Can a Debtor Force a Secured Creditor To Accept "Dirt for Debt"?

Irving E. Walker is the managing partner of the Baltimore office of Cole Schotz, P.C. His selection as "Lawyer of the Year" by The Best Lawyers in America for Baltimore, in Bankruptcy and Creditor Debtor Rights/ Insolvency and Reorganization Law for 2013, and Litigation-Bankruptcy for 2012 and 2014, is one reflection of the wide recognition and respect Irv receives from other lawyers and clients in Maryland and beyond. Irv also has been recognized since 2013 by The Best Lawyers in America for "Bet-the-Company" Litigation, and as being among the best lawyers in America for 15 years in the areas of bankruptcy and reorganization law and litigation-bankruptcy. Corporate Int'l Magazine recognized Irv in its Global Awards with the accolade, "Corporate Restructuring Attorney of the Year in Maryland." Most recently, Irv has been listed as one of "Maryland's Top 100 Lawyers" by Super Lawyers Maryland Edition.

Jonathan A. Grasso is an associate in the Bankruptcy & Corporate Restructuring and Litigation Departments of Cole Schotz, P.C. His practice covers all aspects of complex commercial litigation and restructuring matters in state and federal courts. Jonathan has represented debtors, equity holders, secured and unsecured creditors, landlords and trustees, both in and out of bankruptcy court. He has worked with clients in many industries, including agriculture, construction, hospitality, residential and commercial real estate, retail and professional sports.

Irving E. Walker and Jonathan A. Grasso

ABOUT 25 YEARS AGO, the world of real estate lenders and bankruptcy professionals read with interest about a ground-breaking case in which a federal appellate court approved a Chapter 11 plan under which the secured lender was forced to accept a conveyance of its real property collateral as a complete substitution of its substantial secured claim against the debtor.

This type of Chapter 11 plan is often referred to in bankruptcy professional circles as a "dirt-for-debt" plan. For the debtor who succeeds in obtaining approval of such a plan, it can be a powerful tool to emerge from bankruptcy free of substantial debt, without having to worry about obtaining financing to repay the lender. For the lender, who itself may have its own investors, receiving ownership of its collateral with the burden and risks of ownership and disposition may be the last thing the lender wants.

With the passage of time, the case law concerning "dirt-for-debt" plans, particularly following the Great Recession when a number of real estate developments became the subject of Chapter 11 bankruptcy cases, has developed sufficiently to warrant a fresh look at the state of the law on the issue of what it takes to obtain bankruptcy court approval, or confirmation, of such a plan. The aim of this article is generally to inform real estate practitioners who do not commonly participate in the bankruptcy process about the subject of "dirt-for-debt" reorganization plans in Chapter 11, without getting bogged down in the details or

finer points of what are relatively complex issues of bankruptcy case law.

SOME BASICS ABOUT THE BANKRUPTCY PROCESS • An owner of real estate may file for bankruptcy relief under title 11 of the United States Code (the "Bankruptcy Code") for a variety of reasons. Often, a bankruptcy case is filed to prevent a secured creditor from enforcing its lien rights against the creditor's collateral. Where the collateral is real property, the secured creditor may trigger a bankruptcy filing by commencing a foreclosure action or enforcing the creditor's rights to collect rental income if the collateral is income-producing property. The filing of a bankruptcy petition will halt the creditor's enforcement actions and give the debtor an opportunity to formulate a strategy to manage through the crisis brought to a head by the creditor's actions.

The Automatic Stay

Section 362 of the Bankruptcy Code, known as the "automatic stay", prevents creditors from, among other things, (1) commencing or continuing any action to recover a claim against the debtor that arose before the filing of the bankruptcy case, (2) taking any action to gain possession of property that is part of the debtor's estate, and (3) attempting to enforce a lien against property of the debtor's estate. 11 U.S.C. § 362(a)(1), (3) and (4). It is this section of the Bankruptcy Code that, upon the filing of a bankruptcy petition, protects the debtor and its property from the continuation of any pending or future creditor enforcement actions. If the bankruptcy petition is filed just before the auctioneer at a foreclosure sale auction has sold the real property subject to foreclosure, the auction must be immediately halted. Similarly, the automatic stay bars a creditor from proceeding with a lawsuit against a debtor or the continuation of any action by a judgment creditor to attach the debtor's property.

While the automatic stay provides the debtor with additional time to make decisions regarding the future of its business and assets, this "breathing period" may be of limited duration. A secured creditor may seek relief from the automatic stay to continue its collection actions, including the foreclosure of the debtor's real estate. *See* 11 U.S.C. § 362(d). To obtain relief from the automatic stay, a secured creditor must file a motion for relief and demonstrate one of two alternative grounds for relief: either (1) "cause", including the lack of adequate protection of the creditor's interest in its collateral, or (2) that the debtor does not have equity in the property which is collateral for the creditor's claim and the property is not necessary to an effective reorganization. *Id*. Lengthy articles have been written about the way courts have interpreted these statutory grounds for relief from the automatic stay, and this article will not delve into those interesting issues. For our purposes here, it is enough to note that a debtor in Chapter 11 should not get too comfortable with the protections of the automatic stay, particularly if the secured lender's collateral is not worth substantially more than the debt owed, and from the earliest stage of the Chapter 11 process, the debtor should be thinking of its exit strategy and how it plans to emerge from Chapter 11 as soon as practicable. Whenever possible, a skilled bankruptcy professional will develop a strategy for reorganizing the debtor's financial affairs to permit the debtor to emerge successfully from a Chapter 11 case before the bankruptcy petition is filed. The vehicle for implementing that strategy is a Chapter 11 plan of reorganization.

Chapter 11 Plan of Reorganization

Generally, the ultimate goal of a Chapter 11 bankruptcy case is to obtain confirmation, which means bankruptcy court approval, of a Chapter 11 plan. A plan is a proposal for the payment of creditors' claims and the treatment of holders of equity interests in the debtor which, if approved by

the bankruptcy court, replaces or supersedes the rights and obligations of the debtor, creditors and interest holders as they existed prior to bankruptcy court approval of the Chapter 11 plan. The plan may provide for the reorganization of the debtor and the continuation of the debtor's business, or it may provide for the complete liquidation of all of the debtor's assets for the benefit of creditors and interest holders, or a partial liquidation.

A plan may be proposed by the debtor, a creditors' committee, or any other party to the case. The Bankruptcy Code, however, provides the debtor with the first right to file a plan before any other party, which is known as the "exclusive period". Unless the court enters an order shortening the exclusive period, the debtor has the exclusive right to file a plan for the first 120 days of the Chapter 11 case. 11 U.S.C. § 1121(b). This period may be extended, although the Bankruptcy Code limits any such extension to a date that is no more than 18 months after the date of the order for relief (which is the date on which the debtor voluntarily filed its Chapter 11 petition, in a voluntary case). 11 U.S.C. § 1121(d)(2)(A).

The Bankruptcy Code specifies a number of requirements with respect to the contents of a Chapter 11 plan. *See* 11 U.S.C. § 1123(a). The statute also provides a non-exclusive list of other provisions that may be included in a Chapter 11 plan, and these provisions specifically include, as a plan option, modification of the rights of holders of secured claims. 11 U.S.C. § 1123(b)(5).[1]

Plan Confirmation Requirements Generally

Section 1129 of the Bankruptcy Code specifies the requirements for achieving confirmation. These provisions present a number of complexities, and a book can be written just on these issues. For our purposes here, there are a few salient points worth noting before reaching the main subject of this article. First, the requirements for confirmation are more easily met when the plan is consensual, that is, when the different categories of creditors all vote to accept the plan and do not oppose it. When the plan is not consensual, it should not be surprising to know that confirmation is much more difficult. The process of pursuing confirmation of a plan over the objection of one or more class of creditors is referred to in bankruptcy professional circles as a "cram-down", an apt name for an attempt to shove an unacceptable plan down a creditor's proverbial throat.

Confirmation by "Cram-Down"

Section 1129(b)(1) states that a plan can be confirmed even when all impaired classes have not voted to accept the plan "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). A plan is "fair and equitable" with respect to a class of secured claims, if the plan provides –

(i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such

[1] The one exception to the debtor's ability to modify a secured creditor's rights is if the creditor's only lien rights are on the debtor's principal residence. 11 U.S.C. § 1123(b)(5).

liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2)(A)(i) – (iii).

These are highly technical provisions with a number of terms of significance, and delving into the meanings of all of these sub-parts would take the discussion here beyond the scope of this article.[2] The most important aspect of Section 1129(b) to understand is that this is the pathway to achieve confirmation over the objection of a secured creditor. For the purposes of this article, our focus is on Section 1129(b)(2)(A)(iii), which requires that the secured creditor receive the "indubitable equivalent" of its claim. A "dirt-for-debt" plan will only meet the requirements of Section 1129(b)(2)(A) if it can be demonstrated that the plan provides the secured creditor with the "indubitable equivalent" of its secured claim.

The term "indubitable equivalent", was first used in the well-known case of *Metro. Life Ins. Co. v. Murel Holding Corp. (In re Murel Holding Corp.)*, 75 F.2d 941 (2d Cir. 1935), authored by Judge Learned Hand, one of the most well-respected and oft-quoted federal judges of the Twentieth Century. *See In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 310 (3d Cir. 2010) (discussing *Murel*). In *Murel*, the debtor owned an apartment house in Manhattan and the secured creditor holding a first lien on the property commenced foreclosure proceedings which were stayed when the owner filed a bankruptcy petition. *Murel*, 75 F.2d at 941. The secured creditor requested relief from the stay to resume foreclosure, which the bankruptcy court denied. In reversing that decision, Judge Hand recognized the right of the secured creditor to "adequate protection" of its interest in the real property collateral. While the debtor had filed a proposed plan of reorganization, that plan would have compelled the first lienholder to forgo any amortization payments for 10 years, leaving to sheer speculation whether the creditor would ever be repaid. *Id.* at 942-43. With these facts, Judge Hand found the debtor's plan wanting and observed: "A creditor who fears the safety of his principal will scarcely be content with . . . [interest payments alone]; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that . . . unless by a *substitute of the most indubitable equivalence*."

Id. at 942 (emphasis added).

Since *Murel*, it is generally understood that "indubitable equivalence" is a strict standard requiring that the creditor receive the equivalent of its secured claim without being subjected to any additional material risk. *See United States v. Arnold (In re Arnold and Baker Farms)*, 177 B.R. 648, 662 (9th Cir. B.A.P. 1994) (*cert. denied*, 117 S. Ct. 68 (1997)). Whether a particular plan meets this standard is often determined based largely on a factual determination of the valuation of the real property collateral rather than legal argument, although the determination generally is recognized as requiring mixed findings of fact and conclusions of law. Before discussing the application of the "indubitable equivalent" standard to a "dirt-for-debt" plan, there is one more piece of the puzzle that must be addressed, namely determination of the extent to which a claim is deemed secured for bankruptcy purposes.

---

[2] For those readers with a keen interest in acquiring a deeper understanding of the Bankruptcy Code cram-down provisions of Section 1129(b), please note: first, the authors applaud your interest; and second, we would welcome the chance to meet you, as any reader with such an interest surely must be a kindred spirit with the authors, who will gladly buy the first round of drinks for a lengthy discussion of the cram-down statute.

The Extent to which a Claim Is Secured

In bankruptcy, a claim is secured only to the extent of the creditor's interest in the bankruptcy estate property that constitutes the creditor's collateral. 11 U.S.C. § 506(a). To the extent that the claim exceeds the value of the collateral on which the creditor has a duly perfected lien, the creditor's claim is unsecured for bankruptcy purposes. *Id*. Section 506(a) further provides that the value of collateral is to be determined "in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." *Id*. This means that whether the valuation methodology adopted by the court in a confirmation hearing will be fair market value[3] or liquidation value, or some other approach, will depend on the court's assessment of the proposed use of the property in the context of the proposed plan. With respect to the date of valuation, where the valuation is part of plan confirmation, the property should be valued as of the plan confirmation date, as opposed to when the bankruptcy case was first filed or some future date. *See In re Heritage Highgate, Inc.*, 679 F.3d 132, 143 n.9 (3d Cir. 2012) ("Where, as here, the purpose of the valuation is to determine the treatment of a claim by a plan, the values determined at the § 506(a) hearing must be compatible with the values that will prevail on the confirmation date . . . .") (quotation omitted); *In re Atlanta S. Bus. Park Ltd.*, 173 B.R. 444, 450 (Bankr. N.D. Ga. 1994).

A simple illustration of the application of Section 506(a) should elucidate how this element applies in the context of a "dirt-for-debt" plan. If a first mortgagee has a valid lien on the debtor's residential development as security for repayment of a loan, the unpaid balance of which is $ 1,000,000 as of the petition date, and the development has a fair market value[4] of $ 800,000 at the time the court is being asked to determine the value, the creditor would have a secured claim in the amount of $800,000 and an unsecured claim in the amount of $200,000.

[3] Fair market value is often defined by appraisals used in bankruptcy as follows (or something similar):

> [t]he most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: buyer and seller are typically motivated; both parties are well informed or well advised, and acting in what they consider their best interests; a reasonable time is allowed for exposure to the open market; payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone with the sale.

See e.g. In re Motors Liquidation Co., 482 B.R. 485, 494 n. 39 (Bankr. S.D.N.Y. 2012) (citing *The Dictionary of Real Estate Appraisal* (4th ed. 2002)); *see also In re Monica Road Assocs.*, 147 B.R. 385, 388 (Bankr. E.D. Va. 1992).

[4] Courts generally start with fair market value in evaluating "dirt-for-debt" plans, with additional adjustments made thereafter. *See e.g. In re Clarendon Holdings LLC*, 2011 WL 5909512, at *4 (Bankr. E.D.N.C. Oct. 19, 2011) (rejecting liquidation value and instead using a fair market value standard in a "dirt-for-debt" plan) (vacated on other grounds by *Clarendon II*, No. 7:11-CV-247-H, 2013 WL 8635348 (E.D.N.C. 2013)); *In re Bannerman Holdings LLC*, No. 10-01053-SWH, 2010 WL 4260003, at *4 (Bankr. E.D.N.C. Oct. 20, 2010) (using a fair market value for the property in a "dirt-for-debt" plan) (reversed on other grounds by *In re Bannerman Holdings, LLC*, No. 7:11-CV-0009-H (E.D.N.C. Sept. 30, 2011).

"DIRT-FOR-DEBT" PLANS: RECOGNITION, TYPES, OBSERVATIONS AND MORE • The seminal case on "dirt-for-debt" plans is *Sandy Ridge Dev. Corp. v. La. Nat'l Bank (In re Sandy Ridge Dev. Corp.)*, 881 F.2d 1346 (5th Cir. 1989) ("*Sandy Ridge*"). The debtor in *Sandy Ridge* owned a piece of property known as "Brightside." Sandy Ridge owed its lender ("LNB") $ 2,400,000 that was secured by a first priority lien on Brightside. The lender was under-secured, as the value of the collateral was less than the amount of its claim. As part of the plan, Sandy Ridge proposed to transfer Brightside to LNB for a credit on the indebtedness to the extent of the fair market value of Brightside. *Id.* at 1348. The bankruptcy court denied approval of Sandy Ridge's plan and the district court affirmed that decision, but the Fifth Circuit reversed with respect to the issue of whether the plan met the cram-down requirements under Section 1129(b)(2)(A), holding that the transfer of property to a secured creditor in satisfaction of the secured portion of the creditor's claim met the indubitable equivalent requirement of Section 1129(b)(2)(A)(iii). *Id.* at 1350

The Fifth Circuit noted that Section 1129(b)(2)(A), the cram-down section for secured claims, deals solely with the portion of the creditor's claim that is secured. *Id.* at 1349-50. The court reasoned:

"Since the value of LNB's secured claim is equal to the value of Brightside, a plan which provides that LNB will realize the indubitable equivalent of Brightside will satisfy the requirements of section 1129(b)(2)(A)(iii). The current plan provides that LNB will receive Brightside itself, and since common sense tells us that property is the indubitable equivalent of itself, this portion of the current plan satisfies the indubitable equivalent requirement.

Id. This logic of the *Sandy Ridge* opinion is compelling, and ever since has been followed by many courts.

Variations on the Theme: Different Types of "Dirt-for-Debt" Plans

In the 25 years since *Sandy Ridge*, bankruptcy lawyers have made a number of attempts to extend that precedent by seeking approval of a variety of different forms of "dirt-for-debt" plans, with mixed results. All "dirt-for-debt" plans involve the conveyance of real property collateral to a secured creditor in satisfaction of at least a portion of a secured creditor's claim. The variety of such plans may be divided into two basic types: (1) the "pure" *Sandy Ridge* type, under which **all** of a lender's real property collateral is conveyed to the lender in full satisfaction of the secured portion of the lender's claim, and if the lender is under-secured, it retains an unsecured claim in the amount of the under-secured portion of its claim; and (2) a "partial dirt-for-debt" plan, which provides for the debtor to convey to the lender **less than all** of the lender's collateral, with one of the following variations: (i) the lender's entire claim is deemed to be paid or satisfied in full, with no deficiency claim, and the lender's lien on the collateral not conveyed is released; or (ii) the lender is recognized to have a continuing secured claim on the collateral retained by the debtor and is paid over time the remaining portion of its secured claim.[5]

This categorizing of partial "dirt-for-debt" plans is not meant to be exhaustive, as the form of Chapter 11 plans is limited only by counsel's imagination, while being mindful of the requirements of the Bankruptcy Code. For the purposes of this article, however, this is more than enough to gain

[5] For example, if a debtor owns two separate parcels of real property and both are subject to a lien held by the same lender for the same loan, a Chapter 11 plan may seek to convey to the lender one parcel for a credit against the loan balance, while keeping the other parcel and providing for monthly payments of principal and interest for a period of years with a maturity date when the remaining balance would be due.

an understanding as to what realistically can and cannot be accomplished under a Chapter 11 "dirt-for-debt" plan. The answer may be drawn from the cases since *Sandy Ridge*.

After *Sandy Ridge*, a number of courts across the country have considered whether "dirt-for-debt" plans satisfied the indubitable equivalent requirement of Section 1129(b)(2)(A)(iii). The overwhelming majority have answered this question in the affirmative with respect to a pure *Sandy Ridge* plan. *See In re SUD Props., Inc.*, 462 B.R. 547, 555 (Bankr. E.D.N.C. 2011) (collecting cases); *In re 431 W. Ponce De Leon, LLC*, 515 B.R. 660, 681 (Bankr. D. N.D. Ga. 2014) (citations omitted) ("In appropriate circumstances, such 'dirt-for-debt' treatment can provide the indubitable equivalent of the creditor's claim.").

Whether a particular "dirt-for-debt" plan has passed muster under the indubitable equivalent standard depends on the facts and circumstances of the case and the provisions of the plan. It is now clear that the type of plan proposed in *Sandy Ridge*—a "pure" *Sandy Ridge* plan—under which a secured creditor receives all of its property in satisfaction of the secured portion of its debt, and the court determines the credit to be given for the secured portion of the debt, is the indubitable equivalent of the secured claim. *See In re CRB Partners, LLC*, No. 11-11924-CAG, 2013 WL 796566, at *4 (Bankr. W.D. Tex. March 4, 2013) ("There is little question that plans proposing to surrender all property to which a lien attaches are 'fair and equitable' and the creditor in such cases receives the indubitable equivalent of its secured claim.") (citation omitted). It is the "partial" "dirt-for-debt" plans that present the more difficult cases to the courts, and are more difficult for debtors to get approved. As reflected in the cases discussed below, the critical issue in these cases is the court's valuation of the property to be surrendered.

Examples of Partial "Dirt-for-Debt" Plans that Succeeded

In cases involving partial "dirt-for-debt" plans, the debtor typically has alleged that its secured lender is over-secured,[6] and therefore the return of only a portion of its collateral is necessary to repay the creditor in full. One recent example is the case of *In re Investors Lending Grp., LLC*, 489 B.R. 307 (Bankr. S.D. Ga. 2013). In that case, the debtor's secured lender held a lien on twelve properties. Under the debtor's initial Chapter 11 plan, the debtor (with the unsecured creditors' committee, a co-plan proponent) proposed to surrender to the lender five of the twelve properties in full satisfaction of the bank's claim, while retaining the other seven properties to fund its operations and to pay other creditors.

In opposing the plan, the lender argued for a lower valuation based on an estimate of what the property would sell for upon foreclosure or liquidation rather than fair market value. The bankruptcy court adopted that approach,[7] which already was reflected in the debtor's proposed plan, and noted that to confirm a partial "dirt-for-debt" plan, the court must take particular care that a lender forced to accept property in satisfaction of its claim over the lender's objection ultimately receive "the indubitable equivalent of cash". 489 B.R. at 314. As further noted by the court, "valuation is not an exact science, and the chance for error always exists. A

[6] An "over-secured creditor" refers to a situation where the secured debt is less than the value of the collateral. The difference between an over-secured creditor's debt and the value of the collateral is commonly called the "equity cushion." *See In re Residential Capital, LLC*, 508 B.R. 851, 856 (Bankr. S.D.N.Y. 2014).

[7] It is worth noting that other courts, while acknowledging the appropriateness of a conservative valuation, have concluded that such an approach does not require adoption of the liquidation value. *See, e.g., In re Ponce de Leon 1403, Inc.,* 423 B.R. 349, 366 (Bankr. D. P.R. 2014) ("This does not mean that the Court has to provide a liquidation value or a safety net for the loss.").

conservative approach should, therefore be taken in order to protect the secured creditor in this regard." *Id*. (quotation omitted). Toward that end, the court adjusted the liquidation valuation to reduce the values of the properties to be surrendered to account for an 8% realtor's commission and expected closing costs that would be borne by the lender upon the sale of the properties. With these modifications, the court indicated its willingness to approve the debtor's plan. *Id.*

Another recent case involving a "partial dirt-for-debt" plan is *In re Bath Bridgewater S., LLC*, No. 11-06817-SWH, 2013 WL 968154 (Bankr. E.D.N.C. March 12, 2013). The plan in that case provided for the surrender of up to five different properties to satisfy the full claim of the secured creditor, and specified the order that the collateral would be surrendered, while leaving to the court the determination of exactly how much real estate needed to be surrendered to provide the secured creditor with the indubitable equivalent of its claim. *Id.* at *2. The bankruptcy court rejected the lender's arguments opposing the plan, which included the legal argument that a "partial dirt-for-debt" plan is not filed in good faith (a requirement of confirmation) and can never put a secured creditor in the same or better position than it would have been in a Chapter 7 liquidation. *Id.* at *4.

Based on the evidence, the court determined that the value of the first two properties to be surrendered would leave a deficiency of between $ 660,000 to $ 800,000, and that the next property to be surrendered under the plan had a value of between $ 1,180,000 to $ 1,360,000. The court determined that even under the conservative valuation approach, the surrender of the entire third property was unnecessary, and only required that 18 out of the 28 lots that comprised the third property needed be surrendered to provide the secured creditor with the indubitable equivalent of its claim. *Id.* at 7. Therefore, the court held that subject to the plan meeting the other requirements of confirmation, the debtor would be able to retain 10 of the 28 lots of the third property, as well as the fourth and fifth properties comprising the secured creditor's collateral.[8]

Debtors are not the only parties able to file a "dirt-for-debt' plan. The case of *In re 431 W. Ponce De Leon*, 515 B.R. 660 (Bankr. N.D. Ga. 2014), was unusual, as it was the senior secured creditor who filed the plan at issue in that case, as a competing plan offered as an alternative to the debtors' plan. The senior secured creditor proposed a liquidating plan under which secured claims held by it and other secured creditors would be paid from the sale of the creditors' respective collateral within six months of confirmation, and if the properties were not sold within six months, then the secured creditors could foreclose on their collateral. *Id.* at 667-68.

One of the debtors objected to the senior secured creditor's plan on the basis that it discriminated between various secured creditors. *Id*. at 681. The debtor's discrimination argument was based on the plan provisions that allowed the senior secured creditor to assert a deficiency claim while two other secured creditors were not allowed to assert a deficiency claim. *Id.* The court stated that allowing a secured creditor to only receive the sales proceeds from its collateral was essentially a "dirt-for-debt" plan that would not provide such creditor with the indubitable equivalent of its claim unless "no reasonable doubt exists that the creditor[s] will be paid in full." *Id.* (citing *In re Riddle*, 444 B.R. 681, 685 (Bankr. N.D. Ga. 2011)).

As to one of the other secured creditors, its collateral was valued at almost ten times its debt, and therefore there was no reasonable doubt that its claim would be paid in full. *In re 431 W. Ponce De Leon, LLC*, 515 B.R. at 682. As to the second creditor, its collateral was valued at $ 850,000 and the

[8] While the bankruptcy court held that the "dirt-for-debt" provisions met the requirements for confirmation of the plan, the plan ultimately was not confirmed due to other unrelated provisions in the plan. *Id.* at *7-8.

secured creditor's claim was $ 681,856.30 as of the petition date. The court concluded that this creditor would also receive the indubitable equivalent of its claim from the proceeds of the sale of its collateral when considering the significant equity cushion together with the improving real estate market in the area. *Id.* The court thus approved provisions of the plan that placed the risk of any loss from the sale of the real property collateral on the secured creditors.

Examples of Cases that Failed

The case of *In re CRB Partners, LLC*, No. 11-1924-CAG, 2013 WL 796566 (Bankr. W.D. Tex. March 4, 2013), provides an example of a partial "dirt-for-debt" plan that was not confirmed as well as the stringent valuation standards that bankruptcy courts have applied in the context of confirmation proceedings involving such a plan. In that case, there were two affiliated debtors in separate but jointly administered cases, and each debtor owned a real estate project on which liens were held by the same lender. One debtor owned an office building, and the other debtor owned a property comprised of residential lots and amenities including a clubhouse, swimming pool, tennis courts, and a golf course, plus a number of additional acres not yet developed (the "Cameron Property"). *Id.* at *1. After a valuation hearing, the bankruptcy court valued the Cameron Property at $ 1,340,000. Under the proposed joint Chapter 11 plan, the debtors proposed to convey the Cameron Property in full satisfaction of the lender's claim, while retaining the office building. The plan further provided that any balance owed to the lender in excess of the value of the property would be paid from a "Liquidating Fund", the source of funds for which was not clearly specified. *Id.* at *2. The secured creditor's claim, at the time of confirmation, totaled $2.73 (less than three dolars!) more than the value of the property to be surrendered. *Id.* at *6. The court denied confirmation of the plan. *Id.* at *7.

In analyzing the case before it, the court noted that to meet the indubitable equivalent standard, the court was required to determine the value of the property on a conservative basis. Quoting from another case,[9] the court explained:

"First, the Plan shifts the burden of sale of the [property] from the Debtors to the secured creditor. By doing so, the Debtors have shifted the risk of loss as well as the potential for gain, to the secured creditor … the secured claimant will not be earning interest on this portion of the secured claim until such time as the property is sold and converted to cash … [and] valuation is not an exact science, and the chance for error always exists."

Id. at *4. After determining that the value of the property was just a few dollars more than the lender's claim, the court understandably held that such an insignificant cushion was not enough to "insure the safety of or prevent jeopardy to the principal". (quoting *United States v. Arnold (In re Arnold and Baker Farms)*, 85 F.3d 1415, 1422 (9th Cir. B.A.P. 1996) (cert. denied, 117 S.Ct. 68 (1997)).

Another case worth considering is *In re Bannerman Holdings, LLC*, No. 7:11-CV-0009-H (E.D.N.C. Sept. 30, 2011) ("*Bannerman*"), in which the district court reversed the decision of the bankruptcy court confirming the plan.[10] The debtor in *Bannerman* filed a plan proposing to transfer only eleven of fifteen condominiums and a parking lot to its secured creditor in full satisfaction of its claim, while retaining the remaining collateral. The bankruptcy court confirmed the plan, based on the court's determination that the property to be surrendered had a value of $ 4,779,925.00, and that this was sufficient

[9] In re Simons, 113 B.R. 942, 947 (Bankr. W.D. Tex. 1990).

[10] The bankruptcy court opinion may be found at *In re Bannerman Holdings, LLC*, No. 10-01053-SWH, 2010 WL 4260003 (Bankr. E.D.N.C. Oct. 20, 2010).

to provide the secured creditor with the indubitable equivalent of its $ 4,642,660.44 claim. *Id.* at 8-9.

On appeal, the district court stated that "[t]he bar for a finding of indubitable equivalence is exceedingly high," and that "there must be no doubt that the secured creditor receives consideration equal to its claim in value or amount." *Id.* at 9-10 (quotation omitted). Due to this high threshold, the district court did not consider whether the bankruptcy court's valuation was in error, because even using the bankruptcy court's valuation, the secured creditor was not provided the indubitable equivalent of its claim, as (1) there was only a small equity cushion of less than 3% of the outstanding debt, (2) the bankruptcy court had to make substantial adjustments to the appraisals to reach its valuations of the properties, and (3) the real estate market was poor. *Id.* at 19.

Another very recent case should demonstrate the difference between the partial "dirt-for-debt plans that work and those that do not. In *In re Bate Land & Timber, LLC*, 523 B.R. 483 (Bankr. E.D.N.C. 2015) ("*Bate*")[11], the debtor, a real property investment and timber management company, owned numerous tracts of real property secured by several deeds of trust in favor of its secured creditor. The debtor's amended plan sought to satisfy the secured creditor's claim by surrendering only two of its properties in full satisfaction of its debt. Alternatively, if the court found that the two properties would not fully satisfy the secured creditor's debt, the debtor proposed either to surrender some additional parcels to be determined by the debtor at a later date or to repay the remaining balance of the loan over 20 years from future sales proceeds. *Id.* at 488.

In determining the value of the properties to be surrendered, the court used the debtor's appraisals as a starting point, and reduced the appraisal amounts to make sure a conservative value was used. *Id.* The court ultimately valued the properties at $ 3,143,000 and $ 5,700,000 for a total value of $ 8,843,000. *Id.* at 507, 510. Since the court valued the properties at $ 8,843,000 and the secured creditor was owed at least $ 14,931,823.06, the surrender of the initial two properties proposed by the debtor's plan fell well short of meeting the requirement of providing the indubitable equivalent of the secured creditor's entire claim. *Id.* at 486, 510. The debtor therefore was directed by the court to provide additional properties to be surrendered or to pay the balance of creditor's claim over time. *Id.* at 511.

A Few Observations

As reflected in the recent cases discussed above, the most significant factor in a court's consideration of a partial "dirt-for-debt" plan, or any plan where the court is not given discretion to determine the credit to be applied to reduce the debt owed to the secured creditor, is the value of the property to be conveyed or surrendered to the secured creditor. The debtor has the burden of proof to show that the indubitable equivalent requirement is met. *See United States v. Arnold (In re Arnold and Baker Farms)*, 177 B.R. 648, 654 (9th Cir. B.A.P. 1994) (cert. denied, 117 S.Ct. 68 (1997)) (citing *In re B.W. Alpha, Inc.*, 100 B.R. 831 (Bankr. N.D. Tex. 1988)). Although the standard of proof applied is a preponderance of the evidence, s*ee id.* (citing *Grogan v. Garner*, 498 U.S. 279 (1991)); *but see In re Prosperity Park, LLC*, No. 10-31399, 2011 WL 1878210, at *4 (Bankr. W.D.N.C. May 17, 2011), the reported opinions on partial "dirt-for-debt" plans reflect that bankruptcy courts take a more conservative approach in these kinds of

[11] One of the noteworthy aspects of *Bate* is that it is from the United States Bankruptcy Court for the Eastern District of North Carolina, a court which has seemingly been a hotbed of "dirt-for-debt" proposed Chapter 11 plans over the past several years. *Bate,* at 497 ("Over the past few years, for reasons that seemingly are cosmic in nature and to which the bankruptcy judges of this district are not privy, the Eastern District of North Carolina has provided a non-stop bounty crop of dirt-for-debt cases, each with its own fresh, unique twist.").

cases than they do when making valuation determinations for the many other kinds of disputes that commonly occur during a Chapter 11 case.

As noted by one bankruptcy court in a recent case, "any plan proposing a cramdown and involving only a partial surrender of collateral . . . poses challenges and risks in the crucial process of valuation." *In re CRB Partners, LLC*, No. 11-1924-CAG, 2013 WL 796566, at *6 (Bankr. W.D. Tex. March 4, 2013). If there is any doubt that the secured creditor will realize from the real property collateral the full amount owed, then the indubitable equivalent requirement will not have been met. *See id.* (citation omitted).

The strict indubitable equivalent standard thus leads courts to apply conservative values for the collateral to be surrendered. *See In re Investors Lending Grp., LLC*, 489 B.R. 307, 314 (Bankr. S.D. Ga. 2013) ("[I]f a Plan is to be confirmed which approves 'dirt-for-debt' or 'partial dirt-for-debt,' the decision must be so conservatively or sparingly applied as to ensure that the lender forced over its objection to accept property in satisfaction of a claim receives the indubitable equivalent of cash.") (citation committed)*; In re SUD Props.*, No. 11-03833-8-RDD, 2011 WL 5909648, at *6 (Bankr. E.D.N.C. Aug. 23, 2011) ("Many courts when valuing collateral in 'dirt-for-debt' plans have taken conservative approaches.") (citations omitted); *see also In re Simons*, 113 B.R. 942, 947 (Bankr. W.D. Tex. 1990) ("[V]aluation is not an exact science, and the chance for error always exists. A conservative approach, should, therefore be taken in order to protect the secured creditor in this regard.").

The conservative approach taken by bankruptcy courts in valuation hearings involving partial "dirt-for-debt" plans can be understood by recognizing that (1) valuation of real property is inherently uncertain, and future sale results may well differ from a court determination based on conflicting expert opinions; and (2) the court must be convinced that a proposed valuation of property to be surrendered to a secured creditor leaves no reasonable doubt about providing the creditor with the equivalent of full payment of its secured claim, so that the debtor can retain portions of the creditor's pre-bankruptcy collateral free of the creditor's lien, and without risk of being subjected to a deficiency claim if the sale turns out to be less than the court determined value of the property.

Benefits of "Dirt-for-Debt" Plans

A debtor benefits from a "dirt-for-debt" plan by shifting significant risks to the secured creditor. For example, the secured creditor, instead of the debtor, incurs significant holding costs relating to real estate taxes, maintenance, marketing the real property for sale and other sale costs all before receiving any money from the real property. *See In re CRB Partners,* LLC, No. 11-11924-CAG, 2013 WL 796566, at *5 (Bankr. W.D. Tex. March 4, 2013). Similarly, the creditor will not have use of its cash until the secured creditor is able to sell the property. At the time of confirmation of the plan, the amount of money the lender will ultimately receive from the real estate is uncertain. Therefore, a "dirt-for-debt" plan may ultimately result in a creditor receiving a lower amount than the credit given in the bankruptcy case. *See In re Simons*, 113 B.R. 942, 947 (Bankr. W.D. Tex. 1990).

"Dirt-for-Debt" Plans During Period of Decreasing Real Estate Prices

While "partial dirt-for-debt" plans will always be difficult to confirm, they become even more difficult in a down real estate market. *See e.g. In re Ponce De Leon 1403, Inc.*, 523 B.R. 349, 394 (Bankr. D.P.R. 2014) ("[G]iven the depressed real estate market in Puerto Rico it will be difficult for a partial 'dirt-for-debt' proposed plan to provide the creditor with the 'indubitable equivalent' of its secured claim. Therefore, Chapter 11 plans that propose to surrender all of the property as the indubitable equivalent need to be thoroughly analyzed and evaluated due to the

depressed real estate market conditions."); *see also In re CRB Partners, LLC*, 2013 WL 7965566, at *6. *In re Martindale*, 125 B.R. 32 (Bankr. D. Idaho 1991) describes well the difficulty of "dirt-for-debt" plans in depressed real estate markets:

"Perhaps at a different time in a different real estate market a plan proposing to surrender mortgaged land to the mortgagee in return for satisfaction of the debt may be confirmable. However, in an uncertain market it is doubtful that such a plan offers the creditor the indubitable equivalent of its claim unless the appraised value of the property, demonstrated by competent proof, far exceeds the amount of the debt to be paid."

Id. at 38.

As described by one court, with "'real estate values now steadily decreasing, and with our ability to ascertain value severely enfeebled, … findings [that the surrender of a portion of a creditor's collateral provides that creditor with the indubitable equivalent of its claim] are all but impossible.'" *In re Ponce de Leon, 1403, Inc.*, 523 B.R. at 394 (citation omitted). In fact, a bankruptcy court order approving a "dirt-for-debt" plan has even been vacated where it was unclear if the bankruptcy court took certain factors into account, such as the effect of a depressed market on the confirmability of the plan. *See In re Clarendon Holdings, LLC*, Case No 7:11-cv-247-H, 2013 WL 8635348, at *2 (E.D.N.C. March 18, 2013) (vacated on other grounds by *Clarendon II*, No. 7:11-CV247-H, 2013 WL 8635348 (E.D.N.C. 2013)).

"Dirt-for-Debt" Plans During Period of Increasing Real Estate Prices

Just as a depressed real estate market may hurt the ability to confirm a "dirt-for-debt" plan, an improving real estate market may help to confirm a "dirt-for-debt" plan, as the court may more easily recognize that the secured creditor is taking on less risk from the surrender of collateral. More recently, at least one court has indicated a willingness to rely on improving real estate values to support its findings that a debtor has given the indubitable equivalent of a secured creditor's claim through the surrender of collateral. *See e.g. In re 431 W. Ponce De Leon, LLC*, 515 B.R. at 682 ("Given the equity in the property and the improving real estate market in Atlanta, the Court finds that no reasonable doubt exists that [the creditor] will be paid in full by receipt of the proceeds of the sale of the [creditor's collateral]").

CONCLUSION • With 25 years of experience since *Sandy Ridge*, it is now safe to say that a "pure dirt-for-debt" plan, one like the plan approved in *Sandy Ridge*, as a matter of law can be confirmed. It is likewise true that most courts that have considered the issue have indicated a willingness, as a matter of law, to approve a partial "dirt-for-debt" plan under which the debtor surrenders some, but not all, of a secured creditor's collateral in full satisfaction of the creditor's claim, with the debtor retaining the balance of the property free of any further debt to the creditor. Whether a particular plan with such provisions will be confirmed in a particular case will depend, in large measure, on the court's determination of the value of the property to be surrendered as well as the level of risk that the creditor ultimately will not realize the full amount owed. From the perspective of a secured creditor, that the creditor could be forced to give up part of its collateral as well as any deficiency claim, before completing the sale of the collateral surrendered, may be unthinkable, and certainly anathema. But from the perspective of a real estate developer or owner who is striving to accomplish a financial reorganization, a partial "dirt-for-debt" plan could well be the formula for success to emerge from bankruptcy unburdened by debt while still retaining core assets for its future business.