

## DEBTOR/CREDITOR

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*Bank Thwarts Real Estate Developer*

Last month, the Supreme Court of the United States made it harder for single-asset real estate debtors to confirm Chapter 11 plans over the objection of the mortgage holder.

The case presented a typical scenario. The debtor was a limited partnership. The sole asset was a \$54,000,000 office building subject to a \$93,000,000 mortgage. Other than the bank holding the mortgage, the debtor had no significant creditors.

The debtor presented and sought to confirm a plan which would reduce the amount of the mortgage to the \$54,000,000 value of the property and pay the bank's \$39,000,000 deficiency claim at approximately 16% of its present value. Certain of the debtor's partners would contribute \$6,000,000 of new capital over the next five years in exchange for a 100% ownership interest in the partnership. The capital contribution by the existing partners is referred to in these cases as "new value".

Prior to last month's Supreme Court decision, many courts had permitted a reorganization plan like the one above, notwithstanding the objection of the mortgagee. Those courts had held that the pre-bankruptcy equity holders of the debtor could, by contributing a sufficient amount of new value, maintain ownership of the debtor and the real property while paying the lender only slightly more than the value of the collateral. Disputes in these prior cases revolved around whether the proposed new value contribution was of sufficient amount compared to the value of the real estate being retained. In practice, there was little consistency among courts in determining the amount of new value contribution that was sufficient.

The Supreme Court held that this type of plan could

not be confirmed because it gave only existing equity holders in the debtor the opportunity to contribute new value and become equity holders in the debtor post bankruptcy. The court insisted that if the debtor was to be permitted to retain the lender's collateral through a new value contribution, (1) the ability to contribute new value must be opened to anyone and (2) the amount of new value required to obtain ownership of the debtor after confirmation of plan must be subject to market forces in order to produce highest amount. In practical terms this means that the bank must be able to bid against the debtor's equity holders for the right to make the new value contribution and control the debtor and its real property. Because the new value contribution typically is used to pay the bank's deficiency claim, the bank can safely bid up to the full amount of its deficiency claim without actually having to part with any money.

Creative attorneys for Chapter 11 single-asset real estate debtors will no doubt be able to write plans which do not use the new value contribution for payment of the bank's deficiency claim in order to discourage the bank from bidding. However, the Supreme Court has nonetheless shifted the dynamics of a single-asset real estate Chapter 11 case in favor of the secured lender.

*Bank of America National Trust and Savings Ass'n v. 203 N. LaSalle Street Partnership*, 67 U.S.L.W. 4275 (May 3, 1999).

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*This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation.*

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