No. 17-455

In The
Supreme Court of the United States

FIRST SOUTHERN NATIONAL BANK,

Petitioner,

v.

SUNNYSLOPE HOUSING LIMITED PARTNERSHIP,

Respondent.

**On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit**

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Does Bankruptcy Code § 506(a) require valuation of collateral:

(a) as used by the debtor in the reorganization plan, when recorded servitudes require such property use and any buyer from the estate would have to comply with the restrictions and accordingly would take them into account in its purchase price; or

(b) from the creditor's perspective of the higher price a buyer might pay after creditor foreclosure, when it is no longer merely collateral and the servitudes are eliminated, but that foreclosure will not take place under the plan?

RULE 29.6 STATEMENT

Sunnyslope Housing Limited Partnership is a limited partnership. No publicly held corporation or entity owns 10% or more of any general or limited partnership interest.

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INTRODUCTION

The *en banc* opinion below correctly held that under Bankruptcy Code § 506(a) and *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), the bankruptcy court properly valued the apartment project owned by respondent Sunnyslope Housing Limited Partnership ("Sunnyslope") as subject to the restrictive covenants running with the land that limit Sunnyslope's interest in the property and obligate it to operate the project as low-income housing. Even though a foreclosure by secured creditor petitioner First Southern National Bank ("First Southern") would eliminate the restrictive covenants and thereby increase the value by allowing a new purchaser from the bank to rent apartments at market rates, § 506(a) requires valuation to be made in light of the *debtor estate's* "actual use" of the property, rather than from the *creditor's* perspective of a "foreclosure sale that will not take place." App.11a–14a; *Rash*, 520 U.S. at 960–62. First Southern asks the Court to construe this as meaning the post-foreclosure resale value the creditor could achieve *or* the replacement value of the property as held by the estate and used under the plan, whichever is higher.

The low-income use restrictions here must be taken into account because they are not simply junior liens that can be ignored in valuing the project. They limit the bankruptcy estate's interest in the property because they are servitudes – binding legal prohibitions on any other use while in the hands of the estate

or any buyer from the estate. The original lender agreed to this when making the loan. Affordable housing is not only the actual use under Sunnyslope's plan, but the only legal use until and unless there is a plan default and First Southern actually forecloses. The bank's doomsday scenarios, and its supposition that affordable housing is a mere use of choice, do not take this uncommon situation into account.

Although First Southern has attempted to manufacture a circuit split, there is none. Both the Ninth Circuit below and the Seventh Circuit in *United Air Lines Inc. v. Regional Airports Improvement Corp.*, 564 F.3d 873 (7th Cir. 2009), determined the market value of collateral based upon what a willing buyer would pay for a replacement of the property as used by the reorganized debtor under its plan. The Seventh Circuit did not apply a hypothetical foreclosure value test.

This case is unusual in other respects that render it inappropriate for this Court's time and attention. First, rarely does foreclosure value exceed replacement fair market value. Still, this Court acknowledged in *Rash* that it may happen, yet held that replacement value is always the test under § 506(a)'s text. There are no other circuit cases in this context.

Second, most secured creditors in First Southern's position would exercise their right to recover as much as they would in a chapter 7 liquidation and to prevent plan confirmation absent such treatment. *See* Pet.7. First Southern now seeks the value it would have

received in a liquidation by virtue of immediate foreclosure, but it waived that right by exercising an alternative right to full payment of the $8.5 million note amount. §§ 1129(a)(7), 1111(b). It later sought to rescind its election, but the bankruptcy court's refusal to allow its untimely change of heart was upheld on appeal and is not at issue here. App.9a. As the Ninth Circuit recognized, had First Southern elected to exercise the right to recover liquidation value instead of treating its entire claim as secured, it had "the ability to prevent approval of the reorganization plan." App.19a.

The result of First Southern's choice is that it will be paid the entire $8.5 million note amount under the plan, making a $3.5 million profit on its $5 million purchase, and its "under-water" deficiency remains secured. The bank would prefer to foreclose and obtain $7.6 million from a collateral resale more quickly, but the Code displaces that right until and unless there is a plan default. Banks invest in long-term receivables, and it has that instead.

Finally, this case is a clumsy vehicle for resolving the question presented because the Court will need to grapple with the issue of equitable mootness, which the Court has repeatedly refused to review. First Southern correctly observes that most plan valuation appeals are dismissed for equitable mootness, and that is precisely what would need to happen here in the event the Court granted the writ.

STATEMENT OF THE CASE

A. The CC&Rs are Integral to the Secured Loan, and Remain Binding.

Sunnyslope's affordable housing project was financed through multiple government loans, with equity owners receiving tax credits for their investment. Critically, the senior secured 40-year "Capstone Loan" later acquired by First Southern was funded by municipal bonds issued by the Phoenix Industrial Development Authority ("IDA") only because of multiple affordable housing restrictions ("CC&Rs") recorded immediately after and in conjunction with the senior deed of trust and State of Arizona and City of Phoenix junior deeds of trust in an integrated, simultaneous transaction. App.5a–6a, 98a–103a; Internal Revenue Code § 142(d). It is undisputed that these CC&Rs run with the land and terminate only upon foreclosure of the Capstone Loan. App.5a–6a, 13a.

Sunnyslope defaulted in the depth of the recession, and HUD repaid the IDA bonds and sold the $8.5 million loan to First Southern for $5.05 million. Pet.6a. The HUD sale conditioned the Capstone Loan sale to First Southern on continued application of the CC&Rs by selling only its right, title and interest, and never causing the CC&Rs to be released. App.13a–14a; *see also* Pet.14 (misleading implication of release).

HUD's sale agreement further provided that the lien on the property was subject to "any applicable bankruptcy, insolvency, reorganization and other laws affecting creditors' rights generally" as well as

"covenants, conditions and restrictions, rights of way, easements and other matters of public record." 103a–104a.

First Southern thus bought the Capstone Loan at a substantial discount, knowing that it would remain subject to the CC&Rs until foreclosure and the risk of a borrower bankruptcy. It bought a lien on property worth less than its foreclosure value for less than its foreclosure value. *See BFP v. Resolution Tr. Corp.*, 511 U.S. 531, 539 (1994) (recognizing that characteristics such as foreclosure-forced sales or undesirable zoning restrictions mean property is "simply *worth* less").

B. First Southern's Valuation Assumes a Foreclosure.

First Southern commenced foreclosure and obtained a receiver. He found a purchaser who agreed to buy the project for $7.65 million after foreclosure. Pet.6a, 105a. Sunnyslope filed a chapter 11 petition, followed by a plan "cramming down" the First Southern secured claim.

In project valuation proceedings, First Southern relied on an appraisal of $7,740,000 based on the "extraordinary assumption" that "upon transfer of title via foreclosure or deed-in-lieu of foreclosure, any restriction requiring that the property continue to be utilized as affordable housing would be extinguished and have no further effect." App.7a, 105a–106a. First Southern's expert thus recognized that the CC&Rs must be extinguished by foreclosure to enable rental at

market rates. App.30a. First Southern initially presented no evidence of project value as restricted by the CC&Rs. Its expert opined on rebuttal to a restricted value of $4,885,000, rejected by the bankruptcy court for lack of supporting facts. App.31a, 69a, 106a–108a, 146a–148a, 166a.

The bankruptcy court valued the CC&R-restricted project plus the tax credits at $3.9 million. First Southern did not dispute that it would cost $3.9 million to acquire a property like the project (including tax credits) with similar CC&Rs. App.12a.

C. First Southern Is Paid in Full Under the Plan.

The Capstone Loan held by First Southern is paid *in full* under Sunnyslope's reorganization plan. The secured claim value is paid in monthly installments with interest over the 40-year period typical of affordable housing financing. The unsecured balance is paid in a lump sum when that period expires pursuant to § 1111(b), according the bank the full benefit of its bargain, as limited by bankruptcy law. First Southern retains its lien until fully paid. The CC&Rs expire at the end of the plan term, or earlier if there is a plan default and foreclosure. App.8a.

On an evidentiary record that included the project useful life exceeding 40 years and sound management and funding, the court found the increased value from the CC&Rs terminating at plan end or upon a default, allowing rentals to increase to market rates, assured

sufficient refinancing or sale proceeds for First Southern's full payment. The bankruptcy court found as a fact that this overcame the risks of continued use during the term and potential plan defaults, especially in light of no contradictory First Southern evidence. App.8a, 16a–17a, 109a–115a, 125a.

D. The Investors Fund the Plan, Equitably Mooting This Appeal.

The district court granted a stay pending appeal of the initial plan confirmation order. App.8a. It then ruled on the merits, affirming the bankruptcy court's determination that the project should be valued as encumbered by the CC&Rs. But the district court agreed with First Southern on a subsidiary argument that First Southern's secured claim should be increased by the value of federal tax credits that benefit equity owners in such a Low Income Housing Tax Credit project, and remanded. App.8a, 70a.

The bankruptcy court conducted an evidentiary hearing and valued the tax credits, bringing First Southern's secured claim to $3.9 million. App.71a–72a. It found that Sunnyslope could manage the increased monthly payments in light of a management fee subordination, so the plan remained feasible and other plan rulings did not need to be changed. It confirmed the plan as modified. App.72a–74a.

First Southern appealed to the district court again, but this time the bankruptcy court and district court denied its stay requests. App.9a. The bankruptcy

court found that reversing plan confirmation to allow First Southern's foreclosure would extinguish the junior claims of the State of Arizona and the City of Phoenix, also harming their interests and tenants' interests in desperately needed affordable housing. The district court reasoned that there were no significant legal issues on which First Southern was likely to prevail, that substantial harm to the debtor and the public interest would result from a stay, and that the bank's injury was monetary, not irreparable. First Southern is a bank, but it did not offer to post a supersedeas bond and it did not seek a stay from the Ninth Circuit.

In reliance on these orders, Cornerstone at Camelback LLC transferred $1.2 million, and the Sunnyslope plan took effect. App.9a. The investment was made under an Internal Revenue Code "1033 exchange" on the deadline to replace previously owned property condemned by the City. App.34a; 26 U.S.C. § 1033. If plan confirmation were to be reversed, Cornerstone (and ultimately its principals) would be subjected to tax liabilities from the condemnation proceeds of more than $1.5 million. App.34a. They would also be subjected to retroactive forfeiture of the tax credits utilized on federal income tax returns. Treas. Reg. § 1.103-8(b)(6). And Cornerstone would be unable to recover the $1.2 million that was paid to third parties, which included plan payments to First Southern and other creditors and taxing authorities, and for a long-term lease of adjacent parkland and capital improvements to it, project improvements, and contractual obligations.

Cornerstone had no prepetition connections with Sunnyslope, and it is not a party to this appeal. Yet First Southern's requested relief would require complete reversal of the entire plan confirmation order and revaluation of the bank's secured claim to the amount it could obtain by selling the property after foreclosing out the CC&Rs.

REASONS TO DENY THE WRIT

I. SECTION 506(a) IS CLEAR AND UNAMBIGUOUS ABOUT THE VALUATION TEST APPLIED IN *RASH* AND FOLLOWED BY THE NINTH CIRCUIT.

Bankruptcy Code § 506(a) provides that a creditor has a "secured claim to the extent of the value of *such creditor's interest* in the *estate's interest* in" collateral and that "[s]uch value shall be determined in light of the purpose of the valuation and of the *proposed disposition or use* of such property." 11 U.S.C. § 506(a) (emphasis added).

A. The Creditor's Interest.

The "creditor's interest" may encompass only some debtor assets, *e.g.*, only accounts receivable, and is a collateral interest only. The "estate's interest" may be limited too, *e.g.*, a life estate, or fee title restricted by easements. *Rash*, 520 U.S. at 961 (court may be required to evaluate "limited or partial interests in collateral").

Rash expressly rejected First Southern's fundamental position, explaining that the statutory term "creditor's interest" is not equated to "the net value a creditor could realize through a foreclosure sale." *Id.*; *see also* App.54a–55a (comparing First Southern's arguments to circuit *Rash* decision overruled by the Court).

B. The Estate's Interest.

In this case, the estate's interest in the project is encumbered by the rent and occupancy restrictions in the CC&Rs. Those CC&Rs were integral to the Capstone Loan, which would not have been funded by the IDA without them. They are subordinate to the Capstone deed of trust, but they are not simply "junior liens" securing monetary obligations. While the "creditor's interest" has priority, that allows First Southern to eliminate the CC&Rs only by foreclosing them out.

Subordination of restrictive covenants does not make them cease to exist. The Sunnyslope CC&Rs are servitudes – recorded covenants that run with the land, binding the estate and its successors – and are enforceable by injunction, absent a foreclosure. *See Powell v. Washburn*, 125 P.3d 373, 375 (Ariz. 2006) (restrictive covenants enforceable by injunction); *Federoff v. Pioneer Title & Tr. Co. of Ariz.*, 803 P.2d 104, 108 (Ariz. 1990) (requirements for covenant running with the land); *Gouveia v. Tazbir*, 37 F.3d 295, 301 (7th Cir. 1994) (trustee cannot sell free of deed restrictions; creditors had constructive notice of restrictions when

extending credit); *In re 523 E. Fifth St. Hous. Preservation Dev. Fund Corp.*, 79 B.R. 568, 571–76 (Bankr. S.D.N.Y. 1987) (same, in affordable housing case); RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 7.9 (2000) (restrictive covenant servitude extinguishable by foreclosure of priority lien, but not extinguishable in bankruptcy unless required by statute).[1] As the Restatement explains:

> A servitude should not be deemed a "lien" within the meaning of [Bankruptcy Code] § 101(37) because the servitude itself imposes the obligation, rather than creating security for performance of an obligation created in some other transaction. Nor is a servitude an executory contract. It is an interest in land, usually of indefinite duration, that is ordinarily enforceable by coercive remedies under [Restatement] § 8.3.

RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 7.9 Reporter's Note.

C. The Proposed Disposition or Use.

Rash held that plan "disposition or use" of collateral "is of paramount importance to the valuation

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[1] Even if servitudes were to be deemed property interests subject to free and clear sales under § 363(f), they cannot be extinguished under a plan because they are not "liens" terminable under a plan sale. 11 U.S.C. § 1129(b)(2)(A)(ii). Nor are they "interests" of "creditors" having monetary "rights to payment," because they are enforceable by state and tenant injunctions. 11 U.S.C. §§ 101(5), (10), 1141(c).

question." 520 U.S. at 962. When, as here, collateral is retained and used, the court determines replacement value as "the price a willing buyer in the debtor's trade, business, or situation would pay a willing seller to obtain property of like age and condition." *Id.* at 959 n.2.

Debtor Sunnyslope's business has always been affordable housing; property of "like" condition is covenant-restricted affordable housing. While a hypothetical post-foreclosure buyer from the creditor need not take that into account, any buyer from the debtor's estate must do so. App.58a. It is the perspective of a buyer from the debtor that governs when, as here, the very purpose of the plan is to prevent a foreclosure sale. The *Rash* majority rejected the dissent's position, precisely what First Southern argues here, "that the value should be determined from the creditor's perspective, *i.e*., what the collateral is worth, on the open market, in the creditor's hands, rather than in the hands of another party." 520 U.S. at 966 (Stevens, J., dissenting). And manifestly, § 506 provides for valuing property as collateral titled in the debtor, not post-foreclosure when owned by the creditor free and clear with a change in permissible use.[2]

Sunnyslope's reorganization plan thus provided for the only legal use that anyone could make of the project, unless surrendered to First Southern for foreclosure. App.12a–13a. It was not a mere choice as First

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[2] The foreclosure sale itself does not determine fair market value. *BFP*, 511 U.S. at 537–38.

Southern argues or idiosyncrasy as the Ninth Circuit dissent characterized it. Pet.18, App.20a n.1.[3]

The language of § 506(a), straightforwardly explained in *Rash* and followed by the *en banc* Ninth Circuit here, does not include First Southern's supposed addition of "or the foreclosure value, whichever is greater" after "proposed disposition or use of such property." Courts do not add language to statutory text. *See Alabama v. North Carolina*, 560 U.S. 330, 352 (2010) ("We do not – we cannot – add provisions to a federal statute."); *Lamie v. U.S. Tr.*, 540 U.S. 526, 538 (2004) ("'There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted.'" (quoting *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978)).

The only material difference between this case and *Rash* is that here the foreclosure value is higher than the replacement value. But *Rash* acknowledged that this would sometimes be the case. *See Rash*, 520 U.S. at 960 (noting that foreclosure value is "*typically* lower" than replacement value (emphasis added)). And *Rash* expressly rejected "a ruleless approach allowing use of different valuation standards based on the facts and circumstances of individual cases." *Id.* at 964 n.5. Cram-down value depends on the estate's proposed use of the estate's interest in the property, certainly when

[3] The *en banc* dissent posited that a conservation-minded debtor might try to impose wilderness restrictions to prevent development, but in this case, the CC&Rs were integral to funding the Capstone Loan and in effect when First Southern bought it.

it is the only legal use, not which calculation will produce the highest dollar figure.

II. THERE IS NO SPLIT OF AUTHORITY; *UNITED AIR LINES* AND THE NINTH CIRCUIT PROPERLY APPLIED *RASH*.

The Ninth Circuit's *en banc* opinion and the Seventh Circuit's *United Air Lines* opinion properly applied *Rash* to very different issues. There is no reason to expect that the Seventh Circuit would reach a different result than the Ninth Circuit on the same or similar facts. First Southern's supposed conflict is fabricated.

United Air Lines concerned improved property collateral: terminal gates at Los Angeles International Airport. 564 F.3d at 875. In attempting to value the collateral, the bankruptcy court had applied a discount rate to the annual rent that United paid to the airport. *Id.* at 876. But that rent was for unimproved space; the airport had agreed not to charge rent for the improvements because the airline had paid for their installation. *Id.* The bankruptcy court's valuation method did not value the lenders' actual collateral – improved space. *Id.*

The "disposition or use" of the property under United's plan was not an issue in *United Air Lines*. Rather, the issue was whether bankruptcy court accounted for the value of improved, in-use space. *See id.* at 876 ("A price for unimproved space does not measure the value of the collateral."); *id.* at 877 ("Any

valuation method that treats improvements as worthless can't be appropriate.").

The court noted that if the lenders foreclosed, they "could rent the gates to United or some other airline" at a higher rate than United paid to the airport. 564 F.3d at 876–77. But that was merely illustrative of the point that the *market price* of fully built-out gates must be ascertained, and was dictum irrelevant to the holding. The court's analysis focused on the price paid by other airlines for other LAX improved terminal gates, evidencing "the price that could be agreed by willing buyers and sellers negotiating for a replacement." *Id.* at 875 (citing *Rash*), 876–79. In *United Air Lines*, the property would have merely changed owners, not usage, after a foreclosure. The court never analyzed potential post-foreclosure alternative use, *e.g.*, for post-foreclosure newly authorized luxury private jets, but only the market value of improved gates leased to a commercial airline like United.

The Seventh Circuit did not hold, as First Southern contends, that "a bankruptcy court may not value the collateral based on the debtor's proposed use if that use would result in a value *less* than what the creditor could obtain in foreclosure." Pet.16. Nor did the court say that "proper valuation under § 506(a) could be no less than the actual value the secured creditor could obtain in foreclosure." Pet.17. *United Air Lines* has only been cited eight times in the eight years since it was decided, and never for the proposition for which First Southern cites it.

First Southern argues that the Ninth Circuit was wrong because it chose the lower value and that the Seventh Circuit was right because it chose the higher value. But neither court's decision was based on the dollar figure. The statutory language and *Rash* apply uniformly, whatever the numbers may be.

Winthrop does not create a circuit split over *Rash* because it was a pre-*Rash* case. *In re Winthrop Old Farm Nurseries*, 50 F.3d 72, 74 (1st Cir. 1995). Presaging *Rash*, *Winthrop* expressly refused to interpret § 506(a) as requiring collateral valuation of "the net amount a secured creditor could recover if it seized or foreclosed on the collateral and disposed of it in accordance with applicable state law." *Id.* at 74–75. And the *Winthrop* parties stipulated to liquidation and fair market value amounts, with no discussion of calculating liquidation value. *Id*. at 72.

In re Heritage Highgate never "equated [replacement value] with the asset's foreclosure value" or set foreclosure value as a "floor," as the academic amici claim. Law Professors' Br. at 5–6. Rather, the court refused to value collateral based on hypothetical projections of future value recovery, as the creditor sought. 679 F.3d 132, 142–43 (3d Cir. 2012). And the two bankruptcy cases those amici cite as holding *Rash* inapplicable in chapter 11 cases likewise do no such thing. They only distinguish *Rash* in the indubitable equivalence "dirt-for-debt" cram-down context where partial collateral is surrendered to the secured creditor – an alternative *Rash* did not address. *In re Sugarleaf Timber, LLC*, 529 B.R. 317, 32n n.14 (M.D. Fla. 2015); *In re*

Bate Land & Timber, LLC, 523 B.R. 483, 500 n.15 (Bankr. E.D.N.C. 2015). There is no need to "clarify" that *Rash* applies in chapter 11 because the amici's cited cases show no such dispute. Potential inapplicability of *Rash* in chapter 11 cases is also a new argument not raised in the petition. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 97 n.4 (1991) ("[W]e do not ordinarily address issues raised only by *amici*. . . .").

None of the lower court cases cited by First Southern justify this Court's review at this time. Three are pre-*Rash*.[4] Only one concerns a difference between foreclosure value and market value as used by the debtor. In that chapter 13 case, a bankruptcy court held that a creditor secured by a mobile home was not entitled to the value of a carport and patio on which it did not have a lien, even though under state foreclosure law it might be able to sell the mobile home "in place" and a buyer would value the right to lease space with those improvements. *In re Young*, 367 B.R. 183 (Bankr. N.D. Cal. 2007). The other cases are chapter 12 and 13 bankruptcies where courts alternatively did and did not value property based on actual use or a more lucrative use that the court found was or was not true replacement value for fact-intensive reasons.[5]

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[4] *Speck v. United States*, 104 B.R. 1021 (D.S.D. 1989); *In re Sherman*, 157 B.R. 987 (Bankr. E.D. Tex. 1993); *In re Ehrich*, 109 B.R. 390 (Bankr. D.S.D. 1989).

[5] *In re Donato*, 253 B.R. 151 (M.D. Pa. 2000); *In re McElwee*, 449 B.R. 669 (Bankr. M.D. Pa. 2011); *In re Bishop*, 339 B.R. 595 (Bankr. D. S.C. 2005); *In re Bell*, 304 B.R. 878 (Bankr. N.D. Ind. 2003).

III. THE ISSUE PRESENTED IS UNLIKELY TO RECUR, MUCH LESS CAUSE THE CATASTROPHE FORECAST BY FIRST SOUTHERN AND ITS AMICI.

This case presents the unique circumstance where foreclosure value would be *higher* than the existing use of the property due to legal restrictions on use by the estate and any buyer from the estate. The facts are so uncommon that counsel has not found a single other reported case like it, and First Southern has cited none. There has been no debate among the courts of appeals (or any other courts) on the issue, even though *Rash* was decided 20 years ago. *See U.S. Bancorp Mortg. Co. v. Bonner Mall P'ship*, 513 U.S. 18, 27 (1994) ("[D]ebate *among* the courts of appeals sufficiently illuminates the questions that come before us for review."). Without such consideration, this Court's intervention would be premature. *See Bank of Am. Nat'l Tr. & Savings Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 443 (1999) (granting certiorari once clear circuit split had developed). *Sunnyslope* by no means raises an issue where national uniformity is at stake, especially when binding legal restrictions mandating a less profitable use are taken into account.

Second, this case is unique because First Southern waived the protections that Bankruptcy Code § 1129(a)(7)(A) provides creditors through the "best interest of creditors test" – something most creditors would not do. Under that test, creditors are entitled to receive at least as much as they would "receive or

retain if the debtor were liquidated" in a chapter 7 case. § 1129(a)(7)(A).[6]

First Southern is vigorously arguing here that it should get its liquidation value, *i.e.*, what it would get by a resale were it able to foreclose. But First Southern waived that right by choosing to exercise its rights under § 1111(b) instead. When a secured creditor exercises its option under § 1111(b) to have its collateral continue to secure the entire amount of its debt and be paid the entire amount, it waives its unsecured deficiency claim. 7 *Collier on Bankruptcy* ¶ 111.03[5], at 111–29 (16th ed. 2017). Thus, the liquidation value test no longer applies, and instead the court need only find that the present value of deferred payments equals the secured creditor's interest in its collateral, *i.e*. the deferred payment cram-down test. §§ 1129(a)(7)(B), 1129(b)(2)(A)(i)(II); *Dewsnup v. Timm*, 502 U.S. 410, 430 n.3 (1992).

In other words, § 1129(a)(7)(B) "in effect exempts secured creditors making an election under section 1111(b)(2) from application of the best interest of creditors test." H.R. Rep. No. 95-595, 1978 U.S.C.C.A.N.

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[6] One bankruptcy case has held that the liquidation value measures what a creditor would receive or retain from a chapter 7 trustee, not what it might realize from other sources. *In re Dow Corning Corp.*, 237 B.R. 380, 411 (Bankr. E.D. Mich. 1999). But no court has applied that to the foreclosure value of collateral. In a chapter 7 case, a trustee would abandon estate assets with no equity value for unsecured creditors, enabling the secured creditor to foreclose. *See Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 499, 508–09 (1986) (Rehnquist, J., dissenting) (describing abandonment provision).

5963, 6477 (1977). As the Ninth Circuit recognized, First Southern could have, but did not, utilize its "ability to prevent approval of the reorganization plan." App.19a. Most creditors in the bank's position would have exercised that right, and defeated plan confirmation.

Third, First Southern inaccurately forecasts the risks of a creditor receiving less upon a plan default than it would in foreclosure under the Ninth Circuit's holding. The Court recognized in *Rash* that cram-downs pose the risk for creditors that the debtor may again default and the property may deteriorate from extended use. *Rash*, 520 U.S. at 962. In this unusual case, however, that risk is reduced for the very reason that foreclosure value is higher: If and when there is a plan default, the value will increase with post-foreclosure market rental rates and the sale price will concomitantly increase. App.8a. Moreover, as Justice Scalia explained in *Till v. SCS Credit Corp.*, "[i]f Congress wanted to compensate secured creditors for the risk of a plan failure, it would not have done so by prescribing a particular method of valuing collateral." 541 U.S. 465, 507 (2004) (Scalia, J., dissenting). *Rash* adopted the replacement value standard because of § 506(a)'s text, not to compensate for increased risk.

Finally, it is most unlikely that the Ninth Circuit's holding will adversely affect the development of low-income multi-family housing in the United States or the credit markets for distressed HUD-guaranteed loans as First Southern and its bank association amici posit. It has been a federal priority to "assist private

industry in providing housing for low and moderate income families and displaced families," since enactment of the National Housing Act of 1961, 12 U.S.C. § 1715*l*(a), long before HUD began selling distressed loans in 2010. *See* Laurie Goodman & Dan Magdar, *Selling HUD's Nonperforming Loans: A Win-Win for Borrowers, Investors, and HUD*, The Urban Institute (Jan. 2016) (explaining that HUD began selling nonperforming loans insured by the Federal Housing Administration in 2010).

HUD's ability to sell a defaulted loan in the event its mortgage guarantee is triggered is irrelevant for purposes of issuing such guarantees. Instead, Congress mandated only that HUD ensure, through agreement or regulation, that the project be used for affordable housing. 12 U.S.C. §§ 1715*l*(b), 1715*l*(d)(3)(iii).

The availability of HUD-insured loans under the National Housing Act of 1961, together with the availability of the Low-Income Housing Tax Credit under the Tax Reform Act of 1986, 26 U.S.C. § 42, is what drives development of low-income multi-family housing projects in the United States, not the market for distressed HUD loans. *See* Office of the Comptroller of the Currency, *Low-Income Tax Credits: Affordable Housing Investment Opportunities for Banks*, Community Developments – Insights (April 2014) (explaining that "[t]he Low-Income Housing Tax Credit (LIHTC) is the federal government's primary program for encouraging the investment of private equity in the development of affordable rental housing for low-income households").

And if HUD is concerned that a particular borrower might file bankruptcy and that this would actually impact the resale value of a defaulted loan, HUD can itself foreclose and then sell the property instead of the loan. The bankruptcy automatic stay does not apply to HUD's foreclosure of HUD-insured loans for multi-family housing projects. § 362(b)(8). The notions that HUD would elevate a possible impact on purchase prices for post-foreclosure note sales over its statutory mandate to further affordable housing, and that HUD multi-family home loan sales will be depressed because of the Ninth Circuit decision, are nothing but unsupported speculation.

IV. *RASH* AND *SUNNYSLOPE* ARE IN ACCORD WITH FUNDAMENTAL BANKRUPTCY PRINCIPLES.

The Bankruptcy Code was drafted to enable reorganization and maximization of value to all parties in interest – not just creditors, let alone the largest ones. *See Toibb v. Radloff*, 501 U.S. 157, 163 (1991) ("Chapter 11 also embodies the general Code policy of maximizing the value of the bankruptcy estate."); *Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 51 (2008) ("Chapter 11 strikes a balance between a debtor's interest in reorganizing and restructuring its debts and the creditors' interest in maximizing the value of the bankruptcy estate."); *Pioneer Inv. Servs., Co. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 389 (1993) ("[T]he bankruptcy courts are necessarily entrusted with broad equitable powers to balance the

interests of the affected parties, guided by the overriding goal of ensuring the success of the reorganization.”).

First Southern was Sunnyslope’s largest creditor, but not the only one deserving of protection. In addition to trade creditors, the City of Phoenix and the State of Arizona held claims exceeding $3.5 million, as well as interests in providing affordable housing and tenant rights.

The bankruptcy court found that Sunnyslope’s business operations were viable and that it could feasibly pay its debts under the plan. As a result, Sunnyslope was able to continue its business of providing affordable housing, and new equity invested significant capital. Consistent with the Code’s purpose, the plan thereby maximized value for all parties in interest, including unsecured and subordinate lien creditors. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (“The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources. In some cases reorganization may succeed only if new creditors infuse the ailing firm with additional capital.” (citation omitted)).

While enabling reorganizations, the Code provides specific protections for secured creditors; these do not, as First Southern argues, Pet.24, include requiring a debtor to consent to foreclosure just to maximize the return to a single creditor at the expense of all others and the estate. There is no unconstitutional taking

when a creditor's claim is satisfied in accordance with Code-authorized cram-down treatment that was in effect when the loan was made. *In re Thompson*, 867 F.2d 416, 422 (7th Cir. 1989).[7]

A. Adequate Protection When a Chapter 11 Case is Filed.

Secured creditor rights at the inception of a chapter 11 case focus primarily on the automatic stay, which prevents collateral foreclosure. A secured creditor is entitled to "adequate protection" when foreclosure is blocked and collateral use is allowed, but that only protects against any decrease during the bankruptcy case "in the value of [the secured creditor's] interest in such property." § 361(1),(2),(3).

The meaning of that phrase was elucidated in *Timbers*, where this Court agreed with the Fifth Circuit that a bankruptcy court erred by calculating adequate protection payments "on the estimated amount realizable on foreclosure." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 369 (1988). It held that a secured creditor's § 506(a)

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[7] The petition misleadingly suggests the Frazier-Lemke Act shows the Takings Clause is a problem. Pet.28–29. The Court unanimously upheld a modified version of the Frazier-Lemke Act because it adequately preserved three rights of secured creditors: (1) the right to retain the lien until the secured indebtedness is paid; (2) the right to realize on the security by a judicial public sale after obtaining stay relief; and (3) the right to bid in secured debt at a collateral sale. *Wright v. Vinton Branch of the Mountain Tr. Bank*, 300 U.S. 440, 458–59 (1937).

" 'interest in property' obviously means his security interest without taking account of his right to immediate possession of the collateral on default." *Id.* at 372. And *Timbers* noted that before the current Bankruptcy Code, an "undersecured creditor had no absolute entitlement to foreclosure" in a reorganization case. *Id.* at 380–81.

Resolving a circuit split, *Timbers* overruled *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984), which had held that a secured creditor's right to take possession of and sell collateral on the debtor's default was a state law "interest in property" that the court had to protect in a bankruptcy case. *Id.* at 435. Notably, *American Mariner* reasoned from the case touted as "foundational" by First Southern for the principle that secured creditors are entitled to the indubitable equivalence of their foreclosure rights, *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935). *See* 734 F.2d at 432–33. And this Court in *Timbers* rejected the notion that *Murel Holding* means more than that a secured creditor is entitled to the present value of its collateral under a plan. 484 U.S. at 379.

B. Secured Creditor Reorganization Plan Protections.

At the end of a reorganization case, the Code again specifies secured creditor protections. In addition to assurance of the liquidation value that a creditor would receive in a chapter 7 – waived here by First Southern – plan treatment can be forced, or "crammed down,"

only when one of three alternative tests is met. But that does not mean that creditors are entitled to recover their collateral foreclosure value. As *Rash* explained, "[t]he Code's cram down option displaces a secured creditor's state-law right to obtain immediate foreclosure upon a debtor's default." 520 U.S. at 964.

Sunnyslope's plan utilized the first method, deferred cash payments to the secured creditor retaining its lien, with sufficient interest to result in receiving the present value of the secured claim as of the effective date. § 1129(b)(2)(A)(i). Collateral alternatively could be sold with the secured creditor receiving sale proceeds, but subject to credit bidding rights, and capped at the loan balance (not a higher amount the creditor might obtain from a post-foreclosure resale). § 1129(b)(2)(A)(ii). Or the secured creditor could realize the "indubitable equivalent" of its secured claim. § 1129(b)(2)(A)(iii). While First Southern argues for entitlement to the indubitable equivalent of a foreclosure sale, *RadLAX* explained that clause (iii) indubitable equivalence is inapplicable when another alternative is met. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 647–48 and n.4 (2012).

Congress' comprehensive bankruptcy scheme deliberately addressed the risk of collateral undervaluation by the bankruptcy court in a deferred payment cram-down with a specific solution: the right to elect § 1111(b) treatment. Upon such an election, the lien secures the full amount of the allowed claim, including the portion held by the court to be unsecured,

and the full amount must be paid by the end of the plan term. First Southern exercised that right, and will receive over time the full Capstone Note amount – more than its perceived foreclosure value.

First Southern and its amici have cobbled together snippets of language from cases to compile a supposed principle that a secured creditor must receive from a bankruptcy estate at least the amount for which it can resell the collateral after foreclosure. But they have cited no Code language or case actually holding this. And they have no explanation why the Code provisions protecting secured creditors from perceived collateral undervaluation – the liquidation value test that First Southern waived and the § 1111(b) election it utilized – are not the means Congress provided to protect secured creditors in this context.

V. THIS CASE IS BURDENED BY EQUITABLE MOOTNESS, WHICH THE COURT HAS REPEATEDLY DECLINED TO REVIEW.

The relief First Southern seeks would effectively double Sunnyslope's largest payment obligation under the plan, and would do so at the expense of all other parties in interest. Granting that relief would eviscerate the already-consummated plan, with disastrous effects on all other parties in interest who relied on the plan's implementation in structuring their business operations and making post-confirmation capital investments. First Southern could have avoided the

potential for such disruption – and thus presented a cleaner vehicle for certiorari – had it posted a supersedeas bond, easily affordable for the bank, and stayed confirmation. Instead, First Southern only sought a free stay, and stopped asking once the district court rejected the request in light of its ruling against the bank on the merits.

As a result of First Southern's failure to stay confirmation, this Court could not grant relief without addressing the doctrine of equitable mootness, *i.e.*, whether *effective* relief and "unscrambling the egg" is possible for the already-consummated plan. Yet the Court has repeatedly declined to address equitable mootness, and this case presents no better opportunity to do so. *See In re One2One Commc'ns, LLC*, 805 F.3d 428, 448 (3d Cir. 2015) (Krause, J., concurring) (observing that this Court has declined to grant numerous petitions for certiorari presenting the question); *see also Aurelius Capital Mgmt., L.P. v. Tribune Media Co.*, 136 S. Ct. 1459 (2016). It has not been the subject of robust debate in the court of appeals, so it is "not surprising that [this Court] had denied those petitions." *In re One2One*, 805 F.3d at 448 n.18 (Krause, J., concurring). The Court has denied certiorari on equitable mootness even when the United States requested review. *See id.* at 448 (citing Petition for a Writ of Certiorari, *United States v. GWI PCS 1, Inc.*, 533 U.S. 964 (2001)).

But if the Court grants the writ here, equitable mootness is front and center. First Southern has not disputed that granting the relief it seeks would undo the plan – forcing the Court to address whether it

would accept such a drastic outcome for all parties in interest (including those not parties to this appeal) in order to satisfy a single creditor.

The inability to grant effective relief that undergirds equitable mootness mirrors that aspect of the "case or controversy" mootness doctrine. *See Church of Scientology of Cal. v. United States*, 506 U.S. 9, 12 (1992) ("[I]f an event occurs while a case is pending on appeal that makes it impossible for the court to grant any effectual relief whatever to a prevailing party, the appeal must be dismissed." (internal quotation marks omitted)). The Court denies review when, despite the parties remaining before the Court, it cannot realistically undo the action at issue which has irretrievably occurred. *See Brockington v. Rhodes*, 396 U.S. 41, 43 (1969) (holding that candidate's appeal from order denying writ of mandamus to appear on ballot for 1968 election was moot once that election occurred); *Hall v. Beals*, 396 U.S. 45, 48 (1969) ("The 1968 election is history, and it is now impossible to grant the appellants the relief they sought in the district court."); *see also N.J. Tpk. Auth. v. Jersey Cent. Power & Light*, 772 F.2d 25, 27 (3d Cir. 1985) (finding mootness where "the acts sought to be enjoined have irretrievably occurred").

The same principles apply when transactions under a confirmed reorganization plan have been substantially consummated, and appellate courts lack the ability to grant *effective relief* without undoing the plan. *See, e.g.*, *In re Nica Holdings, Inc.*, 810 F.3d 781, 786 (11th Cir. 2015) (equitable mootness when appellate court cannot grant effective judicial relief); *In re*

Manges, 29 F.3d 1034, 1039 (5th Cir. 1994) (equitable mootness "is a recognition by the appellate courts that there is a point beyond which they cannot order fundamental changes in reorganization actions," and equitably moot cases are dismissed because "effective judicial relief is no longer available."); *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (noting that "[u]ndoing all of [the plan transactions] is impossible" and holding that an appeal must be dismissed); *In re Chateaugay Corp.*, 10 F.3d 944, 952 (2d Cir. 1993) ("[T]he finality rule limits the remedies a court can offer." (internal quotation marks omitted)). As with Article III mootness, the thing to be undone has, for all practical purposes, already happened. Parties to the plan, including non-parties on appeal, have relied on confirmation order finality and the absence of a stay, resulting in consummated reorganization transactions that cannot be "unscrambled."

While entitlement to rely on judgment finality is a basic legal concept in any case, it is especially apt in bankruptcy for two reasons. If any of the multiple parties to a bankruptcy plan could force alteration of plan settlements years later, the disincentives to resolve differences and the leverage gained from threats to disrupt consummated transactions would imperil organizations overall. "Every incremental risk of revision on appeal puts a cloud over the plan of reorganization, and derivatively over the assets of the reorganized firm." *UNR Indus.*, 20 F.3d at 770. And second, "[b]y protecting the interests of persons who acquire assets in reliance on a plan of reorganization,

a court increases the price the estate can realize *ex ante*, and thus produces benefits for creditors in the aggregate." *Id.* "People pay less for assets that may be snatched back or otherwise affected by subsequent events." *Id.*

That includes investment in a restructured company as well as the purchase of its assets. "One reason some third parties have reliance interests more worthy of protection than others is that we want to encourage behavior (like investment in a reorganized entity) that contributes to a successful reorganization." *In re Tribune Media Co.*, 799 F.3d 272, 279 (3d Cir. 2015).

Here, an investor contributed $1.2 million to fund the plan. That money has been used by Sunnyslope to pay creditors and taxing authorities, make capital improvements, implement contracts, and acquire a park lease. The money simply cannot be recovered. The investor's equity holders will also face IRC § 1033 tax consequences costing them $1.5 million if the plan is undone, as well as losing affordable housing tax credits, potentially even retroactively.

In addition to the investor, the City of Phoenix and State of Arizona will be adversely affected if the plan protecting payment of their claims and their interest in local affordable housing is extinguished by an appellate reversal. Post-closing contracts and expenditures cannot be rescinded, and individuals and governments will be irreparably damaged by reversal now.

A case where the appealing creditor posted a bond and stayed confirmation would present none of these

hurdles to resolving the merits. This case therefore does not present a clean vehicle for the Court to resolve a circuit split even if there was one.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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