Benchnotes

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An Atypical Case of Foreclosure Value Exceeding Replacement Value

As the U.S. Supreme Court observed in *Associates Commercial Corp v. Rash*, the "foreclosure-value standard" is "typically lower" than replacement value.[1] However, that was not the case in *In re Sunnyslope Housing Ltd. Partnership*,[2] where the debtor owned and operated a low-income housing apartment complex in Phoenix (Sunnyslope). The debtor confirmed its chapter 11 reorganization plan on the basis that it would continue to operate Sunnyslope as affordable housing. The U.S. Court of Appeals for the Ninth Circuit sitting *en banc* addressed the issue of whether the bankruptcy court erred when it valued Sunnyslope as a low-income tax credit property by applying *Rash*'s replacement-value standard, rather than the greater hypothetical value obtained by foreclosing and eliminating the affordable-housing covenants that were recorded against the property. The Ninth Circuit held that 11 U.S.C. § 506(a) and *Rash* require the use of replacement value when the "proposed disposition or use of such property" continues to be affordable housing under the debtor's chapter 11 reorganization plan.[3]

Sunnyslope was constructed using an $8.5 million loan with an interest rate of 5.35 percent and secured by a first position deed of trust. The loan was guaranteed by the Department of Housing and Urban Development (HUD). Sunnyslope was encumbered by five recorded covenants that ran with the land that would ensure that, absent foreclosure, it would continue to be operated as affordable housing.[4] The covenants ran in favor of, among others, HUD, the city of Phoenix and the state of Arizona through the Department of Housing. After Sunnyslope defaulted on the loan, HUD sold it to First Southern National Bank, but Sunnyslope remained subject to the affordable housing covenants.

First Southern's appraiser valued the property at about $4.9 million (with the rent restrictions in place) and $7.74 million (assuming that the rent restrictions were eliminated in a hypothetical foreclosure). Sunnyslope's appraiser valued the property at $2.6 million (subject to the rent restrictions) and $7 million (if the restrictions were eliminated). Thus, both appraisers agreed that Sunnyslope's unrestricted fair-market value was greater than if it continued to be operated as low-income housing.[5] The bankruptcy court valued Sunnyslope as affordable housing because the debtor's reorganization plan called for its continued use as low-income housing.

In the first appeal to the U.S. District Court for the District of Arizona, the court affirmed the bankruptcy court on the valuation of the real property, although it did remand with instructions to have the bankruptcy court take into account the value of the tax credits; neither the original lender nor First Southern ever asserted a secured interest in the tax credits. After the valuation of the tax credits on remand, in the second appeal on valuation the district court affirmed the bankruptcy court's valuation and the order confirming the debtor's reorganization plan. A divided Ninth Circuit Court of Appeals panel overturned the bankruptcy court's ruling, holding that the court should have valued Sunnyslope without regard to the affordable housing covenants. Rehearing *en banc* was granted.

The Ninth Circuit commenced its analysis with 11 U.S.C. § 506(a)(1) by looking to determine the value of the creditor's claim in the context of a cramdown by examining the "creditor's interest in the estate's interest in [the secured] property."[6] The Ninth Circuit then noted that § 506(a)(1) also requires that the claim be valued in light of the "purpose of the valuation and the proposed disposition or use of such property." Based on its prior precedent in *In re Taffi*, the Ninth Circuit said that it was not interested in hypothetical foreclosure values as the debtor was in bankruptcy and not outside of bankruptcy.[7] In analyzing *Rash*, the Ninth Circuit observed that the Supreme Court emphasized that the cramdown valuation must be "in light of the proposed repayment plan reality: no foreclosure sale."[8]

However, First Southern argued that the property should be valued at its "highest and best use," which assumed no low-income restrictions. The Ninth Circuit rejected this argument, as it ran directly contrary to the plain language of § 506(a)(1). First Southern also tried to distinguish *Rash* by noting that in the instant case, the foreclosure value was greater than the replacement value. The Ninth Circuit concluded that *Rash* acknowledged that this unique scenario might occur. Nonetheless, the Ninth Circuit was not inclined to depart from *Rash* or else it would be forced to assume a foreclosure that is directly contrary to the result avoided by filing the voluntary chapter 11 petition and proposing a reorganization plan that embraces the continued use of Sunnyslope as affordable housing.

The Ninth Circuit's opinion also addresses the "fair and equitable" test, plan feasibility, and the

1 520 U.S. 953, 960 (1997).
2 859 F.3d 637 (9th Cir. 2017).
3 *Rash* at 640.
4 *Id.* at 641.
5 *Id.* at 642.
6 *Id.* at 643.
7 *Id.* (citing 96 F.3d 1190, 1192 (9th Cir. 1996)).
8 *Id.* at 644 (citing 520 U.S. at 963).

§ 1111(b) election. Oral argument and the briefs contain a cogent discussion of equitable mootness. In the end, the Ninth Circuit's *en banc* decision affirmed the confirmation order and left the plan intact. As of this writing, First Southern has asked Justice Anthony Kennedy for a 30-day extension of the deadline to file its petition for *writ of certiorari*.

Miscellaneous

• *In re Gardens Reg'l Hosp. & Med. Ctr. Inc.*, 2017 WL 2080241 (Bankr. C.D. Cal. May 15, 2017) (notwithstanding §§ 363(d)(1) and 541(f) of Bankruptcy Code, which authorize nonprofit entities to sell estate assets only if the sale is in accordance with nonbankruptcy law, court held that debtor was not required to obtain consent of California Attorney General in order to sell hospital that closed post-petition because, upon cessation of operations at hospital, debtor was no longer "health facility" under state law);

• *In re Johnson*, 2017 WL 1740309 (Bankr. D.D.C. May 2, 2017) (bankruptcy court held that debtors who completed their credit counseling one day outside of 180-day pre-petition statutory period were ineligible to file bankruptcy case under § 109(h)(1) regardless of their acknowledged good faith; "This is a harsh result. If, however, the court determines that a debtor is ineligible under § 109(h)(1) to be a debtor under the Bankruptcy Code, the court cannot disregard the statute and is obligated to dismiss the case");

• *In re SunEdison Inc.*, 562 B.R. 243 (Bankr. S.D.N.Y. 2017) (bankruptcy court was presented with application for Bankruptcy Rule 2004 examination of debtor and production of broad range of documents, including electronically stored information; noting that "the cost of compliance with discovery requests has substantially increased over the years," court held that proportionality concept applicable with respect to document requests under Rule 26 of Federal Rules of Civil Procedure is equally applicable for document requests as part of Rule 2004 examination);

• *Lansaw v. Zokaites (In re Lansaw)*, 853 F.3d 657 (3d Cir. 2017) (individual debtors' landlord had locked them out of premises wherein they operated a daycare and threatened them both verbally and physically post-petition; Third Circuit held that damages for emotional distress resulting from willful violation of automatic stay are "actual damages" that are compensable under § 362(k)(1));

• *Peterson v. Imhof*, 2017 WL 1837856 (D.N.J. May 8, 2017) (in opinion deciding number of pretrial issues, district court held that defendants' pre-petition waiver of statute-of-limitations defense was enforceable in bankruptcy; "[W]hile [the] Defendants argue that public policy runs counter to enforcing a waiver of a statute of limitations defense ... so too is there a public policy interest in enforcing [sophisticated] parties' contractual agreements");

• *Sundquist v. Bank of Am. NA*, 566 B.R. 563 (Bankr. E.D. Cal. 2017) (bankruptcy court granted award of $45 million in punitive damages and $1 million in actual damages against Bank of America for willful and repeated violations of automatic stay, including continuing with foreclosure sale post-petition, evicting debtors, and commencing numerous legal and non-legal actions with intent to intimidate debtors over several years; in order to avoid windfall to debtors, court ordered that $40 million of punitive damages be remitted to various consumer bankruptcy advocacy and educational institutions);

• *Combs v. Cordish*, 2017 U.S. App. LEXIS 11931 (8th Cir. July 5, 2017) (chapter 7 debtor was not judicially estopped from pursuing discrimination claims arising from post-bankruptcy events; "[B]ecause those claims were not property of the Chapter 7 estate, neither the bankruptcy court nor the district court [were] misled by Combs' omission of those claims on the bankruptcy schedules, and Combs did not derive an unfair advantage over any opposing party by not listing the claims.");

• *Weil v. Elliott*, 859 F.3d 812 (9th Cir. 2017) (Ninth Circuit held that "[t]he time limit imposed by § 727(e)(1) is not a 'jurisdictional' constraint. It is an ordinary, run-of-the-mill statute of limitations, specifying the time within which a particular type of action must be filed"; thus, court of appeals reversed BAP's decisions and instructed bankruptcy court to reinstate its decision to revoke debtor's discharge, despite untimeliness of initial revocation complaint);

• *In re Ross*, 858 F.3d 779 (3d Cir. 2017) (nothing in Bankruptcy Code or related Bankruptcy Rules restricted bankruptcy court's ability to issue broad injunctions against debtor's ability to re-file, even where debtor sought to dismiss his case voluntarily under § 1307(b); however, circumstances did not justify injunction actually issued in this case because injunction (1) went beyond 180-day bar authorized under § 109(g) for certain bad-faith filers, (2) went beyond relief requested by lender, (3) was broader than injunction issued against debtor's spouse and (4) was not supported by reasonable explanation to justify bankruptcy's exercise of discretion);

• *Chaney v. Grigg (In re Grigg)*, 568 B.R. 498 (Bankr. W.D. Pa. 2017) (after determining creditor's claims to be nondischargeable, bankruptcy court instructed claimant to seek sanctions under 28 U.S.C. § 1927 within "reasonable" amount of time after all appeals had concluded; for reasons that were not well explained to court, creditor delayed in reopening bankruptcy case and moving for sanctions for more than one year after appeals concluded; using timeliness standard under Rule 60(b) and considering all relevant factors, court concluded that motion for sanctions was untimely and denied it as such);

• *In re Coughlin*, 568 B.R. 461 (Bankr. E.D.N.Y. 2017) (While chapter 13 debtor successfully paid pre-petition arrearage through his plan, he failed to make the direct post-petition payments to his mortgage lender, despite plan's requirements for such payments to be maintained "outside of the plan"; court concluded that such direct post-petition payments constituted "payments under the plan" for purposes of § 1328(a), thus nonpayment of such amounts could have prevented debtor from receiving discharge, yet, in light of discharge order being entered without opposition, and relying on *Espinosa*, court found no basis to revoke or withdraw it);

• *In re Estrada*, 568 B.R. 533 (Bankr. C.D. Cal. 2017) (applying *expressio unius* doctrine, court found nothing in § 727(d) that would bar debtor from seeking to vacate his own discharge under Rule 60(b), although there might be strong policy reasons to ensure that debtor is "free from any harassment or pressure to vacate a discharge"; in this case,

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debtor's ineffective chapter 7 counsel, as well as other facts and circumstances, justified order under Rule 60(b)(6) vacating discharge to allow the debtor to convert to chapter 13 and file a 100 percent plan);

• *Seaver v. Glasser (In re Top Hat 430 LLC)*, 568 B.R. 314 (B.A.P. 8th Cir. 2017) (defendant was not an insider for purposes of § 547(b), despite having previously been married to debtor's principal, having three adult children with him prior to their divorce, owning 2 percent of debtor's equity and working for debtor in a non-management role; BAP agreed with bankruptcy court's conclusion that these factors did not support finding of "sufficient closeness to be treated as an insider");

• *In re Motors Liquidation Co.*, 568 B.R. 217 (Bankr. S.D.N.Y. 2017) (on New GM's motion to enforce 2009 sale order against group of Connecticut ignition-switch plaintiffs, court held that such plaintiffs could not proceed on "failure to recall or retrofit" claims based on Old GM's conduct, but that they could proceed in Connecticut District Court on allegations for failure to warn, based on conduct of Old GM and New GM, and failure to recall and retrofit, based solely on New GM's alleged post-closing wrongful conduct; New GM admitted that "failure to warn" claims were expressly assumed under terms of sale and order approving sale; concerning "failure to recall and retrofit" claims, court applied Second Circuit's prior decision and concluded that claims concerning "post-closing accidents involving cars without the Ignition Switch Defect ... are not 'claims' within the meaning of section 101(5) and therefore are outside the scope of the Sale Order");

• *Bank of New York Mellon v. Watt*, 2017 WL 3496034 (9th Cir. Aug. 16, 2017) (holding that appellate court lacked jurisdiction over appeal vacating confirmation of chapter 13 plan as orders reversing confirmation are not final);

• *In re Lopez-Munoz*, 2017 WL 3405059 (1st Cir. Aug. 9, 2017) (court affirmed bankruptcy court's decision not to appoint chapter 11 trustee based on "for-cause" standard; debtor allegedly fraudulently transferred assets pre-petition, and there may have been some errors and omissions on statements and schedules and in debtor's testimony at § 341 meeting of creditors; there was no clear error in denying creditor's motion for alleged conflict of interest that prevented debtor from pursuing turnover claim where bankruptcy court found claim not viable);

• *In re AE Liquidation Inc.*, 2017 WL 3319963 (3d Cir. Aug. 4, 2017) (court held that chapter 7 estate of defunct jet aircraft manufacturer was not liable for Worker Adjustment and Retraining Notification Act claims as mass layoffs were not probable until day they occurred; financing of buyer of debtor's business suddenly fell through and caused sale of debtor's business to fail);

• *Countrywide Home Loans Inc., et al. v. Cowin (In re Cowin)*, 864 F.3d 344 (5th Cir. 2017) (Fifth Circuit affirmed bankruptcy court's findings and conclusions that damages flowing from debtor's scheme to deprive mortgageholders of foreclosure sale proceeds were nondischargeable under 11 U.S.C. § 523(a)(4) and (a)(6); debtor was using tax lien foreclosure sales to strip deed-of-trust liens from real property based on Texas law);

• *In re Partida*, 862 F.3d 909 (9th Cir. 2017) (court held that Mandatory Victims Restitution Act overrode automatic stay and permitted U.S. Department of Justice to collect criminal restitution imposed on debtor; while this was an issue of first impression in Ninth Circuit, this decision was in line with opinions from Sixth and Second Circuits);

• *Consolidated Repair Grp. v. Mainline Equip. Inc. (In re Mainline Equip. Inc.)*, 2017 WL 3223009 (9th Cir. July 31, 2017) (court held that county of Los Angeles could not enforce its tax lien on personal property pursuant to 11 U.S.C. § 542(2); bankruptcy court granted summary judgment to debtor that liens were statutory in nature and had not been perfected against hypothetical *bona fide* purchaser of personal property);

• *SGK Ventures LLC v. Rosenberg, et al. (In re SGK Ventures LLC)*, 2017 WL 2683686 (N.D. Ill. June 20, 2017) (court held that bankruptcy court wrongly permitted equitable subordination and reversed, while affirming bankruptcy court's denial of recharacterization of insider loans to distressed borrower/debtor);

• *Gavilon Grain LLC v. Rice*, 2017 WL 3508721 (E.D. Ark. Aug. 16, 2017) (district court reversed bankruptcy court and held that trustee's contract-based claims against creditor/defendant should be arbitrated, despite creditor having filed proof of claim; after chapter 11 case was converted to chapter 7, trustee sued Gavilon for breach of contract (counts 1 and 2), unjust enrichment (counts 3, 4 and 5) and turnover under § 542 (count 6); Gavilon moved to dismiss and argued, among other things, that pre-petition contracts provided for arbitration and there was a strong public policy favoring arbitration; trustee responded that turnover is core proceeding arising under title 11 and that bankruptcy court has exclusive jurisdiction under 28 U.S.C. § 157(b)(1) and (2)(E); court reasoned, *inter alia*, that turnover powers should be read to avoid Article III entanglements at this stage of litigation; furthermore, court concluded that filing proof of claim did not constitute waiver of right to arbitrate; court ultimately ordered trustee's substantive claims against Gavilon be arbitrated by National Grain and Feed Association with turnover action stayed until arbitration was completed);

• *Price v. DeVos (In re Price)*, 2017 WL 2729073 (Bankr. E.D. Pa. June 23, 2017) (holding that debtor's student loan debt was dischargeable under 11 U.S.C. § 523(a)(8) as she met standards laid out in *Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987), and adopted by Third Circuit); and

• *Anderson v. Rainsdon (In re Anderson)*, 2017 WL 3466591 (B.A.P. 9th Cir. Aug. 11, 2017) (resolving split of two divisions of the Idaho Bankruptcy Court, Ninth Circuit BAP held that contingent right to real estate commission is estate property, even if transaction does not close until after petition date; BAP relied on § 541 and *Jess v. Carey (In re Jess)*, 169 F.3d 1204 (9th Cir. 1999), which "trumps any distinction in state law"). abi