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Killing Two Birds with One Stone

BAP Denies Novel Attempt for § 364(d) Exit Financing in SARE Case, Rules Stay Relief Should Have Been Granted

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Bankruptcy professionals are no doubt familiar with the general structure of chapter 11, the mechanisms provided in the Bankruptcy Code for a debtor in possession (DIP) to obtain financing in a chapter 11 case and the standards for confirmation of a chapter 11 plan. Chapter 11 was enacted in large part to promote the policy of helping troubled businesses reorganize rather than liquidate and, as a result, affords significant latitude for creativity within certain bounds.

To that end, the Code provides several advantages and incentives for lenders willing to finance a debtor's operations during the pendency of a bankruptcy case, often giving those lenders rights that would not ordinarily be available to them in a nonbankruptcy setting. Among those provisions, § 364(d) allows a debtor to grant a lender senior "priming" liens on property of the debtor's estate to secure post-petition financing if the debtor can establish, among other things, that it has provided adequate protection to existing lienholders. However, when a debtor proposes a plan to exit bankruptcy as an operating entity with financing in place, those special advantages provided for DIP financing are not available, and a reorganized debtor must operate under normal nonbankruptcy laws at that point.

Faced with a near impossibility of obtaining the post-confirmation exit financing necessary to fund operations, debtors in a single-asset real estate (SARE) case recently attempted a novel approach to entice an exit lender to extend financing. In conjunction with a proposed reorganization plan, the debtors sought to apply the priming provisions of § 364(d) (typically used to secure financing during a bankruptcy case) to the proposed exit financing needed to fund the reorganized debtors after confirmation.

The debtors filed a separate financing motion (prior to confirmation) asking for court approval of the proposed loan and of the grant to the exit lender of priming liens on the debtors' real estate under § 364(d)(1). The existing secured creditor objected to the financing and filed its own motion for relief from the automatic stay. The bankruptcy court deferred ruling on the § 364 financing motion while denying the stay-relief motion. On appeal to the Tenth Circuit Bankruptcy Appellate Panel (BAP) in *In re Aspen Club & Spa LLC*,[1] the appellate court reversed the bankruptcy court, holding that the benefits of DIP financing afforded under § 364 are not available after confirmation. Without that financing, the proposed plan could not be confirmed, which therefore mandated that stay relief should have been granted. The BAP's opinion provides instructive analysis of both § 364's financing provisions and motions for relief from stay in SARE cases under § 363(d)(3).

Background

Aspen Club & Spa LLC and Aspen Redevelopment Co. LLC (collectively, the "debtors") filed separate chapter 11 petitions on May 16, 2019, in the U.S. Bankruptcy Court for the District of Colorado. Shortly thereafter, the bankruptcy court entered an order determining that the debtors were subject to the SARE provisions of the Bankruptcy Code. At the time of filing, the debtors were in the process of developing luxury condominiums, employee housing units, and a fitness club and spa (the "property").

The construction and development plans required investment from several pre-petition creditors. FirstBank was among the initial investor group,

1 CO-19-043, 2020 WL 4251761 (B.A.P. 10th Cir. July 24, 2020).

agreeing to provide $45 million in financing. After providing $30 million, FirstBank refused to extend additional funding, which led to a lack of additional investment in the development and eventually resulted in the halting of construction (among other issues). Subsequently, an entity called GPIF Aspen Club LLC acquired FirstBank's interest in its loan, which was secured by the property.

The debtors filed a joint reorganization plan on Sept. 13, 2019, which provided that all property of the estate would vest in the "reorganized debtors" and included both Aspen Club and Aspen Redevelopment. The plan provided for priming exit financing secured by a lien against all property of the estate, senior to all liens other than allowed mechanic's liens. A few days later, the debtors filed a motion to approve that proposed exit financing pursuant to § 364(d), seeking court approval of a $140 million loan that would prime GPIF's lien pursuant to § 364(d)(1). In response, GPIF filed a motion for relief from the automatic stay under the SARE provisions of § 362(d)(3), alleging that the debtors' plan was patently unconfirmable because it was predicated on court approval of a nonconsensual priming lien, which could not be approved by the bankruptcy court or under state law.

After holding hearings on the debtors' exit-financing motion and GPIF's stay-relief motion, the bankruptcy court acknowledged that whether the debtors' exit financing could be approved was a threshold issue (because confirmation was impossible without the financing), but ultimately ruled that in the absence of controlling case law, the debtors were not, "as a matter of law, precluded from seeking an exit financing facility on a first-priority priming lien senior to pre-existing liens on property of the estate pursuant to 11 U.S.C. § 364(d)(1)."[2] The bankruptcy court denied the stay-relief motion without a final ruling on the exit-financing motion, primarily on the basis that there was equity in the property. In so ruling, the bankruptcy court skirted the issue presented by § 362(d)(3) of whether the debtors' plan had "a reasonable possibility of being confirmed within a reasonable time," because it had deferred its ruling on the financing motion.

Appeal to the BAP

On appeal, the BAP first addressed whether the bankruptcy court used the proper standard in denying relief from stay. GPIF sought relief under § 362(d)(3), which provides that a creditor with a secured interest in "single-asset real estate" is entitled to relief from stay unless the debtor, within 90 days of entry of the order for relief, either files a plan with a "reasonable possibility" of confirmation, or commences monthly payments to the creditor in the amount of the applicable non-default contract interest rate. The record was undisputed that GPIF did not receive any payments from the debtors, so the appeals court found that the bankruptcy court was required to determine whether the plan had a "reasonable possibility" of being confirmed within a reasonable time.

In the stay-relief motion, GPIF contended that the debtors' plan did not have a reasonable possibility of being confirmed, as it required the approval of a priming lien exit facility that could not be approved under the Bankruptcy Code or state law. However, as the appeals court noted, the bankruptcy court failed to address whether the exit financing could be approved, instead focusing on whether there was any equity in the property. The appeals court found that this omission constituted a reversible error, because a determination under § 362(d)(3) requires addressing evidence that the debtor has a reasonable possibility of confirming a plan within a reasonable time. The bankruptcy court's failure to address the exit financing, without which the debtors' plan could not possibly be approved, meant that the bankruptcy court did not properly apply the SARE standard under § 362(d)(3), and therefore had abused its discretion in denying the stay-relief motion.[3]

Exit Financing Under § 364

The appeals court held, for the first time on appeal, that post-confirmation exit financing is unavailable under § 364(d)(1) because estate property vests in the reorganized debtor upon confirmation, and § 364(d)(1) applies only to trustees and DIPs — not reorganized debtors. In the first instance, the BAP noted that § 364 permits a *trustee* (which, pursuant to § 1107(a), includes the DIP) to obtain credit secured by *property of the estate*. Given the structure of § 364, the prospect of the reorganized debtors executing the loan documents and receiving funds was impossible, as the DIP ceases to exist after confirmation and there is no longer any property of the estate, thus rendering § 364 inapplicable.

The BAP acknowledged that the second approach — by which the liens would be recorded before confirmation — was less clear. However, the court noted that the text of § 364 indicated that it might not be relied upon for exit financing for two main reasons. First, the court noted that the provisions of § 364 clearly provide for a mechanism by which a *trustee or DIP* could fund the cost of administering a bankruptcy case — not post-confirmation operations after the property of the estate has vested in the reorganized debtor. Second, the court found that § 364(a) provided for administrative-expense priority as an inducement to be offered by the DIP to attract credit. Such administrative expense status is granted under § 503(b)(1) of the Bankruptcy Code only for costs of preserving the bankruptcy estate, not for the costs of a reorganized debtor.[4] Furthermore, the court noted that § 1129 required all administrative expenses to be paid in full on the plan's effective date; thus, such treatment would clearly conflict with the use of funds for post-confirmation expenses, as it would make the exit financing due in full on the plan's effective date.

The BAP observed that §§ 1123 and 1129 allow a plan to alter the priority of a non-accepting secured creditor's lien as long as the plan proponent can demonstrate that the creditor will realize the indubitable equivalent of its claim.[5] However, determination of the indubitable equivalent would require a court to make a finding as to value of the property for purposes of the exit-financing motion and plan confirmation.

2 *Id.* at *4.

3 *Id.* at *7.

4 "If the trustee is authorized to operate the business of the debtor under section 721, 1108, 1183, 1184, 1203, 1204, or 1304 of this title, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense." 11 U.S.C. § 364(a).

5 11 U.S.C. § 1129(b)(2)(A)(iii).

The bankruptcy court had only made a finding of value for purposes of the stay-relief motion, which is not binding for plan purposes.

Accordingly, the BAP reversed the bankruptcy court and remanded the case to the bankruptcy court to make findings of fact as to whether there was a reasonable possibility that the plan provided the secured creditor with the "indubitable equivalent of its claims," such that the plan could be confirmed in a reasonable time. As a practical matter, given the bankruptcy court's finding of value made in connection with the stay-relief motion, it was highly unlikely that the § 1129 "indubitable equivalent" standard could be met.[6]

Analysis

Aspen Club presented a case of a highly distressed debtor with few viable options for reorganization proposing a creative procedural maneuver to try to finance an "underwater" real estate project by enticing a new lender with a priming senior lien. While neither the bankruptcy court nor BAP reached the factual merits of the financing motion (and it is not clear that the debtors could have satisfied the requirements of § 364 to permit a priming lien), the BAP rightly shot down the attempt to stretch the Code's post-petition financing rules to a post-confirmation setting. That result is certainly consistent with the terms of financing provisions of the Code themselves: Post-petition financing under § 364 is available to *the trustee* (or DIP),[7] makes no mention of reorganized debtors, and only authorizes granting liens on *property of the estate*.[8]

Also interesting was the BAP's pronouncement that the bankruptcy court had abused its discretion in denying stay relief without deciding the threshold issue that would determine whether a plan was confirmable. For the BAP, it was not appropriate for the lower court, when faced with an unsettled issue of law, to figuratively throw up its hands and defer all consideration to a confirmation hearing. The BAP conceded that the bankruptcy court "acted within its discretion" in deferring any ruling on the financing motion. However, "by issuing a final order denying the stay motion, the Bankruptcy Court needed to decide whether § 364 precluded confirmation of the Plan,"[9] and the failure to decide that issue constituted an abuse of discretion.[10] The BAP reasoned that the standard for granting stay relief in a SARE case under § 362(d)(3) *requires* a court to determine whether a debtor can confirm a plan within a reasonable time,[11] because in enacting § 362(d)(3), Congress intended to limit a bankruptcy court's discretion to prolong SARE cases, thus the court "must rule on this question when presented."[12]

The dissent in *Aspen Club* argued that the majority's position was inconsistent, and that the lower court did not abuse its discretion in denying the stay-relief motion because it did not wish to reach a decision on the threshold issue in the case, which was an issue of first impression. The majority disagreed, explaining that the bankruptcy court's failure to address that threshold issue ran afoul of the mandate of § 362(d)(3) of a prompt decision to avoid "the additional delay and expense of a confirmation hearing if confirmation is not possible."[13]

Conclusion

A primary goal of congressional enactment of the SARE provisions, most notably § 362(d)(3), was to address the perceived abuses of the bankruptcy process by real estate debtors to prolong a case when there is no chance of reorganization.[14] The *Aspen Club* debtors, faced with an apparent inability to find sufficient financing to complete their project and exit bankruptcy, proposed a novel theory to attempt to attract financing, but one that the BAP found was fatally flawed and on which the bankruptcy court should have ruled. In that circumstance, the Bankruptcy Code's SARE provisions require such a case to be disposed of promptly if a creditor seeks stay relief, rather than force creditors into protracted and expensive litigation over confirmation of a plan that will not be successful. abi

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6 Based on the bankruptcy court's findings, the property's value simply was not sufficient to support the proposed $140 million exit loan and the other existing liens. Even if the bankruptcy court had taken up the § 364 motion on its merits, it is difficult to see how the debtors would have been able to demonstrate that GPIF was adequately protected. Indeed, the debtors were not able to meet confirmation standards either upon remand, the chapter 11 case was eventually dismissed, and the secured creditor began foreclosure proceedings. *See* Rick Carroll, "Fox Gives Up Aspen Club Fight as Foreclosure Action Begins," *Aspen Times* (Sept. 10, 2020), *available at* aspentimes.com/news/fox-gives-up-aspen-club-fight-as-foreclosure-action-begins (last visited Sept. 23, 2020).

7 11 U.S.C. § 364(a).

8 11 U.S.C. § 364(c), (d).

9 *Aspen Club* at *8.

10 The BAP relied on ample authority from both the Tenth Circuit BAP and other circuits to highlight the importance of meeting this statutory standard in SARE cases. *Id.* at *6, n.48 & 49 (collecting cases).

11 *Id.* at *7.

12 *Id.* at *8.

13 *Id.*

14 *Id.* at n.64.