Real Estate Committee

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River East Plaza LLC II: The Collision of the § 1111(B) Election with Indubitable Equivalency

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The election under 11 U.S.C. § 1111(b) is one of the least understood weapons in the undersecured lender's arsenal. The election is most useful when the lender's collateral has been severely impaired by temporary market conditions. A chapter 11 debtor will often seek to take advantage of the lower value of the collateral by proposing a plan that pays the secured creditor the value of its secured claim at the depressed market value. Under such a plan, the undersecured creditor's deficiency claim would be treated as an unsecured claim, thereby likely receiving only pennies on the dollar, and the creditor would still retain its lien on the collateral to the extent of the market value thereof, pending all payments under the plan being made. This is the classic § 1129(b)(2)(A)(i) "cramdown" plan.

However, § 1111(b) enables a class of undersecured creditors to elect to waive voting and distribution rights with respect to their deficiency claims and have the entire allowed claims treated as secured claims. By electing treatment under § 1111(b) when a § 1129(b)(2)(A)(i) cramdown plan is proposed, the secured creditor is able to increase the amount of its secured claim (along with the value of its lien on the collateral) to the aggregate of its secured and unsecured deficiency claims. This election does not increase the value of the secured creditor's lien.

In *In re River East Plaza LLC*,[1] a creative debtor attempted to circumvent the impact of the lender's § 1111(b) election by proposing a cramdown plan using the "indubitable-equivalent" provision of § 1129(b)(2)(A)(iii) of the Code instead of the treatment permitted under § 1129(b)(2)(A)(i). *River East* involved an estate that was comprised of a building with a first-lien mortgage. The U.S. Bankruptcy Court for the Northern District of Illinois found that the building was worth $13.5 million, far less than the mortgagee's total claim of $38.3 million. Initially, the debtor submitted a plan proposing to pay the mortgagee the value of its secured claim, on the effective date, in cash—$13.5 million. Because the secured creditor wanted to protect its right to a greater recovery in the event of future appreciation in the value of the building, it elected treatment of its claim under § 1111(b).

In an attempt to avoid the impact of the mortgagee's § 1111(b) election, the debtor submitted an amended plan, which contemplated payments over time to the mortgagee of the entire § 1111(b) claim, but with a lien on substitute collateral rather than on the building. The proposed replacement collateral was a 30-year Treasury bond that would pay the amount of $38.3 million by the end of the 30-year period. The bond had a present value of no less than the then-current value of the building—$13.5 million.

If the debtor could successfully replace the bond for the building as the collateral securing the mortgagee's claim, the debtor would be able to borrow new money against the building, which would then be free of mortgage encumbrances. The debtor could then use this new money to pay for enhancements and improvements so that it could sell the building at a greater price, reaping the rewards of appreciation and improvements, without having to satisfy the mortgagee's $38.5 million claim. Meanwhile, the mortgagee would remain stuck merely with a lien on a 30-year Treasury bond as its only collateral. Although the debtor's amended plan did not meet the crammed down requirements of § 1129(b)(2)(A)(i), the debtor argued that the amended plan could be crammed down on the secured creditor under the indubitable-equivalent provision of § 1129(b)(2)(A)(iii).

The bankruptcy court disagreed with the debtor and denied the confirmation of the amended plan. Further, the court granted the mortgagee relief from the stay under § 363(d)(3)(A) as the case was a single-asset real estate case and the debtor had already filed two unconfirmable plans and more than 90 days had elapsed since the case had been filed. Pursuant to 28 U.S.C. § 158(d)(2)(A), the debtor appealed directly to the Seventh Circuit, which stayed the order for relief pending the determination of the appeal.

The Seventh Circuit affirmed, and held that the risk profile of a lien on a 30-year Treasury bond and a lien on the building were not equivalent and that the secured lender should not be required to accept the substitution of its collateral.[2] Judge Richard Posner, writing for the court, noted that even though a substitution of more valuable, less volatile collateral would be the "indubitable equivalent" of the undersecured creditor's lien, "no rational debtor would propose such a substitution because it would be making a gift to the secured."[3] The court concluded that the only way for a debtor to substitute collateral in such a scenario would be where "the substitute collateral is likely to be worth less than the existing collateral. "[4]Finally, the Seventh Circuit vacated its stay of the bankruptcy court's order granting the mortgagee relief from the automatic stay under § 362(d)(3)(A) and held that the bankruptcy judge did not abuse his discretion by refusing to let the debtor amend its plan a third time after the 90-day deadline had expired.[5]

1. *In re River East Plaza LLC,* 2012 WL 169760 (7th Cir. Jan. 19, 2012).

2. *Id.* *6 (7th Cir. Jan. 19, 2012).

3. *Id.* *5 (7th Cir. Jan. 19, 2012).

4. *Id.* *5 (7th Cir. Jan. 19, 2012).

5. *Id.* *7 (7th Cir. Jan. 19, 2012). However, the Supreme Court has already agreed to review this same bankruptcy case in connection with the debtor's prior plan, which attempted to eliminate the secured creditor's right to credit-bid under § 1129(b)(2)(A)(ii) through the application of the indubitable-equivalent provision of § 1129(b)(2)(A)(iii). The Seventh Circuit did not allow the debtor to avoid the credit-bidding provision of the Bankruptcy Code. *See River Road Hotel Partners LLC v. Amalgamated Bank,* 651 F.3d 642, 645 (7th Cir.2011); *cert. granted*, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* No. 11–166, 2011 WL 3499633 (Dec. 12, 2011).