Secured Lenders Take Note! In re Sunnyslope is something you want to know about

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In re Sunnyslope Hous. Ltd. P'ship, 859 F.3d 637 (9th Cir. 2017), as amended (June 23, 2017)("Sunnyslope"), is a noteworthy case for secured lenders. The case involves confirmation of the cram down plan proposed by Sunnyslope Housing Limited Partnership (the "Debtor" or "Sunnyslope") in its Chapter 11 bankruptcy case. The dispute now in the courts concerns what a debtor must pay under a plan if the debtor proposes to keep real property over the objection of a secured lender.

In Sunnyslope, the United States Court of Appeals for the Ninth Circuit, sitting en banc, created a split with the Seventh Circuit and other lower courts in finding that Associates Commercial Corp. v. Rash, 520 U.S. 953, 965, 117 S.Ct. 1879, 1886, 138 L.Ed.2d 148 (1997) ("Rash"), mandated the application of the replacement-value standard. The Supreme Court defined that standard as the amount a willing buyer would pay on the open market for like property.

The Sunnyslope Decision. In Sunnyslope, the secured lender, First Southern National Bank ("FSNB"), argued that the foreclosure value of the property should have been used to determine the amount of its secured claim under §506(a)(1). Before the bankruptcy was filed a state court receiver had obtained a purchase offer that was much higher than the value that the debtor attributed to the property in its plan. The key difference for valuation was that Sunnyslope proposed to continue using the property for low-income housing and valued it that way. FSNB objected, contending that the use restrictions would be divested through foreclosure, thereby enabling the property to be used for a higher and better purpose. The valuation difference was significant. Without use restrictions, the purchase offer was $7.65 million. In its bankruptcy, Sunnyslope proposed a value of $3.9 million because of the use restrictions. The bankruptcy court confirmed the debtor's plan that proposed to pay the secured lender only $3.9 million, with interest at 4% (a lower rate than in the original loan), over 40 years, with a balloon at the end. Through this plan, the lender would recover significantly less that the $7.65 million foreclosure value.

The Split on the Correct Test for Value. Whether a bankruptcy court is required to apply only replacement value is open to debate and academics and judges strongly disagree. Some feel that Rash is limited to Chapter 13 cram down cases and/or to personal property valuation. Rash involved a chapter 13 plan and the proposed retention of a truck, so foreclosure value was significantly lower than replacement value. But other courts have not conceded that Rash applies in Chapter 11 cases or in cases involving real property. For example, in United Air Lines, Inc. v. Reg'l Airports Imp. Corp., 564 F.3d 873 (7th Cir. 2009), in valuing airline terminal gates that the debtor had improved, the Court of Appeals for the Seventh Circuit determined that foreclosure value operates to set a floor on the secured creditor's recovery. That court stated: "[i]f the Lender foreclosed and took over the space, it could rent the gates to United or some other airline at more than $17 a square foot- at perhaps four times that much, to go by prices at the airport's one terminal that leases fully built-out gates." Id. at 876-77.

The Third Circuit Court of Appeals has articulated a somewhat different standard. In In re Heritage Highgate, Inc., 679 F.3d 132 (3d Cir. 2012), the court adopted the replacement value standard identified in Rash, and applied it in a case that involved real property. However, that court equated replacement value with the asset's fair market value, as "most respectful of a property's anticipated use." Id. at 142.

The variation in approaches leads to a lack of uniformity in the bankruptcy process and calls into question what valuation standard applies to confirmation of a cram down plan. When a debtor chooses to retain the collateral rather than to return

it to the secured creditor, the Bankruptcy Code requires the plan to provide the creditor “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.” § 1129(b)(2)(A)(i)(II). Does Rash mandate the use of replacement value even when that valuation method returns less to the secured creditor than it could obtain on its own using its state law rights? Until the Supreme Court decides the issue, debtors and secured creditors are in limbo.

Supreme Court Review. In an effort to have uniformity added to asset valuation in cram downs, as an amicus party, I initiated a brief that has been filed with the United States Supreme Court, asking that Court to accept a writ of certiorari to the Ninth Circuit and decide the question. I have been joined by several academics who specialize in bankruptcy law and other retired bankruptcy judges. The amici take no position on the merits of this question but join together in an effort to have the Supreme Court clarify whether Rash applies to Chapter 11 cases where real property is retained by the debtor.

A copy of our brief can be accessed here Amicus Brief

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