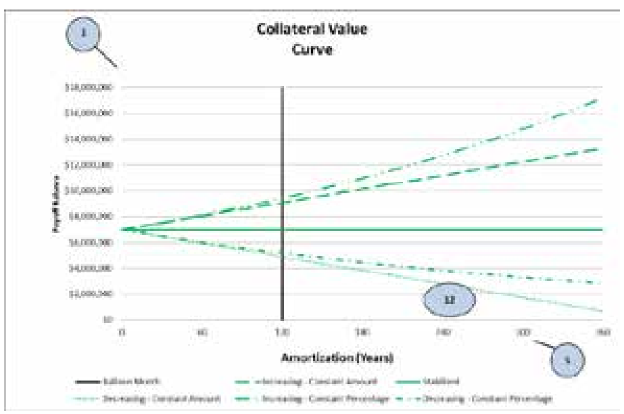
Shorter amortizations create lower payoff balances

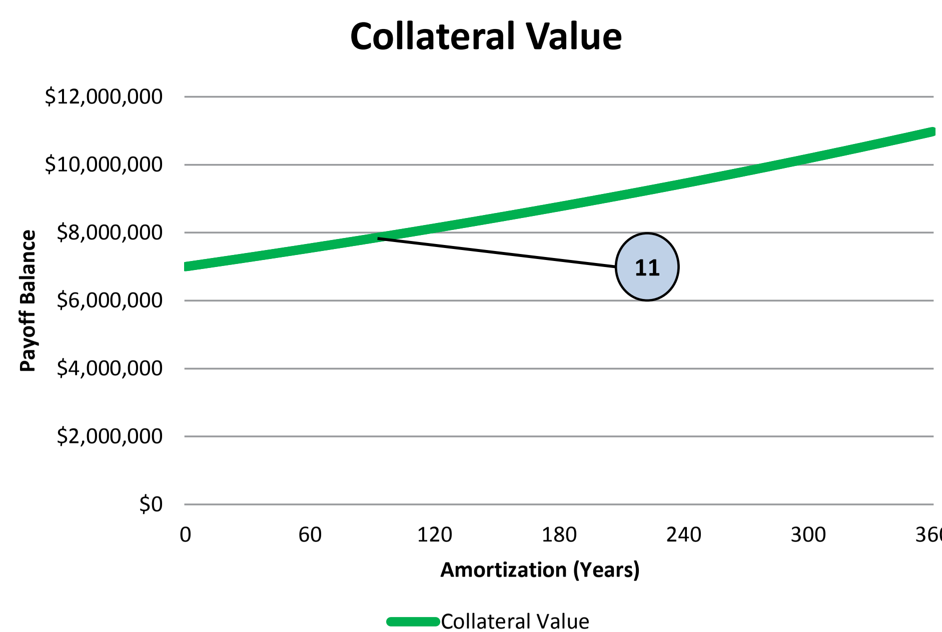
Amortizing Balance	$ 7,000,000	$ 7,000,000	$ 7,000,000
Amortization (Years)	5	15	30
Interest Rate	7.000%	7.000%	7.000%
No. of Payments Per Year	12	12	12
Payment Amount	$ 138,608	$ 62,918	$ 46,571

Payment amount is higher for shorter amortization

Collateral

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





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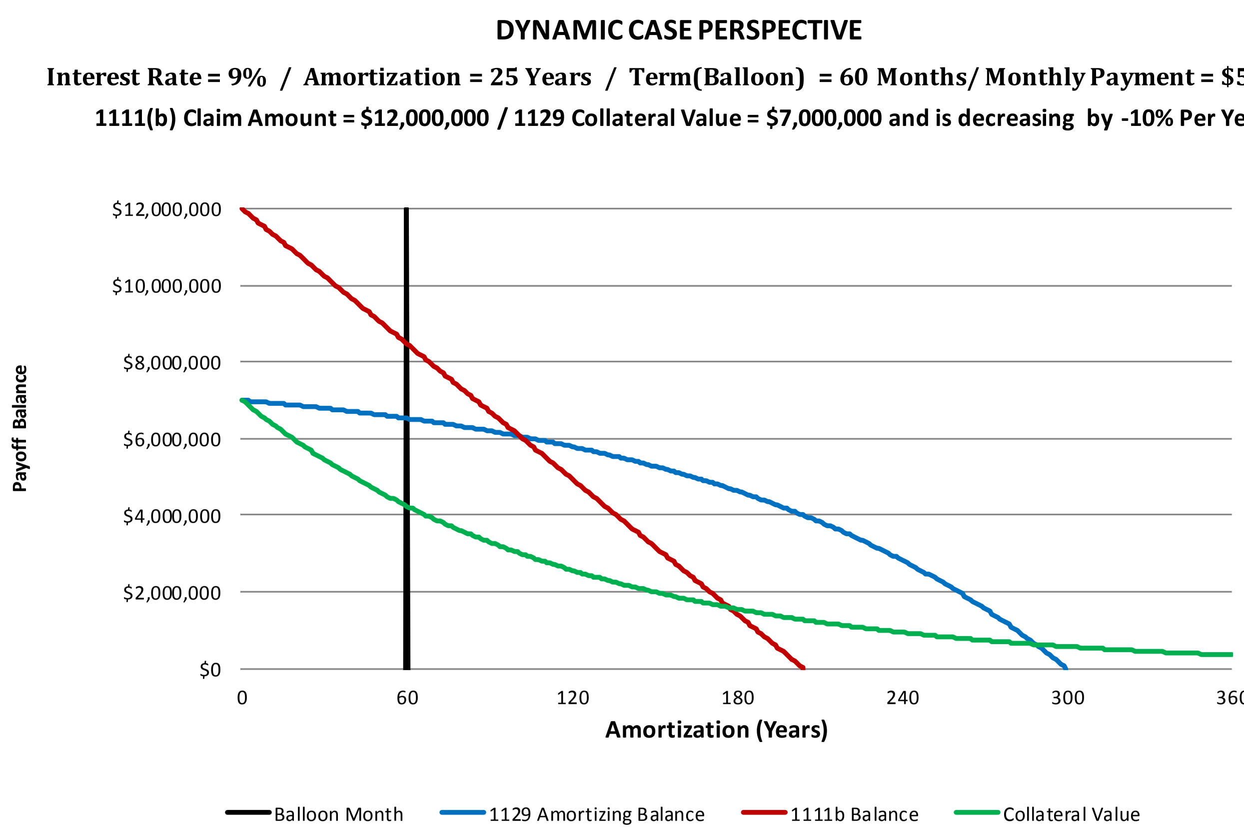
Collateral with Decreasing Value



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Feasibility Determination Quick Reference Sheet

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FEASIBILITY CONDITIONS

In order to be feasible, the Plan must satisfy these two conditions:

Condition One	There must be a "reasonable assurance of Plan performance"
Condition Two	The Plan's implementation must "not likely to be followed by an unanticipated financial reorganization or liquidation"

FEASIBILITY REQUIREMENTS

To satisfy these conditions, the Debtor must be reasonably likely to meet the following three requirements:

Requirement One	Provide the cash necessary to pay all of the on-going claim payment obligations described in the Plan
Requirement Two	Maintain a sufficient level of cash throughout the Plan term to provide for the Property's operating and capital costs while maintaining a level of economic viability sufficient to make the Plan payments
Requirement Three	Provide the cash necessary to pay all of the remaining claim payment obligations, if any, due at the end of the Plan term

FACTORS CONSIDERED IN DETERMINING PLAN FEASIBILITY

To form our Opinion, as to the satisfaction of these Conditions and Requirements, we considered the following factors in determining whether the Plan is feasible:

Feasibility Factor One	The (future) earning power of the business
Feasibility Factor Two	The adequacy of the (reorganized) capital structure
Feasibility Factor Three	The economic conditions of the business
Feasibility Factor Four	The efficiency and effectiveness of management in control of the business after confirmation
Feasibility Factor Five	The reasonableness and impact of the plan terms to the success of the plan

1111(b) ELECTION QUICK REFERENCE SHEET

OVERSECURED CREDITOR

The following example utilizes an initial loan amount of $110.00 with lender's collateral valued at $125.00 (or any amount of $110.00 or greater).

Loan → Debtor's Bankruptcy Filing → Claim → Debtor's Claims Reconciliation → Allowed Claim → Debtor's Valuation & Bifurcation → • Secured Claim • Unsecured Claim

	Loan	Claim	Allowed Claim	• Secured Claim • Unsecured Claim
***Balances*:**				
Loan Amount	$ 110	n/a	n/a	n/a
Claim Amount	n/a	$ 110	n/a	n/a
Value of Lender's Collateral	$ 125	$ 125	$ 125	$ 125
Value of Lender's Security Interest	n/a	n/a	$ 110	$ 110
Allowed Claim Amount	n/a	n/a	$ 110	$ 110
Secured Claim Amount	n/a	n/a	n/a	$ 110
Unsecured Claim	n/a	n/a	n/a	$ -
Amortizing Balance	$ 110	n/a	n/a	$ 110
Minimum Payment Requirement	$ 110	n/a	n/a	$ 110
***Creditor's Plan Voting Rights*:**				
Secured Claim Amount				Yes
Unsecured Claim				n/a
***Lien Rights*:**				
Debtor's May Extinquish Secured Claim By Selling Property (Outside of Plan) thru §363 Sale				Yes
Debtor's Plan May Extinquish Secured Claim By Paying the Value of Security Interest				Yes
Lender Retains Right to Credit Bid Sale of Property (Outside of Plan or Thru Plan)				Yes
Debtor May Modify Liens or Substitute Collateral				Yes

UNDERSECURED CREDITOR

The following example utilizes an initial loan amount of $110.00 with lender's collateral valued at $50.00 (or any "consequential" amount less than $110.00).

1111(b)(2) Election Not Made: Loan → Debtor's Bankruptcy Filing → Claim → Debtor's Claims Reconciliation → Allowed Claim → Debtor's Valuation & Bifurcation → • Secured Claim • Unsecured Claim

1111(b)(2): → Creditor's 1111(B)(2) Election Made → Secured Claim

	Loan	Claim	Allowed Claim	• Secured Claim • Unsecured Claim	Secured Claim (1111(b)(2))
***Balances*:**					
Loan Amount	$ 110	n/a	n/a	n/a	n/a
Claim Amount	n/a	$ 110	n/a	n/a	n/a
Value of Lender's Collateral	50	$ 50	$ 50	$ 50	$ 50
Value of Lender's Security Interest	n/a	n/a	$ 50	$ 50	$ 50
Allowed Claim Amount	n/a	n/a	$ 110	$ 110	$ 110
Secured Claim Amount	n/a	n/a	n/a	$ 50	$ 110
Unsecured Claim	n/a	n/a	n/a	$ 60	$ -
Amortizing Balance	$ 110	n/a	n/a	$ 50	$ 50
Minimum Payment Requirement	$ 110	n/a	n/a	$ 50	$ 110
***Creditor's Plan Voting Rights*:**					
Secured Claim Amount				Yes	Yes
Unsecured Claim				Yes	No
***Lien Rights*:**					
Debtor's May Extinquish Secured Claim By Selling Property (Outside of Plan) thru §363 Sale				Yes	Yes
Debtor's Plan May Extinquish Secured Claim By Paying the Value of Security Interest (i.e., collateral value)				Yes	Yes
Lender Retains Right to Credit Bid Sale of Property (Outside of Plan or Thru Plan)				Yes	Yes
Debtor May Modify Liens or Substitute Collateral				Yes	No

<u>**SARE Cases & the Good Faith Filing Requirement**</u>

By: Christopher A. Ward, Esq., Polsinelli PC, Polsinelli LLP in California[1]

The good faith inquiry arises in connection with single asset real estate ("**SARE**") filings when a secured creditor elects to either: 1) obtain relief from the automatic stay pursuant to § 362(d) of the Bankruptcy Code (the "**Code**"); or 2) dismiss the Chapter 11 in its entirety as a bad faith filing pursuant to § 1112(b) of the Code. Regardless of whether a creditor decides to move under § 362(d) or § 1112(b), courts continue to recognize bad faith Chapter 11 filings as "cause" justifying relief from the stay or dismissal. In doing so, however, there is no consistent manner in which courts evaluate good faith in the context of SARE filings. The first section of this memorandum provides the reader with a brief overview of SARE filings in the bankruptcy context. The following section discusses the good faith filing requirement and distinguishes among the approaches exercised by circuit courts in analyzing this requirement.

1. **Overview**

Notwithstanding the reemergence and acceleration of SARE filings just prior to the enactment of the Code in 1978, Congress did not afford special treatment to SARE debtors at this time.[2] The Code bundled all business reorganizations under the Chapter 11 statute, and, therefore, SARE debtors were permitted to reorganize under the same rules and protections of other Chapter 11 debtors.[3] In the years that followed, SARE filings prompted allegations of abuse stemming from SARE debtors who had entered bankruptcy without equity or sufficient cash-flow to sustain a Chapter 11 plan.[4] SARE filings often would take place on the eve of foreclosure in an effort to merely stave off foreclosure proceedings or to gain leverage in negotiations with creditors.[5] SARE debtors, who could not pay secured creditors under the contractual terms and conditions of the respective loan, required more time and lower payments.[6] Simply put, SARE debtors needed loan modifications and sought to accomplish such through Chapter 11 plan confirmation.[7] By "hiding out in bankruptcy," shielded by the automatic stay,

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[1] Chris is the Co-Chair of Polsinelli's Bankruptcy and Financial Restructuring practice group and Managing Shareholder of Polsinelli's Delaware office. Chris is Chair, Mid-Atlantic Region for the ABI's Endowment Fund and currently serves as Co-Chair of ABI's Financial Advisors and Investment Banking Committee. He was also the Editor and an Author of ABI's *The Chief Restructuring Officer's Guide to Bankruptcy: Views from Leading Insolvency Professionals*. The author would also like extend his deepest appreciate and thanks to Elizabeth Blakely Paquet, Esq., an associate in Polsinelli's New York office and member of the Bankruptcy and Financial Restructuring practice group for her assistance with these materials.

[2] It should be noted, however, that certain provisions did relate to SARE debtors, yet none applied to them exclusively. *See, e.g.*, §§ 1111(b), 1129(a)(10) and 362(d)(2); *see also* H. Miles Cohn, *Single Asset Chapter 11 Cases*, 26 Tulsa L.J. 523, 525 (1991) (discussing the general application of certain provisions to SARE debtors) (citing *In re Greystone III Joint Venture*, 102 B.R. 560, 562–66 (Bankr. W.D. Tex. 1989)).

[3] *See* Scott L. Swanson, *Is a Housing Cooperative Entity Subject to the Single-Asset Real Estate Provisions of the Bankruptcy Code?*, 2011 Ann. Surv. of Bankr. Law 7 (2011).

[4] *Id.*

[5] *Id.*

[6] Jonathan M. Landers, *Time to Exclude SARE Cases from a Reformed Chapter 11*, 33-APR Am. Bankr. Inst. J. 34 (2014).

[7] *Id.*

SARE debtors were typically able to buy time until the market eventually improved.[8] In most instances, SARE debtors were fueled with the hope that they could force a cram down of the secured creditor's claims through the bankruptcy process.[9] Mortgage lenders complained that SARE debtors, with no real intent or ability to reorganize under Chapter 11, could take advantage of the automatic stay to hold both secured creditors and their collateral "hostage" for significant periods of time.[10] Others perceived the significant litigation costs and delays associated with such filings to be unreasonable given the SARE debtor's limited intentions when filing and the improbability of a successful reorganization under Chapter 11.[11] Although policy justifications such as the protection of jobs and the reduction in value of a business often benefit secured creditors and the economy, such policy justifications were generally inapplicable to SARE debtors, who had few employees and creditors to protect and a single piece of property valued the same amount whether controlled by the debtor or the secured creditors.[12] As such, courts were left to develop their own means of dealing with SARE cases.

Because the Code initially did not provide any method of dealing with alleged abuses, courts utilized the good faith filing requirement to weed out abusive SARE filings early in the bankruptcy process.[13] While many courts determined that SARE cases were *ipso facto* "bad faith" filings,[14] some SARE debtors still managed to stave off foreclosures for considerable lengths of time.[15] Consequently, the lending industry lobbied to create expedited procedures for SARE cases.[16]

It was not until the Bankruptcy Reform Act of 1994 that Congress amended the Code to severely limit the ability of SARE debtors to reorganize under Chapter 11.[17] First, Congress added a statutory definition of SARE under § 101(51B).[18] Congress also set forth a "drastically abbreviated reorganization process"[19] under § 362(d)(3) whereby the protection of the automatic stay expires after only 90 days following the petition date unless the debtor produced a feasible plan of reorganization or resumed scheduled interest payments to secured creditors under the plan.[20] Section 362(d) remained unaltered until the enactment of BAPCPA, whereby the 2005 Amendments expanded the provisions in § 362(d). The Code provisions pertaining to SARE cases currently read as follows:

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8 Leslie A. Berkoff, *The Continued Misuse of Bankruptcy by SARE Debtors*, http://www.financierworldwide.com/the-continued-misuse-of-bankruptcy-by-sare-debtors/#.VLllwy50Y7g.
9 *Id*.
10 *Id*.
11 *See* Scott L. Swanson, *Is a Housing Cooperative Entity Subject to the Single-Asset Real Estate Provisions of the Bankruptcy Code*, 2011 Ann. Surv. of Bankr. Law 7 (2011).
12 *Id*.
13 *Id*.
14 *See e.g. In re Phoenix Piccadilly, Ltd.*, 849 F.2d 1393 (11th Cir. 1988).
15 *See* Kenneth N. Klee, *One Size Fits Some: Single Asset Real Estate Bankruptcy Cases*, 87 Cornell L. Rev. 1285, 1302 (2002).
16 *Id*.
17 *See* Scott L. Swanson, *Is a Housing Cooperative Entity Subject to the Single-Asset Real Estate Provisions of the Bankruptcy Code?*, 2011 Ann. Surv. of Bankr.Law 7 (2011).
18 11 U.S.C. § 101(51B).
19 *See* Scott L. Swanson, *Is a Housing Cooperative Entity Subject to the Single-Asset Real Estate Provisions of the Bankruptcy Code?*, 2011 Ann. Surv. of Bankr.Law 7 (2011).
20 11 U.S.C. § 362(d)(3).

a. ***Section 101(51B)***

The term "single asset real estate" means real property constituting a single property or project, other than residential real property with fewer than four residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental.

11 U.S.C. § 101(51B).

b. ***Section 362(d)***

Section 362(d)(3) of the Code provides, in pertinent part, as follows:

> (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay --
>
> > (3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later --
> >
> > > (A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
> > >
> > > (B) the debtor has commenced monthly payments that --
> > >
> > > > (i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and
> > > >
> > > > (ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; . . . .

11 U.S.C. § 362(d)(3).

In light of these amendments, a secured creditor in a SARE case may obtain relief from the automatic stay pursuant to § 362(d) of the Code in an effort to continue the foreclosure action in state court and liquidate its interest at the sheriff's sale.[21] Specifically, § 362(d)(1) allows the court to grant relief from the stay for "cause." The Code, however, does not define "cause," and,

[21] Robert E. Nies and Michael R. Caruso, *A Secured Creditor's Chapter 11 Chess Match*, 215 N.J.L.J. 238 (2014).

therefore, courts are left to determine what constitutes "cause" based on the totality of circumstances.[22]

The rights granted to SARE creditors in § 362(d) are in addition to, not in place of, other grounds for relief. Depending on the facts and circumstances surrounding the foreclosure and bankruptcy filing, a secured creditor may seek to obtain a dismissal as opposed to stay relief. Section 1112(b)(1) mandates the bankruptcy court to convert or dismiss a case if the movant establishes "cause" for conversion or dismissal.[23] While the Code does not define "cause," the 2005 Amendments to the Code incorporated a non-exhaustive list of factors that constitute "cause" for conversion or dismissal by means of § 1112(b)(4).[24] Pursuant to both §§ 362(d) and 1112(b), bankruptcy courts have recognized and continue to recognize bad faith Chapter 11 filings as "cause" justifying stay relief or dismissal.

2. **Good Faith Filing Requirement**

A good faith standard has been incorporated into bankruptcy law since the Bankruptcy Act of 1898.[25] Since that time, this standard has continued to apply by means of legislative action and judicial interpretation. Bankruptcy courts have determined that implicit in § 1112(b)(1) is the requirement that every Chapter 11 case be filed in good faith.[26] Consequently, a lack of good faith in filing a Chapter 11 petition (otherwise referred to as a "bad faith" filing) constitutes "cause" for dismissal.[27] In the context of SARE cases, § 362(d)(3) does not expressly reference the good faith requirement.[28] In addition, legislative history is devoid of any suggestion that SARE debtors are somehow exempt from the good faith requirement.[29] As such, bankruptcy courts have read the good faith filing requirement into both §§ 362(d) and 1112(b) as a basis for dismissing abusive SARE filings.[30] Given that there is no set standard or test defining

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[22] *Id*.

[23] Section 1112(b)(1) of the Code provides as follows, in pertinent part: (b)(1) Except as provided in paragraph (2) of this subsection . . . . on request of a party in interest, . . . absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes "cause." 11 U.S.C. § 1112(b)(1).

[24] 11 U.S.C. §1112(b)(4).

[25] Keri Friedman, *The Standard for Dismissal and Stay Relief in Single Asset Real Estate Chapter 11 Cases*, 23 No. 3 J. Bankr. L. & Prac. NL Art. 5 (2014) (citing *Matter of Little Creek Development Co.*, 779 F.2d 1068, 1071 (5th Cir. 1986) (noting that "[e]very bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings.")).

[26] *See In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 118 (3d Cir. 2004) (dismissing Chapter 11 case where debtor was financially healthy at the time of filing, had no intention of reorganizing or liquidating as a going concern, and admitted filing was solely to take advantage of the Code's provision capping landlord's rejection claim); *In re SGL Carbon Corp.*, 200 F.3d 154, 160 (3d Cir. 1999) (dismissing Chapter 11 case where debtor was financially healthy at the time of filing and admitted that sole purpose of filing was to obtain a tactical advantage in litigation).

[27] *See Integrated Telecom*, 384 F.3d at 118; *SGL Carbon Corp.*, 200 F.3d at 160-62; *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994); *In re Stolrow's Inc.*, 84 B.R. 167, 170 (9th Cir. B.A.P. 1988).

[28] 11 U.S.C. § 362(d)(3).

[29] *Concurrent Session: Business Track Real Estate Appellate Argument: Debtor and Secured Creditor Lawyers Sparring over Several Timely Issues Arising in Real Estate Cases*, 120111 ABI-CLE 17 (2011).

[30] *See e.g. Little Creek*, 779 F.2d 1068; *In re Humble Place Joint Venture v. Fory (In re Humble Place Joint Venture)*, 936 F. 2d 814 (5th Cir. 1991); *Carolin Corp. v. Miller*, 886 F. 2d 693 (4th Cir. 1989), *Trident Assocs. Ltd.*

the non-statutory good faith filing requirement as applicable to SARE debtors, courts generally have focused on the debtor's objective ability to reorganize and the debtor's subjective intent in filing.[31] The lack of consistency in application, however, has led to a disparate handling of SARE cases among circuit courts.[32]

Courts generally apply factor-based tests to aid in the determination of good faith filing. In *Matter of Little Creek Development Co.*, 779 F.2d 1068 (5th Cir. 1986), the Fifth Circuit held that, as applied to § 362(d) and § 1112(b), the good faith standard requires an inquiry into "the debtor's financial condition, motives, and local financial realities."[33] The court then identified several factors that generally exist in a finding of lack of good faith, including the debtor: 1) having only one asset that is encumbered by a lien; 2) having no employees other than the principals; 3) having little or no cash flow and no available income to sustain a plan of reorganization or make adequate protection payments; 4) having few unsecured creditors; and 5) having "new debtor syndrome" whereby the debtor entity has been created for the sole purpose of isolating the insolvent asset.[34] Under these facts, the case is essentially regarded as a two-party dispute that is better suited to adjudication in state court. Since *Little Creek*, other courts have expanded upon this list of factors.[35]

While *Little Creek* articulated the application of reading the good faith standard into the "for cause" provisions of § 362(d) and § 1112(b), the court did not address whether a finding of lack of good faith warrants stay relief or dismissal if the debtor had a feasible chance of reorganization. Following *Little Creek*, the Eleventh Circuit addressed this very question in *In re Phoenix Piccadilly, Ltd*., 849 F.2d 1393 (11th Cir. 1988). In *Phoenix Piccadilly*, the court held that equity in the property and the debtor's potential for reorganization were insufficient to overcome a bad faith filing.[36] Instead, the court expanded upon the *Little Creek* factors and set forth its own factors indicative of bad faith. Those factors (the "*Phoenix Piccadilly* factors") are as follows: 1) the debtor only has one asset, the property, in which it does not hold legal title (which was held by a bank under a deed of trust); 2) the debtor has few unsecured creditors whose claims are small in relation to the claims of the secured creditors; 3) debtor has few employees; 4) the property is the subject of a foreclosure action as a result of arrearages on the debt; 5) the debtor's financial problems involve a dispute between the debtor and the secured creditors which can be resolved in the pending State Court Action; and 6) the timing of the debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the debtor's secured creditors to enforce their rights.[37]

Partnership v. Metro. Life Ins. Co. (In re Trident Assocs. Ltd. Partnership), 52 F. 3d 127 (6th Cir. 1995); *Integrated Telecom*, 384 F.3d at 108; *In re Albany Partners, Ltd.*, 749 F. 2d 670 (11th Cir. 1984).

[31] *See* Scott L. Swanson, *Is a Housing Cooperative Entity Subject to the Single-Asset Real Estate Provisions of the Bankruptcy Code?*, 2011 Ann. Surv. of Bankr. Law 7 (2011).

[32] *Id*.

[33] *Id.* at 1072.

[34] *Id*.

[35] *See e.g. In re Primestone Inv. Partners, L.P.*, 272 B.R. 554, 557 (D. Del. 2002); *Y.J. Songs & Co.*, 212 B.R. 793, 802 (Bankr. D.N.J. 1997); *C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304, 1311 (2d Cir. 1997); *In re SB Properties, Inc*., 185 B.R. 198, 205 (Bankr. E.D. Pa. 1995).

[36] *Phoenix Piccadilly,* 849 F.2d at 1395.

[37] *Id*. at 1394-95.

By looking only to the debtor's subjective intent in filing the Chapter 11 petition, a split was created among the circuits between those circuits that required only evidence of the debtor's subjective intent (as in *Phoenix Piccadilly*) and circuits that required the additional showing of an objective lack of feasibility in reorganization.[38] It should be noted that while the so-called *Phoenix Piccadilly* factors no longer exclusively apply following the enactment of the Bankruptcy Reform Act, bankruptcy courts continue to consider and use these factors as a guide to aid in the court's exercise of discretion when evaluating SARE filings.

a. **The Subjective Bad Faith Approach**

The majority of circuits has followed the precedent set forth in *Phoenix Piccadilly* and have relied only on the debtor's subjective intent in filing a Chapter 11 petition.[39] These circuits often focus on the so-called "honest debtor," which is a concept used to describe a debtor who is unable to overcome a bad faith filing regardless of whether the debtor has a realistic chance of undergoing a successful reorganization.[40] The Eighth Circuit in *In re Cedar Shore Resort, Inc.*, 235 F.3d 375 (8th Cir. 2000) held that evidence of the debtor's subjective bad faith in commencing a Chapter 11 case was sufficient alone to warrant dismissal.[41] The court reasoned that, even if reorganization would be possible, that possibility cannot cure a petition that was filed in bad faith or that otherwise constitutes an abuse of the bankruptcy system.[42] The United States Bankruptcy Court for the District of Columbia came to the same conclusion in *In re Allen*, 300 B.R. 105 (Bankr. D. D.C. 2003), where the court held that the feasibility of reorganization does not preclude dismissal in light of a petition filed in bad faith or that otherwise constitutes an abuse of the bankruptcy system.[43] Similarly, the Ninth Circuit BAP in *In re ECV Development, LLC*, 2007 WL 7540960 (B.A.P. 9th Cir. 2007) declined to make the feasibility of reorganization a requisite factor in reviewing whether a Chapter 11 case has been filed in bad faith.[44] *Cedar Shore*, *Allen* and *ECV Development* all rejected the Fourth Circuit's holding in *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989), which held that *both* subjective bad faith in filing the bankruptcy petition and objective futility of reorganization must be shown to warrant dismissal

[38] *Compare Id.*, 849 F.2d at 1394–95 (holding that equity in the property and an intent to reorganize is insufficient to overcome bad faith in filing), *and In re Cedar Shore Resort, Inc.*, 235 F.3d 375, 381 (8th Cir. 2000) (holding that a Chapter 11 petition may be dismissed for subjective bad faith alone), *with Carolin*, 886 F.2d at 700–01 (holding that it is necessary to demonstrate an objective lack of feasibility of reorganization as well as subjective bad faith in filing), *and In re 68 West 127 Street, LLC*, 285 B.R. 838, 846–47 (Bankr. S.D.N.Y. 2002) (holding that where the debtor can demonstrate a reasonable likelihood of reorganization, the debtor can overcome the appearance of subjective bad faith).

[39] *See e.g. Clear Blue Water, LLC v. Oyster Bay Management Co., LLC*, 476 B.R. 60, 70 (E.D. N.Y. 2012) (holding that the purpose of the good faith standard is to limit bankruptcy relief to the honest but unfortunate debtor); *Pleasant Pointe Apartments, Ltd. v. Kentucky Housing Corp.*, 139 B.R. 828, 832 (W.D. Ky. 1992) (holding that the single asset debtor had filed its petition for relief in bad faith upon evidence of meeting the *Phoenix Piccadilly* factors); and *In re McCormick Road Associates*, 127 B.R. 410, 412 (N.D. Ill. 1991) (holding that the *Phoenix Piccadilly* factors serve as a per se test for a prima facie showing of bad faith).

[40] *See e.g. Clear Blue Water,* 476 B.R. at 70.

[41] *In re Cedar Shore Resort, Inc.*, 235 F.3d 375, 381 (8th Cir. 2000) (noting that a Chapter 11 petition may be dismissed for bad faith alone where the circumstances warrant, despite the possibility of a successful reorganization).

[42] *Id*. at 380-81.

[43] *In re Allen*, 300 B.R. 105, 124 (Bankr. D. D.C. 2003).

[44] *In re ECV Development, LLC*, 2007 WL 7540960 *9 (B.A.P. 9th Cir. 2007).

of a Chapter 11 case.[45] These cases also noted that, while some courts rely on the test articulated by *Carolin*, few courts outside the Fourth Circuit have adhered to such reasoning.[46] *Allen* points out that even courts in the Fourth Circuit have treated the *Carolin* test as inapplicable to bad faith serial filings.[47] Other courts have relied on the *Phoenix Piccadilly* factors alone with no mention of *Carolin* or the objective futility approach. For example, the Eleventh Circuit's holding in *State Street Houses, Inc*., 305 B.R. 738 (S.D. Fla. 2003), aff'd, 356 F.3d 1345 (11th Cir. 2004), relied on the *Phoenix Piccadilly* factors in and of themselves and made no reference to a further showing in determining whether to dismiss a SARE case based on debtor's alleged bad faith.[48]

b. **The Objective Futility Approach**

As mentioned, the Fourth Circuit in *Carolin* articulated the requirement for an additional showing beyond subjective bad faith to warrant a dismissal. Specifically, *Carolin* required the additional showing of lack of feasibility of reorganization as part of the good faith inquiry and as a condition precedent to dismissal.[49] Citing *Little Creek's* emphasis on the preservation of "going concern,"[50] *Carolin* reasoned that bad faith alone does not strip the debtor's business of all value when there is a realistic chance of reorganization such that going concern is maximized and preserved for the benefit of both the debtor and the creditors.[51]

The Second Circuit has followed the precedent set forth in *Carolin*. While the Second Circuit considers the *Little Creek* and *Phoenix Piccadilly* factors in determining whether a debtor has acted in bad faith,[52] courts in the Second Circuit have required the debtor to evidence some feasibility in effectuating a viable plan of reorganization to avoid stay relief or dismissal. In *In re 68 West 127 Street, LLC,* 285 B.R. 838 (Bankr. S.D.N.Y. 2002), the Bankruptcy Court for the Southern District of New York applied both standards in a burden-shifting manner. The court noted that the creditor bears the burden of demonstrating that the debtor had subjective bad faith in filing for bankruptcy, and then the burden shifts to the debtor to demonstrate that its business has some going concern value that makes it feasible to reorganize.[53] The *68 W. 127 Street* case reasoned that the "for cause" provision of § 362(d)(1) required the court to consider the totality of the circumstances when determining if the debtor filed in bad faith, yet the court acknowledged that the *Phoenix Piccadilly* factors "do no more than assist the exercise of discretion."[54] The court went on to note that "the critical test of a debtor's bad faith remains whether on the filing date there was no reasonable likelihood that the debtor intended to reorganize and whether there is no reasonable possibility that the debtor will emerge from

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[45] *Carolin Corp. v. Miller*, 886 F.2d at 700.
[46] *Cedar Shore*, 235 F.3d at 381; *ECV Development*, 2007 WL 7540960 at *9; *Allen*, 300 B.R. at 124.
[47] *Allen*, 300 B.R. at 124 (citing *In re Delray Assocs., L.P.*, 212 B.R. 511, 516 (Bankr. D. Md. 1997)).
[48] *State Street Houses, Inc.,* 305 B.R. 738 (S.D. Fla. 2003), aff'd, 356 F.3d 1345 (11th Cir. 2004).
[49] *Carolin*, 886 F.2d at 700.
[50] *Id*. at 698.
[51] *Id*. at 701; *see also* Keri Friedman, *The Standard for Dismissal and Stay Relief in Single Asset Real Estate Chapter 11 Cases*, 23 No. 3 J. Bankr. L. & Prac. NL Art. 5 (2014).
[52] *See e.g. C–TC 9th Avenue Partnership v. Norton Co. (In re C–TC 9th Avenue Partnership)*, 113 F.3d 1304 (2d Cir. 1997).
[53] *68 West 127 Street, LLC*, 285 B.R. at 842–43.
[54] *Id*. at 844.

bankruptcy."[55] Since *68 W. 127 Street*, other courts in the Second Circuit have continued to consider subjective bad faith coupled with objective futility of reorganization.[56]

By comparison, the Third Circuit traditionally has recognized reorganizational intent as a prerequisite to good faith filing.[57] While the Fourth and Second Circuits recognize *both* objective futility of reorganization and subjective bad faith filing, a recent case out of the Third Circuit has recognized the objective approach alone.[58] According to *Jer*, "the inquiry of good faith is "based more on an objective analysis of whether the debtor has sought to step outside the 'equitable limitations' of Chapter 11 than the subjective intent of the debtor."[59]

2014 Case Law Developments in Bad Faith

Recent decisions have demonstrated a trend moving away from strict adherence of these subjective factors. In a recent 2014 decision, the Bankruptcy Court for the Southern District of Georgia held that a LLC's bad faith filing warranted "for cause" dismissal.[60] While *Sterling Bluff Investors* considered the *Phoenix Piccadilly* factors in its analysis, the court also recognized that these factors alone are not indicative of a bad faith filing.[61] The court stated that "because finding bad faith in filing a Chapter 11 petition is 'a finding of fact not subject to any per se approach,' the fact that a [SARE] debtor fits neatly within the *Phoenix Piccadilly* factors is not the end of the Court's analysis."[62] The court went on to examine exculpatory factors that are indicative of a debtor's legitimate motivation behind its Chapter 11 filing and, in doing so, the court determined that the debtor's petition was filed to delay or frustrate the legitimate efforts of secured creditors.[63] Although the court's analysis did not evoke the so-called "objective futility" approach, its recognition of additional factors demonstrates a move towards adopting a more objective standard.

9th Circuit SARE Cases (2014)

1) *In re Sullivan* (9th Cir. BAP decision December 2014) – the 9th Cir. BAP held that the bankruptcy court erred when it found that the SARE debtor had filed in bad faith. Relying on the reasoning in *In re Mense* (below) and *In re Marsch* (cited in the memo), the court reasoned that there was no evidence presented from which the bankruptcy court could infer that the debtor intended to unreasonably deter or harass creditors and that, instead, all of the evidence indicated that the debtor had significant financial need for protection under the Code.

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[55] *Id*. at 846 (citing *In re Sletteland*, 260 B.R. 657, 662 (Bankr. S.D.N.Y. 2001); *In re Kingston Square*, 214 B.R. 713, 725 (Bankr. S.D.N.Y.1997)).
[56] *See e.g. In re Loco Realty Corp*., 2009 WL 2883050 (Bankr. S.D.N.Y. 2009); *In re Gen. Growth, Props., Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).
[57] *SGL Carbon Corp.*, 200 F.3d at 165 (citing *Marsch v. Marsch,* 36 F.3d 825; *Connell v. Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.)*, 709 F.2d 762, 764 (1st Cir. 1983) (there must be "some relation" between the filing and the "reorganization-related purposes that [Chapter 11] was designed to serve")).
[58] *In re JER/Jameson Mezz Borrower II LLC*, 2011 WL 6749058 (Bankr. D. Del. 2011).
[59] *Id.* (citing *In re 15375 Memorial Corp*., 589 F.3d 605, 618 n. 8 (3d Cir. 2009).
[60] *In re Sterling Bluff Investors, LLC*, 2014 WL 4199214 (Bankr. S.D. Ga. 2014).
[61] *Id.* at *917-18.
[62] *Id.* (citing *In re Clinton Fields, Inc*., 168 B.R. 265, 269 (Bankr. M.D. Ga. 1994).
[63] *Id*. (internal citations omitted).

2) *In re Mense* (April 2014) – finding that the case was not filed in good faith, the court relied upon the reasoning in *Little Creek* and *Marsch v. Marsch* (please note that these cases are cited in the memo). The court noted as follows: "In finding a lack of good faith, courts have emphasized an intent to abuse the judicial process and the purposes of the reorganization provisions ... **[p]articularly when there is no realistic possibility of an effective reorganization** and it is evident that the debtor seeks merely to delay or frustrate the legitimate efforts of secured creditors to enforce their rights." (citing *Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.)*, 749 F.2d 670, 674 (11th Cir.1984) (emphasis added)). The court ultimately held that the test for whether a Chapter 11 SARE case was filed in good faith "is whether the debtor is attempting to unreasonably deter and harass creditors or attempting to effect a speedy, efficient reorganization on a feasible basis." (citing *Marsch* at 828).

3) *In re SR Real Estate Holdings, LLC* (February 2014) – similarly finding that the case was not filed in good faith, the court also relied upon the reasoning in *Little Creek*. The court noted, however, that "[it] makes this finding regardless of whether Debtor might be able to reorganize through a Chapter 11 plan—an issue on which the court expresses no opinion."

c. **Critique of the Subjective Bad Faith Approach**

Critics of the pure subjective standard argue that such an application is problematic in the context of SARE cases given that most, if not all, SARE debtors will meet the *Phoenix Piccadilly* factors (or a variation of such factors) and, therefore, will be subject to dismissal despite having a legitimate reorganization purpose.[64] Critics advise that despite outward appearance, many debtors still have going concern value and that dismissing a SARE case before the debtor has had an opportunity to reorganize robs both the debtor and the creditors of such going concern value.[65]

Critics also warn that applying a purely subjective standard runs contrary to Congressional intent.[66] In 1998, Congress chose to recognize SARE cases and provide such cases with Chapter 11 protections.[67] Later, by way of the 2005 BAPCPA Amendments, Congress further defined the rules applicable to SARE cases by revisiting the particulars of § 362 and amending § 1112(b)(4).[68] Section 1112(b) now sets forth a non-exclusive list of factors that constitute "cause" for dismissal, including the following: "(A) substantial or continuing loss or diminution of the estate and the *absence of a reasonable likelihood of rehabilitation*…; (b) gross mismanagement of the estate; (3) failure to maintain appropriate insurance that poses a risk to the estate or to the public; (4) unauthorized use of cash collateral substantially harmful to 1 or

[64] *See e.g.* Keri Friedman, *The Standard for Dismissal and Stay Relief in Single Asset Real Estate Chapter 11 Cases*, 23 No. 3 J. Bankr. L. & Prac. NL Art. 5 (2014).
[65] *Id*.
[66] *Id*.
[67] H.R. 5116, 103d Cong. (1996).
[68] 11 U.S.C. §§ 362(d)(3) and 1112(b)(4).

more creditors…."[69] Among these factors, there is no mention of "good faith" nor anything representative of subjective intent. Critics argue that the language in § 1112(b)(4) is deliberate and evidences that the subjective intent of the debtor is not at issue:

> While Congress had previously listed good faith as a mandatory requirement in Chapter X of the prior Bankruptcy Act, and currently provides good faith as a controlling element in § 1126(e) and § 1129(a)(3), the presence of a good faith standard is noticeably absent from the language in 1112. When faced with decades of precedent, Congress's decision not to include subjective bad faith as a basis for dismissal or stay relief indicates its view that courts should only focus on whether the debtor has going concern value and is reasonably likely to confirm a Chapter 11 plan.[70]

Critics posit that limiting the purview to only subjective bad faith cuts against Congress's intent in including the § 1112(b)(4) objective factors because such an approach would ignore the potential benefits to both debtors and creditors in maximizing the going concern value.[71] These concerns are of extreme significance in Bankruptcy Court where there is a built-in balance of benefits and detriments to the parties and an emphasis on successful reorganization. In addition, an emphasis on the going concern value encourages creditors to look beyond immediate remedies and provides SARE debtors with time to develop a plan of reorganization to stay in business.[72]

Critics also acknowledge, however, that a purely objective approach is not without concern. Section 1112(b) protects secured creditors by allowing creditors to seek immediate dismissal "for cause." If, however, the good faith standard is not read into § 1112, creditors who believe that a debtor may have filed in bad faith will be unable to dismiss the case unless the creditor can prove "cause" under one of the § 1112(b)(4) provisions. Critics, however, point out that all is not lost because § 362(d) also includes a "for cause" provision to which courts have applied, and continue to apply, the good faith standard.[73] Nevertheless, for creditors this difference may prove to be significant because a court's application of the good faith standard in § 362(d) will not result in the termination of a SARE debtor's bankruptcy case. While the ability to terminate, annul, modify, or condition a stay pursuant to § 362(d) provides some protection to creditors, the effect is vastly different as compared to dismissal. In addition, bankruptcy courts may be reluctant to lift the stay if the debtor has equity in the property and the property is necessary to effectuate a successful reorganization.[74]

3. **Conclusion**

SARE filings continue in spite of Bankruptcy Reform Act and the 2005 Amendments. While perceived as disfavored by some, SARE filings are acceptable in Chapter 11 since dismissing all SARE cases as bad faith filings would render meaningless the applicable

[69] 11 U.S.C. §1112(b)(4) (emphasis added).
[70] *See e.g.* Keri Friedman, *The Standard for Dismissal and Stay Relief in Single Asset Real Estate Chapter 11 Cases*, 23 No. 3 J. Bankr. L. & Prac. NL Art. 5 (2014).
[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] Robert E. Nies and Michael R. Caruso, *A Secured Creditor's Chapter 11 Chess Match*, 215 N.J.L.J. 238 (2014).

provisions in the Code. In light of the broad application of the "for cause" provisions of § 362(d) and § 1112(b) under which courts continue to apply the good faith standard, there remains a circuit split with regard to what approach to employ in determining if stay relief or dismissal is appropriate under the circumstances. Many believe that it would be prudent for Congress to reconsider the legitimacy of SARE filings and prohibit SARE debtors from seeking redress in the bankruptcy courts given that the existing rules have not curbed such filings.[75]

[75] Leslie A. Berkoff, The Continued Misuse of Bankruptcy by SARE Debtors, http://www.financierworldwide.com/the-continued-misuse-of-bankruptcy-by-sare-debtors/#.VLllwy50Y7g.

SARE Cases: Is "Artificial Impairment" Dead, Alive, or Hiding in Good Faith?

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A. Overview.

In order to confirm a plan of reorganization in any Chapter 11 case, including single asset real estate cases ("SARE"), under Section 1129(a)(10) of the Bankruptcy Code,[2] the plan must be accepted by at least one class of impaired creditors excluding the acceptance votes cast by insiders. In SARE cases, this hurdle is often difficult to clear as SARE cases frequently involve a single secured creditor, a finite number of unsecured creditors (usually trade claims), and equity and thus there may only be two non-insider classes. In this situation, without the support of the secured creditor, whose claim usually dwarfs the unsecured claims in SARE cases, a plan can only be confirmed if the class of unsecured claims is impaired and votes to accept the plan.[3]

By way of example, assume that the debtor is a limited liability company that owns an office building encumbered by a $10 Million fully secured loan, with trade payables of $30,000 and four members. The plan would typically have the following classes of claims and equity: (i) Class 1 – Secured Claim ($10 Million); (ii) Class 2 – General Unsecured Claims ($30,000); and (iii) Class 3 - Equity Securities. If the secured creditor opposes confirmation of the plan of reorganization, the plan cannot be confirmed unless Class 2 is deemed to be impaired and votes in favor of the plan.

The critical question for both the debtor and the secured creditor is: Can the debtor delay payment of the $30,000 owed to the Class 2 General Unsecured Creditors (or otherwise alter their treatment so that they are not paid in full on the plan's effective date) in order to impair Class 2 and obtain a consenting impaired class as required by Section 1129(a)(10)? This is called "artificial impairment" where there is not a clear economic need for the delayed payment of the Class 2 General Unsecured Claims.

As will be more fully discussed herein, the answer varies depending on the jurisdiction in which the case is pending. Some courts, including the Eighth Circuit, have held that the doctrine of artificial impairment is alive and well and prohibits an artificially impaired accepting class from serving as the requisite impaired consenting class under Section 1129(a)(10). Other courts, including the Fifth and Ninth Circuit, have held that while the doctrine of artificial impairment is dead in the context of Section 1129(a)(10), the impairment of one or more classes of claims in order to obtain confirmation of a plan without an economic need for such impairment may nonetheless be considered in conjunction with the Section 1129(a)(3) good faith analysis.

B. The Statutory Framework of Artificial Impairment.

Section 1129(a) provides that the court "shall confirm a plan only if" the requirements of subsection (a) are satisfied. As previewed above, secured creditors in SARE cases often object to plan confirmation using some variant of the "artificial impairment" theory under either Section 1129(a)(3) or Section 1129(a)(10).[4]

Section 1129(a)(10) provides that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan [must] accept[] the plan, determined without including any acceptance of the plan by any insider." The Bankruptcy Code's definition of "impairment" is contained in Section 1124, which provides that a claim is impaired unless it "leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder."

Section 1129(a)(3) requires that the plan be proposed in good faith. Even when a bankruptcy court allows artificial impairment in the context of Section 1129(a)(10), plan opponents often argue that a plan violates Section 1129(a)(3)'s good faith requirement when the debtor has (or appears to have) manufactured the impairment of one or more classes of claims.

C. While the Ninth Circuit Has Rejected the Theory of Artificial Impairment in the Section 1129(a)(10) Context, It Remains a Consideration in the Section 1129(a)(3) Context.

In *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc. (In re L & J Anaheim Assocs.)*, 995 F.2d 940 (9th Cir. 1993), the Ninth Circuit Court of Appeals rejected the theory of artificial impairment in the context of Section 1129(a)(10). In *L & J Anaheim Assocs.*, Kawasaki Leasing International, Inc. ("Kawaski") held a security interest in L & J Anaheim Associates' ("L & J") only real estate, a hotel, which was collateral securing a $13.2 Million nonrecourse note in favor of Kawasaki.[5] L & J filed a Chapter 11 bankruptcy petition after it defaulted on the note and Kawasaki started foreclosure proceedings. After exclusivity lapsed, Kawasaki filed a plan impairing several classes of claims, including its own. Kawasaki, whose secured claim was classified in a class alone, was the only impaired class that voted in favor of plan confirmation. L & J opposed confirmation of the plan arguing that "Kawasaki's legal rights were improved under the Plan it proposed and it therefore was not an impaired creditor within the meaning of section 1124 of the Bankruptcy Code."[6]

The Ninth Circuit responded to L & J's argument by first noting that "impairment is a term of art adopted by Congress to replace the old 'material and adverse effect' standard of the Bankruptcy Act."[7] Under the old "material and adverse effect" standard "a creditor was entitled to vote on a proposed plan only if it was negatively affected by the plan."[8] The Ninth Circuit explained that under the current impairment standard, "any alteration of legal rights constitutes impairment even if the value of the right is enhanced."[9] Accordingly, the Court determined that the "narrow question" that needed to be answered was "whether Kawasaki's 'legal, equitable, [or] contractual rights' were changed by the Plan; if so its claim was impaired."[10] The Ninth Circuit found that under the plan Kawasaki sacrificed its state law rights and remedies against L & J and therefore, it was impaired and confirmation of the plan was appropriate.

Notably, L & J also argued that there should be an exception to the general definition of impairment "where it is used abusively, [such] as where the plan proponent enhances its own position, then attempts to use this fact to show impairment."[11] Addressing the issue in a footnote, the Ninth Circuit stated that such alleged abuse would not change the meaning of impairment, and any such abuse should be considered when determining whether the plan was proposed in good faith under Section 1129(a)(3).

Following *L & J Anaheim Assocs.*, plan opponents within the Ninth Circuit have repurposed their artificial impairment arguments as good faith arguments, contending that classification schemes that employ artificial impairment in order to obtain a consenting impaired class are volatile of Section 1129(a)(3)'s good faith requirement.[12] In so doing, plan opponents often cite to the Ninth Circuit Bankruptcy Appellate Panel's statement that "the act of impairment in an attempt to gerrymander a voting class of creditors is indicative of bad faith."[13] Plan proponents, however, contend that Section 1129(a)(3) does not define good faith nor does it expressly address "bad faith"[14] and cite to the Ninth Circuit's statements that: (i) a plan is "proposed in good faith where it achieves a result consistent with the objectives and purposes of the Code;"[15] (ii) "[i]n enacting the Bankruptcy Code, Congress made a determination that an eligible debtor should have the opportunity to avail itself of a number of Code provisions which adversely alter creditors' contractual and nonbankruptcy rights;"[16] and (iii) "the fact that a debtor proposes a plan in which it avails itself of an applicable Code provision does not constitute evidence of bad faith."[17]

While the Ninth Circuit has not determined when artificial impairment may reach a threshold that it renders a plan violative of Section 1129(a)(3)'s good faith requirement, courts within the Ninth Circuit and the Ninth Circuit Bankruptcy Appeal Panel have held that where a debtor has presented a feasible plan that will pay all allowed claims in full over time, the secured creditor retains its security interests in real property until its allowed claim is paid in full and will receive an appropriate rate of interest, and that debtor has submitted business and economic reasons for deferring payment of allowed unsecured claims, the debtor's impairment of its unsecured claims is not indicative of bad faith.[18]

D. The Eighth Circuit Has Adopted the Theory of Artificial Impairment in the Section 1129(a)(10) Context.

Only months after the Ninth Circuit's decision in *L & J Anaheim Assocs.*, the Eighth Circuit Court of Appeals in *Windsor on the River Assocs., Ltd. v. Balcor Real Estate Finance, Inc., (In re Windsor on the River Assocs., Ltd.)*, 7 F.3d 127 (8th Cir. 1993), took the contrary position and adopted the theory of artificial impairment. In *Windsor on the River*, the Eighth Circuit held that Section 1129(a)(10) was not satisfied because the impairment of the impaired class of creditors was "manufactured."[19]

In that case, the debtor, Windsor on the River Associates Ltd.'s ("Windsor") only significant asset was an apartment complex.[20] Windsor had refinanced the purchase loan with a 4-year note held by Balcor Real Estate Finance, Inc. ("Balcor"). After negotiations to refinance or extend the loan failed, Windsor filed for Chapter 11 bankruptcy protection just days before the note matured.

Windsor's third amended plan proposed to impair three classes of claims: (i) a class containing Balcor's oversecured claim; (ii) a class containing unsecured trade claims in the amount of $13,000; and (iii) a class that was subsequently disallowed. The plan proposed to modify Balcor's note to a 10-year term commencing on the plan's effective date, with payments on a 30-year amortization schedule at 8.5% interest and a final balloon payment. The other two classes were to be paid in full within 60 days after the plan's effective date. Despite Balcor's objection, the bankruptcy court confirmed the plan.

Balcor appealed arguing that Section 1129(a)(10) was not satisfied as a result of the artificial impairment of the other two classes that were being paid after the effective date instead of on the effective date in order to render them impaired. The Eighth Circuit determined that the "central question" was whether "such impairment may be manufactured at the will of the debtor 'just to stave off the evil day of liquidation.'"[21] The Eighth Circuit provided a single answer to that question: no.

Interpreting the statutory language of Section 1129, the Eighth Circuit recognized that "any alteration of a creditor's rights, no matter how minor, constitutes 'impairment.'"[22] However, the Eighth Circuit contended that Congress enacted Section 1129(a)(10) in 1984 "to curb the inequities of such reorganization plans being 'crammed down' the throat of secured lenders" and that the purpose of Section 1129(a)(10) "is to provide some indicia of support by affected creditors and prevent confirmation where such support is lacking."[23] The Court found that "[c]onfirmation of a plan where the debtor engineers the impairment of the only approving impaired class 'so distorts the meaning and purpose of [section 1129(a)(10)] that to permit it would reduce (a)(10) to a nullity.'"[24]

The Eighth Circuit noted that the artificial impairment dispute has arisen most commonly in SARE cases, explaining that:

> [t]he difference is that the debtor is dealing with an oversecured, rather than undersecured, creditor. Because the lender is oversecured, there is no unsecured portion of the claim to classify along with the unsecured trade creditors. The problem, however, is that the approving class of unsecured trade claimants must hold impaired claims. Impairment in such cases is more difficult, since the value of the asset exceeding the secured claim is often sufficient to satisfy the much smaller unsecured trade claims in full.[25]

Fearing the possible effects of plan confirmation under such circumstances, the Eighth Circuit stated that "[c]onfirmation might encourage similarly situated debtors to view the bankruptcy code as an alternative to refinancing,"[26] and reasoned that "such an outcome would directly undermine one of the primary functions of bankruptcy law: to discourage 'side dealing' between the shareholders of a corporation and some creditors to the detriment of other creditors."[27]

Based on the forgoing, the Eighth Circuit ultimately held that "for purposes of 11 U.S.C. § 1129(a)(10), a claim is not impaired if the alteration of rights in question arises solely from the debtor's exercise of discretion" and therefore, because the two consenting impaired classes of claims under the debtor's plan were arbitrarily and artificially impaired, the plan failed to satisfy Section 1129(a)(10).[28]

E. The Theory of Artificial Impairment after *L & J Anaheim Assocs.* and *Windsor on the River*.

Following the Eighth Circuit decision in *Windsor on the River*, a number of lower courts have applied the doctrine of artificial impairment to deny confirmation of SARE debtors' plans of reorganization where the courts found insufficient reasoning for not paying the impaired class(es) of creditors in full on the effective date despite full satisfaction being a financial possibility.[29]

Courts within the Ninth Circuit, however, continue to routinely reject the doctrine of artificial impairment, holding that Section 1124 "does not differentiate between artificial and actual impairment."[30] Rather, "[i]f a claim is properly classified and the plan modifies the creditor's state law rights, there is no reason to inquire into the motive for that claim's treatment under the plan."[31]

In *Hotel Assocs. of Tucson*, the Ninth Circuit Bankruptcy Appellate Panel followed *L & J Anaheim Assocs.*, defining impairment under Section 1124 as hinging *solely* on whether legal, equitable, or contractual rights were altered.[32] In that case, the plan provided for a 30-day delay before paying a class of unsecured creditors' claims in full.[33] The Court noted that *L & J Anaheim Assocs.* was both binding and more convincing than *Windsor on the River* and added that it is not the role of the bankruptcy court

> to ask whether alternative payment structures could produce a different scenario in regard to impairment of classes. Denying confirmation on the basis that another type of plan would produce different results[,] would impede desired flexibility for plan proponents and create additional complications in the already complex process of plan confirmation. Moreover, nowhere does the Code require a plan proponent to use all efforts to create unimpaired classes.[34]

More recently, the Fifth Circuit Court of Appeals addressed artificial impairment in *Western Real Estate Equities, L.L.C. v. Village at Camp Bowie I, L.P. (In the matter of Village at Camp Bowie I, L.P.)*, 710 F.3d 239 (5th Cir. 2013), rejected the Eighth Circuit's adoption of the doctrine in *Windsor on the River*, and joined the Ninth Circuit in holding that "section 1129(a)(10) does not distinguish between discretionary and economically driven impairment."

In *Village at Camp Bowie*, the debtor filed a plan consisting of two impaired classes of creditors, the secured creditor and unsecured trade debt.[35] The secured creditor voted against the plan and all 38 unsecured trade creditors voted in favor of the plan. The secured creditor objected to confirmation on the basis that the debtor impaired the trade claims solely to create an accepting impaired class because despite the debtor being economically able to pay the trade debt on the plan's effective date, the debtor's plan provided for payment in three months, thereby impairing such claims. The secured creditor argued that such impairment constituted artificial impairment and therefore, the plan's acceptance by the artificially impaired classes did not satisfy Section 1129(a)(10). In the alternative, the secured creditor argued that such artificial impairment constituted an abuse of the bankruptcy process that violated the good faith requirement of Section 1129(a)(3).[36]

Joining the Ninth Circuit, the Fifth Circuit held that Section 1129(a)(10) does not distinguish between discretionary and economically driven impairment and there is no motive element of impairment under Sections 1123 and 1124.[37] The Fifth Circuit reasoned that Section 1124 states that "any alteration of a creditor's rights, no matter how minor, constitutes 'impairment.'"[38] "By shoehorning a motive inquiry and materiality requirement into § 1129(a)(10), *Windsor* warps the text of the Code, requiring a court to 'deem' a claim unimpaired for purposes of § 1129(a)(10) even though it plainly qualifies as impaired under § 1124."[39] The Court further reasoned that, inquiring into a motive, as in *Windsor on the River*, is inconsistent with Section 1123(b)(1), which provides that a proponent of a plan "*may* impair or leave unimpaired any class of claims" and does not indicate that impairment must be motivated by economic motives.[40]

Further, the Fifth Circuit scrutinized the Eighth Circuit's approach to interpreting Sections 1129(a)(10) and 1124,[41] countering that the Bankruptcy Code must be read literally and Congress' intent is only relevant when the language of the statute is ambiguous, which was not the case.

Finally, the Fifth Circuit rejected the Eighth Circuit's concern that overlooking artificial impairment would "reduce [Section 1129](a)(10) to a nullity,"[42] explaining that the Eighth Circuit's logic is flawed because it rests on the assumptions that Congress intended Section 1129(a)(10) to imply a materiality requirement and a motive inquiry. The Fifth Circuit further highlighted the importance of Section 1129(a)(10) in SARE cases in which the debtor has negative equity and the secured creditor has a deficiency claim that may allow it to control the vote of the unsecured class. In that circumstance, the secured creditor/plan opponent typically uses Section 1129(a)(10) to block a cramdown by controlling the rejection vote of both the secured creditor class and the general unsecured creditor class.[43] As such, the Fifth Circuit concluded that the Bankruptcy Code's broad definition of impairment benefits the creditor, rather than hinders it.

The Fifth Circuit, like the Ninth Circuit, found that a "plan proponent's motives and methods for achieving compliance with the voting requirement of § 1129(a)(10) must be scrutinized, if at all, under the rubric of § 1129(a)(3), which imposes on a plan proponent a duty to propose its plan 'in good faith and not by any means forbidden by law.'"[44] Good faith is evaluated "in light of the totality of the circumstances surrounding establishment of [the] plan," mindful of the purposes underlying the Bankruptcy Code.[45] Generally, "[w]here [a] plan is proposed with the legitimate and honest purpose to reorganize and has a reasonable hope of success, the good faith requirement of § 1129(a)(3) is satisfied."[46]

The Fifth Circuit found that, in the case at hand, artificial impairment did not violate Section 1129(a)(3)'s good faith requirement, because the debtor "proposed a feasible cramdown plan for the legitimate purpose of reorganizing its debts, continuing its real estate venture, and preserving its non-trivial equity in its properties."[47]

F. Conclusion.

As a preliminary matter, practitioners must determine whether the artificial impairment doctrine is dead, alive, or just hiding in the Section 1129(a)(3) good faith analysis in the jurisdiction in which the case is pending. Even in the jurisdictions where artificial impairment is irrelevant to the Section 1129(a)(10) analysis, it may nonetheless be a significant consideration for the court in determining whether the plan satisfies Section 1129(a)(3)'s good faith requirement. Thus, for both debtors and plan opponents, careful consideration must be given to the classification scheme, including how and why classes of claims are impaired.

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[1] Talitha Gray Kozlowski is a shareholder of Gordon Silver's Bankruptcy and Financial Restructuring practice group. She extends her deepest thanks to Loren Morris Suddes, an associate in Gordon Silver's Phoenix office and a member of the Bankruptcy and Financial Restructuring practice group, for her significant assistance with the preparation of these materials.

[2] Unless otherwise stated, all "Chapter" and "Section" references are to Title 11 of the U.S. Code (the "Bankruptcy Code").

[3] As classification is pertinent to the artificial impairment discussion, the following provides a brief overview of classification within the Ninth Circuit:

Section 1122 provides that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." Section 1122, however, merely mandates that dissimilar claims may not be placed into the same class. See Wells Fargo Bank, N.A. v. Loop 76, LLC, et al., (In re Loop 76, LLC), 465 B.R. 525, 536 (9th Cir. B.A.P. 2012), aff'd 578 Fed. Appx. 644 (9th Cir. 2014). As such, "[o]nce it is determined that separately classified claims are dissimilar under § 1122, however, 'there is no basis or reason to consider the Debtor's motives underlying such classification, whether they be gerrymandering or for business reasons because the Code requires such separate classification regardless of the Debtor's motive." In re Bataa/Kierland, LLC, 476 B.R. 558, 563 (Bankr. D. Ariz. 2012) (citing In re Loop 76, LLC, 442 B.R. 713, 716 (Bankr. D. Ariz. 2010), aff'd, 465 B.R. 525 (9th Cir. B.A.P. 2012)).

As opposed to the requisite separate classification of dissimilar creditors, the Bankruptcy Code does not state that a plan must classify similar claims together. See In re Loop 76, LLC, 465 B.R. at 536. Instead, the plan proponent has broad discretion in classifying claims under Section 1122, and a plan may classify substantially similar claims or interests in different classes when a reasonable, non-discriminatory basis exists for such treatment. See Steelcase, Inc. v. Johnston (In re Johnston), 21 F.3d 323, 328 (9th Cir. 1994); Montclair Retail Center, L.P. v. Bank of the West (In re Montclair Retail Center, L.P.), 177 B.R. 663, 665 (9th Cir. B.A.P. 1995). Nevertheless, courts have held that a plan must not be approved as a result of "placing similar claims differently *solely* to gerrymander an affirmative vote on the reorganization plan." In re Loop 76, LLC, 465 B.R. at 537 (citing Barakat v. Life Ins. Co. of Va. (In re Barakat), 99 F.2d 1520, 1525 (9th Cir. 1996)) (emphasis added). The debtor, however, must offer "a business or economic justification for the separate classification, or show a legal distinction between the claims." In re Montclair Retail Center, L. P., 177 B.R. at 665 (citing In re Tucson Self-Storage, Inc., 166 B.R. 892, 898 (B.A.P 9th Cir. 1994)); In re Loop 76, LLC, 465 B.R. at 536 (Where claims are substantially similar, a plan "may place such claims in different classes if the debtor can show a business or economic justification for doing so.") (citing In re Barakat, 99 F.2d at 1526).

[4] See Western Real Estate Equities, L.L.C. v. Village at Camp Bowie I, L.P. (In the matter of Village at Camp Bowie I, L.P.), 710 F.3d 239 (5th Cir. 2013).

[5] In re L & J Anaheim Assocs., 995 F.2d at 941.

[6] Id.

[7] Id. at 942-43.

[8] Id. at 943.

[9] Id. at 942 (citations omitted).

[10] Id. at 943.

[11] Id. at fn 2.

[12] See, e.g., In re Windmill Durango Office, LLC, 481 B.R. 51, 68-69 (B.A.P. 9th Cir. 2012).

[13] Conn. Gen. Life Ins. Co. v. Hotel Assocs. of Tucson (In re Hotel Assocs. of Tucson), 165 B.R. 470, 475 (B.A.P. 9th Cir. 1994).

[14] See 11 U.S.C. § 1129; In re Sylmar Plaza, L.P., 314 F.3d 1070, 1074-75 (9th Cir. 2002) (citation omitted).

[15] In re Sylmar Plaza, L.P., 314 F.3d at 1074 (citations omitted).

[16] Id. at 1075 (quoting In re PPI Enters., Inc., 228 B.R. 339, 344-45 (Bankr. D. Del. 1998)).

[17] Id. (quoting In re PPI Enters., Inc., 228 B.R. at 347).

[18] See, e.g., In re Windmill Durango Office, LLC, 481 B.R. at 68-69.

[19] In re Windsor on the River Assocs., Ltd., 7 F.3d at 130-31.

[20] Id. at 129.

[21] Id. at 130.

[22] Id.

[23] Id. at 131 (citation omitted).

[24] Id. (citation omitted).

[25] Id. at 131-32 (citation omitted).

[26] Id. at 132.

[27] Id. (citation omitted).

[28] Id. at 132-33.

[29] See, e.g., In re Investors Fla. Aggressive Growth Fund, Ltd., 168 B.R. 760, 766-67 (Bankr. N.D. Fla. 1994); In re Fur Creations by Varriale, Ltd., 188 B.R. 754, 760-61 (Bankr. S.D.N.Y. 1995); In re W.C. Peeler Co. Inc., 182 B.R. 435, 437-38 (Bankr. D. S.C. 1995); In re All Investments, LLC, 468 B.R. 676, 692 (Bankr. D. Del. 2012).

[30] In re Bataa/Kierland, LLC, 476 B.R. 558, 564 (Bankr. D. Ariz. 2012) (citing L & J Anaheim Assocs., 995 F.2d at 942); see also In re Hotel Assocs. of Tucson, 165 B.R. at 474-75.

[31] In re Bataa/Kierland, LLC, 476 B.R. at 564 (citing In re L & J Anaheim Assocs., 995 F.2d at 943 ("In any event, the plain language of section 1124 says that a creditor's claim is 'impaired' unless its rights are left 'unaltered' by

the Plan. There is no suggestion here that only alterations of a particular kind or degree can constitute impairment.”)).

[32] In re Hotel Assocs. of Tucson, 165 B.R. at 474-75.

[33] Id. at 473.

[34] Id. at 475 (citations omitted).

[35] In re Village at Camp Bowie I, L.P., 710 F.3d at 243.

[36] Id.

[37] Id. at 245-46.

[38] Id. at 245 (citations omitted).

[39] Id. (citations omitted).

[40] Id. at 245-46.

[41] Id. at 246.

[42] Id. (citations omitted).

[43] Id. at 247.

[44] Id. (citations omitted).

[45] Id. (citations omitted).

[46] Id. (citations omitted).

[47] Id.

A HAIL MARY OR BAD FAITH FILING? WHY ASSIGNMENT OF INSIDER CLAIMS TO NON-INSIDER PARTIES CANNOT BE USED TO CONFIRM A CRAMDOWN PLAN

HAMID R. RAFATJOO, KEITH C. OWENS, AND JENNIFER L. NASSIRI

This article explores the circumstances in which a debtor may seek to assign an insider claim to a non-statutory insider in an attempt to gerrymander an impaired class to vote to accept the debtor's plan of reorganization, and suggests possible responses for objecting creditors.

Bankruptcy attorneys are always looking for creative ways to confirm a Chapter 11 plan over the objection of non-consenting creditors. A debtor with a large body of trade creditors is often able to confirm a plan over the secured creditor's objection if the plan proposes to pay such creditors more than they would recover in a hypothetical liquidation.[1] This is known as "cramdown" in bankruptcy parlance. However, debtors are more likely to face difficulties confirming plans in single asset real estate cases, or small business cases, that primarily involve two-party disputes. Desperate debtors will occasionally cross the line and attempt to confirm a plan by separately classifying similar claims to create at least one "impaired"[2] class of creditors to vote in favor of the plan, or manipulating the bankruptcy process in such a way that is inconsistent with the Bankruptcy Code. Courts frequently deny confirmation of such plans as bad faith filings.

Because the votes of an "insider"[3] cannot be counted in connection with a creditor's acceptance or rejection of a Chapter 11 plan,[4] debtors occasionally seek to orchestrate an insider's assignment of his or her claim to a non-insider, third party in order to create an impaired, consenting class to vote in favor of the debtor's plan of reorganization over the objection of other creditors. There have been several published and unpublished decisions involving a Chapter 11 debtor's assignment of an insider claim to a non-statutory insider for this purpose. As discussed below, there are no published court of appeals decisions that address this issue. However, several lower courts have intimated that an assignment of an insider claim to a third party does not transform the nature of the claim under the general law of assignments, and thus, the assignee stands in the shoes of the assignor with the same benefits and disabilities as the insider had.

This article explores the circumstances in which a debtor may seek to assign an insider claim to a non-statutory insider in an attempt to gerrymander an impaired class to vote to accept the debtor's plan of reorganization. As described herein, the objecting creditor should argue that the proposed assignment of an insider claim to a non-statutory insider creditor should not be counted for voting purposes to confirm a Chapter 11 plan because the claim retains its status as an "insider" claim under general principles of assignment law. Alternatively, the creditor may argue that even if the assignee is not a statutory insider by virtue of the assignment, he should still be treated as a non-statutory insider, and therefore, his vote should not be counted for purposes of plan confirmation.

CRAMDOWN PLANS IN GENERAL

Chapter 11 plans must classify claims against the debtor, specify the treatment to be given to each class of claim, and provide the means for carrying out the plan. In order to be binding, a plan must be confirmed by the bankruptcy court. For a Chapter 11 plan to be confirmed, it must be accepted by at least one class of impaired claims. "A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section[5] that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan."[6] Assuming that the plan proponent has sufficient votes of an impaired class that accepts the plan, the plan can only be confirmed if it satisfies the statutory requirements for confirmation, which include findings by the bankruptcy court that the plan was proposed in good faith, the plan is fair and equitable and does not unfairly discriminate against similarly-situated creditors, the plan is feasible, the plan provides creditors with at least as much as the creditors would receive in a hypothetical liquidation, equity does not retain its interests[7] unless all holders of claims senior to equity are paid in full or the creditors holding such claims consent to equity's retention of its interests, and the confirmed plan is not likely to be followed by a later liquidation, among other things.

Under certain circumstances, the bankruptcy court may "cram down" a plan over the objection of creditors. In order to confirm a Chapter 11 plan over the objection of a secured creditor, a holder of a secured claim must receive the entire value of the property securing the claim or the entire value of the claim, whichever is smaller. In order for a bankruptcy court to confirm the plan of reorganization that has been rejected by at least one impaired class of creditors, the debtor must have at least one, assenting impaired class that votes to accept the plan, and meet its burden of demonstrating that the plan meets the other statutory requirements for confirmation including that the plan is fair, equitable and does not discriminate against a class of creditors. Although entitled to participate in a distribution, the votes of holders of insider claims cannot be counted for cramdown purposes under Sections 1126(c) and 1129(a)(10) of the Bankruptcy Code.

As discussed above, the votes of insiders cannot be counted in determining whether to confirm a plan of reorganization. However, in order to create an impaired, assenting class for purposes of cramdown, some Chapter 11 debtors have attempted to manipulate the bankruptcy process by causing the insider claims to be assigned to non-statutory insiders who will vote to accept the plan. These debtors will argue that the characterization of the claim prior to the assignment is largely irrelevant, and that courts must look at whether the holder of the claim is an insider at the time of voting. Since the assignees will frequently be unrelated third parties, the debtor will argue that they do not fall within the definition of an "insider" and therefore, their votes to accept or reject a plan should be counted.

Creditors who vote to reject the plan can object to the ability of these votes to be counted in order to confirm a plan over their consent on the basis that (a) an insider claim maintains its character as an insider claim notwithstanding assignment of the claim to a non-statutory insider, and (b) the relationship between the debtor and assignee is such that the assignee should be deemed to be a non-statutory insider.

PROCEDURE FOR DESIGNATING THE VOTES OF CREDITORS WHOSE VOTES WERE SOLICITED OR PROCURED IN BAD FAITH OR NOT IN ACCORDANCE WITH THE PROVISIONS OF THE BANKRUPTCY CODE

Section 1126(e) of the Bankruptcy Code provides that "[o]n request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title."[8] Bankruptcy courts are empowered to decide a preemptory motion to disallow ballots of a creditor prior to plan confirmation.[9]

THE POST-PETITION ASSIGNMENT OF AN INSIDER CLAIM TO A THIRD PARTY DOES NOT TRANSFORM THE NATURE OF THE CLAIM

Several courts have held that the transfer of an insider claim to a third party does not transform the original nature of the claim.[10] "As a general rule, 'an entity which acquires a claim steps into the shoes of that claimant, enjoying both the benefits and limitations of the claim, as a successor in interest.'"[11] In another context, the Ninth Circuit, in approving an assignee's ability to pursue a non-dischargeability action against the debtor under 11 U.S.C. § 523(a)(2)(B), rejected a similar argument that the bankruptcy courts must disregard general assignment law and look to the nature of the claimant rather than the underlying claim itself:

> ...Congress was undoubtedly aware that under general principles of assignment law an assignee steps into the shoes of the assignor. Had Congress wished for assigned debts to be treated differently under § 523(a)

> (2)(B), it would have done more than rely on the word 'is" in subsection (iii). In the absence of such specific language, we believe that Congress intended that the general law of assignment remain applicable. That is, assuming [the assignee] was indeed the recipient of a general assignment of the original judgment, it can stand in the shoes of its assignor and pursue a non-dischargeability action under § 523(a)(2)(B).[12]

Numerous other courts have reached similar conclusions that an assignee stands in the shoes of an assignor and takes whatever rights the assignor had subject to all of the assignor's disabilities.[13] The rationale for applying the general law of assignments to section 1129(a) absent clear congressional intent to the contrary, is clear: "[T]he operation of section 1129(a) would be seriously undermined [if the] Debtor[ ] [who is] unable to obtain the acceptance of an impaired creditor[,] simply could assign insider claims to third parties who in turn could vote to accept. This the court cannot permit."[14] As the United States Bankruptcy Court for the Southern District of New York has noted, "it is incumbent...on the prospective assignees to take into account possible claim defenses when they negotiate the terms of their assignments."[15]

Notwithstanding the overwhelming authority to the contrary, at least one court has held that insider status does not transfer with the claim.[16] In *Concorde Square*, the Ohio bankruptcy court held without any analysis that "[t]he status of the claim-holder is not imputed to the transferee, but is a matter of fact to be determined from evidence of the relationship between the debtor and the third party transferee...."[17] However, the court relied on a single bankruptcy case to reach this conclusion. In *Hempstead Realty*,[18] the New York bankruptcy court was asked to decide the senior lienolder's motion to dismiss or convert a case to Chapter 7 on the basis that the debtor was not capable of confirming a Chapter 11 plan due to the debtor's inability to have at least one consenting impaired class.[19] The court denied as premature the motion, but speculated without any analysis or citation that "various possibilities might occur between now and any proposed confirmation" including that "the insider status ascribed to [an insider claimant] could be cured by the assignment of the [insider's] second mortgage to a noninsider entity whose interest might be impaired by a proposed plan."[20]

Similarly, the court in *In re MCorp Financial, Inc.* stated in *dictum* that the "determination of insider status is made at the time the vote is taken, not at the time the claim arises." The bankruptcy court held that the debtors "failed to sustain their burden of proof in establishing that at least one impaired class ...voted to accept the plan."[21] The court, among other things, held that "the ballot cast by MTrust Corporation n/k/a Ameritrust Corp. should be disregarded and not counted *as it was filed untimely and not voted by the entity that owned the claim*."[22] Because the claim had been voted by MTrust after it had been transferred to Ameritrust, the court properly concluded that MTrust did not have standing to vote the claim. However, the discussion on whether the MTrust ballot was cast by an insider, and when the determination of insider status is made, is *dictum*. Indeed, the bankruptcy court in *MCorp Financial* never analyzed the law on general assignments, or its applicability to section 1129(a). Therefore, a debtor's reliance on the holdings of *Hempstead Realty* and *MCorp Financial* should not be afforded much weight.

Finally, while there have not been any published court of appeals decisions that have addressed the issue, the Ninth Circuit Court of Appeals held in an unpublished decision that an insider claim transferred to a non-insider cannot be counted for voting purposes.[23] The court stated:

> We approve the bankruptcy court's approach, which is amply supported by case law. "As a general rule, 'an entity which acquires a claim steps into the shoes of that claimant, enjoying both the benefits and the limitations of the claim, as a successor in interest.'" *In re Holly Knoll Partnership*, 167 B.R. 381, 385 (Bankr.E.D.Pa.1994) (quoting *In re Applegate Property, Ltd.*, 133 B.R. 827, 833 (Bankr.W.D.Tex.1991)). This rule makes abundant sense in a case such as this in which there is a strong incentive for the debtor to make sure that at least one class of impaired claims remains in sympathetic hands. Were courts to allow purchasers of insider claims to approve Chapter 11 plans without any judicial scrutiny, "[d]ebtors unable to obtain the acceptance of an impaired creditor simply could assign insider claims to third parties who in turn could vote to accept. This the court cannot permit." *In re Heights Ban Corp.,* 89 B.R. 795, 799 (Bankr.S.D.Iowa 1988).[24]

Although the Ninth Circuit's decision is not binding and cannot be cited as having any precedential value, the rationale should be applied in future cases. Based on the foregoing, it is likely that a bankruptcy court will find that an insider claim transferred to a non-statutory insider retains its insider status, and cannot be considered for purposes of creating an impaired, assenting class.

HOLDERS OF INSIDER CLAIMS THAT HAVE BEEN ASSIGNED MAY BE FOUND TO BE NON-STATUTORY INSIDERS

It is not unusual for the third parties who acquire an insider claim immediately prior to or after a bankruptcy filing to have a sufficiently close relationship with the debtor such that they should be deemed a "non-statutory" insider. In the event that the bankruptcy court does not find the assignee of an insider claim to be a statutory insider, the court may nevertheless conclude that the assignee is a non-statutory insider whose vote cannot be considered in connection with confirmation of the debtor's Chapter 11 plan depending upon the relationship between the assignee and the debtor. Specifically, in determining whether a creditor is a non-statutory insider, courts consider: (1) the closeness of the relationship between the debtor and the transferee; and (2) whether the transaction between the transferee and the debtor was conducted at arm's length.[25] The legislative history makes clear that an "insider" is "one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor."[26]

Several courts have held that persons who have a close relationship with the debtor, but who do not necessarily have control over the debtor or its business operations, may still be considered non-statutory insiders.[27] Indeed, several courts have held that insider status can be based on a romantic relationship between a debtor and another individual.[28]

In addition, close friends and former family members have been held to be insiders.[29]

Accordingly, if an assignee if an insider claim has control over the debtor, or a very close personal or romantic relationship with the debtor, such that the transaction was not entered into at arm's length, a bankruptcy court may find the assignee to be a non-statutory insider.

CONCLUSION

Debtors who seek to rely on the assignment of an insider claim to confirm a cramdown plan do so at their peril. As discussed above, creditors can challenge these votes by seeking to designate the claims for voting purposes on various grounds including: (a) the claim maintained its status as an insider claim under the general law of assignment, or (b) the assignee is a non-statutory insider whose vote cannot be counted for purposes of confirming a Chapter 11 plan. Bankruptcy courts should carefully scrutinize assignment of insider claims to determine whether the assignment is intended to circumvent the spirit (if not the letter) of the Bankruptcy Code. As courts seek to cut off this avenue of manipulation, debtors' counsel will find new ways to use the Bankruptcy Code's ambiguity to advocate their position. An experienced bankruptcy lawyer can help creditors navigate through troubled waters.

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NOTES

[1] Secured creditors may attempt to block confirmation by purchasing such claims in order to control the class of unsecured creditor. Such action is permitted if the purpose is to protect an existing creditor's position, and not for any ulterior motive such as putting a competitor out of business. *See Figter, Ltd. v. Teachers Ins. & Annuity Ass'n*, 118 F.3d 635, 639 (9th Cir.1997).
[2] Only classes of creditors that are "impaired" are entitled to vote in favor of or against a Chapter 11 plan. 11 U.S.C. § 1126(f). Impaired claims are generally claims that will not, under the plan, be paid in full or whose legal rights are adjusted by the plan.
[3] The term, "insider" is defined in the Bankruptcy Code, which sets forth eighteen examples of what constitutes a statutory insider, including: (i) a director of the debtor corporation; (ii) an officer of the debtor corporation; (iii) a person in control of the debtor; (iv) a partnership in which the debtor is a general partner; (v) a general partner of the debtor; or (vi) a relative of a general partner, director, officer, or person in control of the debtor, among others. 11 U.S.C. § 101(31). The list of statutory insiders is not exhaustive.
[4] 11 U.S.C. § 1129(a)(10).
[5] Section 1126(e) of the Bankruptcy Code permits "the designation of any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title...."
[6] 11 U.S.C. § 1126(c).
[7] Under certain circumstances, equity may retain its interest even if creditors holding claims senior in priority are not paid in full if equity contributes substantial new value under the plan. *Bank of America Nat'l Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*, 119 S.Ct. 1411 (1999).
[8] 11 U.S.C. § 1126(e).
[9] *See In re Kovalchick*, 175 B.R. 863, 874 (Bankr. E.D. Pa. 1994) (considering motion to designate claim prior to plan confirmation); *In re Pleasant Hill Partners, L.P.*, 163 B.R. 388, 389 (Bankr. N.D. Ga. 1994) (same).
[10] *See, e.g., Matter of Heights Ban Corp.*, 89 B.R. 795, 799 (Bankr. S.D. Iowa 1988).
[11] *In re Holly Knoll P'ship*, 167 B.R. 381, 385 (Bankr. E.D. Pa.1994) (quoting *In re Applegate Property, Ltd.*, 133 B.R. 827, 833 (Bankr. W.D.Tex.1991)).
[12] *In re Boyajian*, 564 F.3d 1088, 1091 (9th Cir. 2009).
[13] *See, e.g., Septembertide Publishing v. Stein & Day, Inc.*, 884 F.2d 675 (2d Cir. 1989) ("It has always been the law in New York that an assignee stands in the shoes of its assignor and takes subject to those liabilities of its assignor that were in existence prior to the assignment.") (citations omitted); *Enron Corp. v. Springfield Assoc., LLC (In re Enron Corp.)*, 379 B.R. 425, 435-36 (S.D.N.Y. 2007) ("[A]n assignee stands in the shoes of the assignor and [is] subject to all equities against the assignor. In other words 'an assignee of a claim takes with it whatever limitations it had in the hands of the assignor.'..."); *In re KB Toys, Inc.*, 470 B.R. 331, 335 (Bankr. D. Del. 2012) (holding that "the plain language, legislative history, and decisional law support the view that a claim in the hands of a transferee has the same rights and disabilities as the claim had in the hands of the original claimant. Disabilities attach to and travel with the claim.").
[14] *Three* Flint *Hill Ltd. P'ship v. Prudential Ins. Co. (In re Three Flint Hill Ltd P'ship)*, 213 B.R. 292, 299 (D. Md. 1997) (denying confirmation, noting that claimant's purchase of claim was not a "carefully reasoned business decision," but instead an accommodation to a friend or business partner).
[15] *In re Metiom, Inc.*, 301 B.R. 634, 642-43 (Bankr. S.D.N.Y. 2003).
[16] *See In re Concorde Square Apartments of Wood County, Ltd.*, 174 B.R. 71 (Bankr. S.D. Ohio 1994)).
[17] *Concorde Square*, 174 B.R. at 75.
[18] *In re Hempstead Realty Assocs.*, 38 B.R. 287, 290 (Bankr. S.D.N.Y. 1984),
[19] *Id.*
[20] *Id.*
[21] *Id.* at 231.
[22] *Id.* (emphasis added).
[23] *See In re Greer West Inv. Ltd. P'ship.*, 81 F.3d 168 (9th Cir. March 25, 1996) (unpublished).
[24] *Id.*
[25] *See In re matter of Krehl*, 86 F.3d 737, 741-42 (7th Cir. 1996); *Shubert v. Lucent Techs., Inc. (In re Winstar Commc'ns, Inc.)*, 554 F.3d 382, 396-97 (3d Cir. 2009) (same) (citations omitted).
[26] H.R.Rep. No. 95-595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6269, 1977 WL 9628; S.Rep. No. 95-989 (1978), *reprinted* in 1978 U.S.C.C.A.N 5787, 5810, 1978 WL 8531; *see also Missionary Baptist Foundation of America, Inc. v. Huffman*, 712 F.2d 206, 210 (5th Cir. 1983 (citing S.Rep. No. 95-989, 95th Cong.2d Sess).
[27] *See, e.g., In re Winstar Communications*, 554 F.3d at 396-97 (rejecting argument that only a "person in control" could be an insider, and holding that "the question is whether there is a close relationship [between debtor and creditor] and ... anything

other than closeness to suggest that any transactions were not conducted at arm's length.") (internal citations omitted); *In re U.S. Med., Inc.*, 531 F.3d 1272, 1280) (10th Cir. 2009) (rejecting control test for non-statutory insiders, and holding that a creditor may be a non-statutory insider when the "creditor and debtor did not operate at arm's length at the time of the challenged transaction.") (citing S. Rep. No. 95-595, at 25 (1978); H.R. Rep. No. 95-595, at 312 (1977); Resnick & Henry J. Sommer, Collier on Bankruptcy, P 547.03[6] (15th rev. ed. 2008)); *In re Friedman*, 126 B.R. 63, 70 (B.A.P. 9th Cir. 1991) (noting that non-statutory insider status may be based on either control by the creditor over a debtor, or under circumstances "where such relationship compels the conclusion that the individual or entity has a relationship with the debtor, close enough to gain an advantage attributable simply to affinity rather than to the course of business dealings between the parties"); *In re Winslow*, 2012 WL 2161598, at *7 (E.D.N.C. Feb. 22, 2012) (rejecting "control test" to determine whether auction company employed by debtor was a non-statutory insider, and focusing instead on the closeness of the relationship between the non-statutory insider and the debtor); *In re Three Flint Hill*, 213 B.R. at 301 (D. Md. 1997) (noting that "control is not dispositive" and focusing more broadly on the closeness of the relationship between the parties and on whether the parties' transactions were made at arm's length*); In re Locke Mill Partners*, 178 B.R. 697, 702 (Bankr. M.D.N.C. 1995) (noting that the degree of control over a debtor is only "one of the...considerations" when determining non-statutory insider status, and that "[t] he word 'insider' should be applied flexibility to include a broad range of parties who have a close relationship with the debtor" such that their "conduct is made subject to closer scrutiny than those dealing at arms['] length with the debtor") (citations omitted).

[28] *See e.g., Kaisha v. Dodson*, 423 B.R. 888, 901 (N.D. Cal. 2010) (finding the woman the debtor was romantically involved with prior to the transfer of stock to be an insider even though they asserted they were not together at the time of the transfer); *Walsh v. Dutil (In re Demko),* 264 B.R. 404, 408 (Bankr. W.D. Pa. 2001) (cohabitation by two people may render individual an insider); *Freund v. Heath (In re McIver)*, 177 B.R. 366 (Bankr. N.D. Fla. 1995) (live-in girlfriend may be an insider).

[29] *See, e.g., In re Holloway*, 955 F.2d 1008, 1011-12 (5th Cir. 1992) (former spouse and friend of debtor was a non-statutory insider for preference purposes); *In re Curry*, 160 B.R. 813 (Bankr. D. Minn. 1993) (debtor's very close friend and business associate was an insider for purposes of fraudulent conveyance liability); *In re Standard Stores*, Inc., 124 B.R. 318, 325 (Bankr. C.D. Cal. 1991) (corporate debtor's president's ex-brother-in-law was a non-statutory insider for preference purposes).

I. Definition of Single Asset Real Estate

A. 11 U.S.C. § 101(51B)

"'[S]ingle asset real estate' means real property constituting a *single property or project*, other than residential real property with fewer than 4 residential units, which *generates substantially all of the gross income of a debtor* who is not a family farmer and on which *no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto*."

B. Judicial Interpretation

1. Single property or project

   a. Debtor can own multiple, noncontiguous parcels of real property and a "single project," so long as they are linked together by some common plan or scheme governing their present use. In re Hassen Imports P'ship, 466 B.R. 492, 507 (Bankr. C.D. Cal. 2012)

   b. Each debtor must be analyzed separately for purposes of section 101(51B) – no "whole business enterprise" exception exists. In the Matter of Meruelo Maddux Properties, Inc., 667 F.3d 1072, 1077 (9th Cir. 2012)

2. Generating substantially all of the gross income of a debtor

   a. This requirement is routinely analyzed in conjunction with the "no substantial business" requirement. See, e.g., In re Oceanside Mission Assocs., 192 B.R. 232, 234-235 (Bankr. S.D. Cal. 1996)

   b. Debtor owning undeveloped land that generates no income falls within the definition of SARE. Oceanside, 192 B.R. at 236 (citing cases)

3. No substantial business other than that of operating the real property and activities incidental thereto

   a. If a debtor's income from its real estate is passive, e.g., collection of rent, then a court is more likely to declare that the debtor falls within section 101(51B)

      i. In the Matter of Scotia Pac. Co. LLC, 508 F.3d 214 (5th Cir. 2007), focused on the passive vs. active income issue in finding that a debtor, which operated sophisticated timber operations, did not fall within the definition of SARE

ii. Kara Homes, Inc. v. National City Bank (In re Kara Homes, Inc.), 363 B.R. 399, 406 (Bankr. D. N.J. 2007) (granting summary judgment in favor of lender and finding that affiliated debtors engaged in the business of acquiring and developing residential real property fell within section 101(51B)'s definition of SARE; central focus of court's analysis of operations unrelated to the real estate was "whether the nature of the activities are of such materiality, that a reasonable and prudent business person would expect to generate substantial revenues from the operation activities – separate and apart from the sale or lease of the underlying real estate")

C. How to Declare or Impose SARE Requirements

1. By the Debtor

a. Debtor can simply check the appropriate box in the "Nature of Business" section of the Petition (Official Form 1)

b. Item 18 in the Statement of Financial Affairs (Official Form 7) requests information concerning the nature, location and name of any business of the debtor. Subpart b requires the debtor to "identify any business . . . that is 'single asset real estate' as defined in 11 U.S.C. § 101"

c. Should a debtor neglect to do one or both of the above and later desire SARE status, it could simply prepare, file and serve amended versions of the Petition and Statement of Financial Affairs.

d. More typically, a Debtor that has declared SARE status in its Petition or SOFA will want to rescind that declaration and may attempt to do so by filing an amended Petition and Statement of Financial Affairs in which the SARE designation and information have been deleted. See, e.g., Kara Homes, 363 B.R. 401-402 (noting filing of amended petitions and statements of financial affairs). Given the acceleration of SARE cases under 11 U.S.C. § 362(d)(3), it is likely that creditors whose claims are secured by an interest in the SARE debtor's real property will resist any effort to "undo" the SARE declaration.

i. Debtors have met such challenges by commencing adversary proceedings, Kara Homes, 363 B.R. at 402, or filing motions, In re The McGreals, 201 B.R. 736, 737 (Bankr. E.D. Pa. 1996), requesting findings that 11 U.S.C. § 101(51B) does not apply.

2. By Creditors

a. Creditors have styled and timed their efforts to force debtors to assume the burdens of SARE designation differently, but the result of a finding that 11 U.S.C. § 101(51B) is always the same: the debtor will have the longer of 90 days following the entry of an order for relief or 30 days after the court determines that 11 U.S.C. § 101(51B) applies to comply with the requirements of 11 U.S.C. § 362(d)(3)(A) or (B).

i. Note: Some courts have held that secured creditors must not seek relief against the debtor until the 90 period set forth in 11 U.S.C. § 362(d)(3) has expired, to afford the debtor some breathing room. In re Hope Plantation Group, 393 B.R. 98, 102-103 (Bankr. D. S.C. 2007); In re National/Northway Ltd. P'ship, 279 B.R. 17, 22 (Bankr. D. Mass. 2002)

b. Motions for Relief from Stay

i. Creditors sometimes file motions demanding relief from the Automatic Stay on the grounds that a debtor constitutes an SARE entity but has failed to comply with the requirements imposed on such entities by the Bankruptcy Code (see discussion of 11 U.S.C. § 362(d)(3), infra). Oceanside, 192 B.R. at 234 (motion for relief from stay); In the Matter of Prairie Hills Golf & Ski Club, Inc., 255 B.R. 228, 228-229 (Bankr. D. Neb. 2000) (motion for relief from stay); In re JJMM Int'l Corp., 467 B.R. 275, 276 (Bankr. E.D.N.Y. 2012) (motion seeking relief from stay or to convert case to one to which 11 U.S.C. § 101(51B) applies). If the Court finds that 11 U.S.C. § 101(51B) applies, the debtor will have just 30 days to comply with 11 U.S.C. § 362(d)(3)(A) or (B).

b. Motions Requesting SARE Designation

i. Creditors also file motions demanding findings that 11 U.S.C. § 101(51B) applies. JJMM, 467 B.R. at 276, supra; In re Yishlam, Inc., 495 B.R. 328, 329 (Bankr. S.D. Tex. 2013) (motion for entry of order determining that debtor is subject to 11 U.S.C. § 101(51B)); Hassen Imports, 466 B.R. at 495 (motion for determination that debtor's holdings constituted SARE)

c. Motions to Expedite Proceedings

i. In one case, a group of similarly situated creditors filed a motion to expedite the bankruptcy proceedings pursuant to 11 U.S.C. § 362(d)(3). Scotia Pac., 508 F.3d at 217-218

II. The Automatic Stay and SARE Entities

A. 11 U.S.C. § 362(d)(3)

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from [] stay . . .

(3) With respect to a stay of an act against single asset real estate . . . by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later —

(A) The debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) The debtor has commenced monthly payments that --

(i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and

(ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate.

B. Abbreviated Period to File a Plan or Pay

1. No later than 90 days after the entry of an order for relief (which might mean 90 days after the commencement of the case), or 30 days after the court designates the debtor as SARE – whichever is later – the debtor must propose a plan that has a reasonable possibility of being confirmed within a reasonable time or must commence payments in accordance with 11 U.S.C. § 362(d)(3)(B).

   a. One court has held that, unless a party demands a finding that the SARE provisions apply, the foregoing time period never expires. In re Abdulla, 2009 WL 348365, *3 (Bankr. D. Mass. Feb. 6, 2009)

   b. If an SARE debtor fails to comply with 11 U.S.C. § 362(d)(3)(A) or (B), relief from stay *shall* be granted. 11 U.S.C. § 362(d)(3). But caselaw suggests that the court retains discretion to order other forms of relief. See, e.g., Hope Plantation, 393 B.R. at 104 (court has discretion under section 362(d)(3) to determine the extent of the relief sought); In re Crown Ohio Invs. LLC, 2010 Bankr. LEXIS 804, *8-9 (Bankr. E.D.N.Y. Mar. 12, 2010) (same; citing cases); In re Triumph Inv. Group, Inc., 2009 WL 2916986, *3 (Bankr. E.D. Pa. Apr. 23, 2009) (same).

2. Available Options

   a. Plan with a Reasonable Possibility of Confirmation within a Reasonable Time

      i. Courts hold debtors to a lesser standard than that required for confirmation. In re MDM Golf of Gillette Ridge LLC, 2014 WL 7359077, * 3 (Bankr. D. Conn. December 23, 2014) (debtor need only show that (1) it is proceeding to propose a plan of reorganization; (2) that the plan has a realistic chance of confirmation; and (3) the plan is not patently unconfirmable) (citing In re Windwood Heights, Inc., 385 B.R. 832, 838 (Bankr. N.D. W.Va. 2008); National/Northway, 279 B.R. at 24 (same); In re RIM Dev. LLC, 448 B.R. 280, 288)

(Bankr. D. Kan. 2010) ("[t]he debtor is not obliged to prove it will confirm the plan it has filed; instead the test is whether the plan is confirmable").

b. Monthly Payments to Secured Creditors

i. May be made with pre- or postpetition rent or other income generated by the real property that secures the creditor's claim. 11 U.S.C. § 362(d)(3)(B)(i). Some courts have questioned whether this means a debtor may make these payments with the secured creditor's cash collateral without providing adequate protection for the use of that cash collateral. Crown Ohio, 2010 Bankr. LEXIS at *11-12; but see section C, infra.

ii. Must equal monthly nondefault contract rate of interest on the value of the creditor's interest in the real property. 11 U.S.C. § 362(d)(3)(B)(ii). Most courts deem this a straightforward application of the contract interest rate to the value of the creditor's interest in the real property. Crown Ohio, 2010 Bankr. LEXIS at *12-13.

C. § 362(d)(3)(B) Payments as Adequate Protection?

1. Courts recognize that the purpose of adequate protection payments differs from the purpose of payments required by 11 U.S.C. § 362(d)(3)(B). In re Heather Apartments L.P., 366 B.R. 45, 50 (Bankr. D. Minn. 2007) (recognizing that the focus of §§ 362(d)(1) and (2) is much broader than that of § 362(d)(3)(B); §§ 362(d)(1) and (2) concern the existence of "substantial equity in pledged collateral" and the "protection of a mortgagee's financial interests while the automatic stay prevents it from foreclosing").

a. Adequate protection is designed to protect the creditor when the automatic stay prevents the creditor from foreclosing, but the value of its collateral is diminishing. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 374 (1988); see also In re Scopac, 624 F.3d 274, 278 (5th Cir. 2010) (noting that adequate protection is a term of art in bankruptcy and "is a payment, replacement lien or other relief sufficient to protect the creditor against diminution in the value of his collateral during the bankruptcy."). Cases construing the term "adequate protection," involve some type of depreciating collateral. See, e.g., In re Carpet Center Leasing Co, Inc., 991 F.2d 682, (11th Cir. 1993) (involving fleet of tractors); In re Advisory Info. & Mgmt. Sys., Inc., 50 B.R. 627 (Bankr. D. Tenn. 1985) (involving equipment). In comparison to adequate protection payments, "[t]he single asset real estate payments are not limited to compensating a secured creditor for the decline in the value of its collateral by a debtor's continued use of the collateral or the delay in foreclosure." In re Civil Partners Sioux City LLC, 2013 WL 5534743, * 23 (Bankr. N.D. Iowa Oct. 7, 2013) (citing Heather Apartments, 366 B.R. at 49–50 & 50 n. 6).

b. Payments to a secured creditor pursuant to 11 U.S.C. § 362(d)(3)(B) are designed to compensate the creditor for the time value of money. See In re South Side House LLC, 474 B.R. 391, 417-418 (Bankr. E.D.N.Y. 2012)(citations omitted); Hope Plantation, 393 B.R. at 101-102; Heather Apartments, 366 B.R. at 50 ("where the case does not early kick forward toward confirmation, a debtor must compensate its mortgagee for the time-value of the mortgagee's debt investment, by the payment of interest at the original contractual rate"); Id. at 51 ("the focus is entirely on an in-hand realization of cash by the creditor, during the pendency of the case, while the property remains in the debtor's hands").

2. At least one court has specifically rejected the notion that adequate protection payments should also satisfy the requirement of § 362(d)(3)(B). In re LDN Corp., 191 B.R. 320, 327 (Bankr. E.D. Va. 1996) ("[i]f the Court permitted the prior adequate protections . . . to count towards the § 362(d)(3) interest payments, it would encourage the delay the statute was meant to prevent; [the debtor] would simply be using [the secured creditor's] own collateral to prolong the inevitable").