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Recognizing Impaired Accepting Class of Secured Tax Claims

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Imposing a chapter 11 plan on a dissenting class of creditors (also known as "cramdown") requires at least one impaired class of claims voting to accept the plan.[2] Single-asset real estate debtors often look to a class of secured tax claims as a potential impaired accepting class for cramdown purposes, especially when the lender holds a deficiency claim large enough to dictate the voting outcome for the class of unsecured claims.[3] Is a secured-tax class impaired when the plan treatment complies with the Bankruptcy Code? What if the plan treatment complies with the Code, but not with applicable nonbankruptcy law? Recent case law shows continuing lack of clarity on these questions.

The Bankruptcy Code's definition of "impairment" suggests that constructing an impaired class is not difficult. Section 1124 states that a class "is impaired under a plan unless, with respect to each claim...of such class, the plan...leaves unaltered the legal, equitable and contractual rights [of the claimholder]." Because the claimholder's rights are determined in part by applicable law, impairment by statute is an oxymoron. As explained by one court, "[i]mpairment results from what the *plan* does, not what the statute does.... A plan which leaves a claimant subject to...applicable provisions of the Bankruptcy Code does no more to alter a claimant's legal rights than does a plan which leaves a claimant vulnerable to a given state's usury laws or to federal environmental laws. The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons, just as surely as it limits contractual rights."[4] Thus, to construct an impaired class of claims, the plan must alter the claimholder's rights *as they exist under applicable law*.

Applicable bankruptcy law for secured tax claims includes 11 U.S.C. §§ 1129(a)(9)(D) and 511. Section 1129(a)(9)(D) requires a plan to provide secured tax claimants regular cash installment payments that (1) are paid over a period ending no later than five years after the date of the order for relief (usually the same date as the bankruptcy filing), (2) have a total value equal to the amount of the allowed claim and (3) are structured in a manner not less favorable than the most favored nonpriority unsecured nonadministrative-convenience claim under the plan. Section 511 looks to applicable nonbankruptcy law to provide the interest rate.

The variables of compliance (or noncompliance) with the Bankruptcy Code, compliance (or noncompliance) with nonbankruptcy law and the acceptance (or nonacceptance) of the plan by the secured-tax class generate seven possible scenarios for treatment of secured tax claims, as illustrated in Chart 1.

Scenarios 5, 6 and 7 are easy to resolve. In scenario 5, nonacceptance by the class is irrelevant because the plan treatment, by complying with applicable bankruptcy and nonbankruptcy law, results in an unimpaired class, and each claimant of an unimpaired class is "conclusively presumed to have accepted the plan."[5] Scenario 6 presents an unsurprising result: nonacceptance of a plan that violates the claimant's rights under nonbankruptcy law.[6] In scenario 7,

1 The views expressed in this article are those of the author and do not necessarily represent those of Winstead PC or its clients.
2 11 U.S.C. § 1129(a)(10).
3 Most courts do not allow separate classification of a lender's deficiency claim from other general unsecured claims. *In re Hillside Park Apts. LP*, 205 B.R. 177, 186-87 (Bankr. W.D. Mo. 1997) (citing cases from Second, Third, Fifth, Eighth and Ninth Circuits).
4 *In re Am. Solar King Corp.*, 90 B.R. 808, 819-20 (Bankr. W.D. Tex. 1988) (finding no impairment when plan incorporated 11 U.S.C. § 510(b)'s mandatory subordination); *see also In re PPI Enters. (U.S.) Inc.*, 324 F.3d 197, 204 (3d Cir. 2003) (finding no impairment when landlord's damages claim is subject to 11 U.S.C. § 502(b)(6)'s cap).
5 11 U.S.C. § 1126(f).
6 For example, the plan may comply with the Bankruptcy Code but eliminate the secured-tax claimant's foreclosure rights under state law.

Chart 1

	Plan treatment complies *with the Bankruptcy Code* and...		Plan treatment *does not comply with the Bankruptcy Code* and...	
	Complies with applicable nonbankruptcy law	Does not comply with applicable nonbankruptcy law	Complies with applicable nonbankruptcy law	Does not comply with applicable nonbankruptcy law
Secured-tax class *accepts the plan*	Scenario 1 (unimpaired)	Scenario 2	Scenario 3 (unimpaired) (see n. 9)	Scenario 4
Secured-tax class *does not accept the plan*	Scenario 5 (unimpaired)	Scenario 6	Scenario 7	

voting is irrelevant because the plan fails to comply with § 1129(a)(9)(D), which renders the plan unconfirmable as a matter of law.[7] In any event, scenarios 5, 6 and 7 do not provide an accepting class.

Scenario 1 is also easy to resolve. If the plan treatment complies with applicable bankruptcy and nonbankruptcy law, then there is no impairment because the claimholder's rights are not altered.[8] Unfortunately, case law to date fails to distinguish scenario 1 (no impairment) from impairment scenarios.[9]

For example, in June 2011, the court in *Trenton Ridge* held that the secured-tax class was impaired even though the plan treatment complied with § 1129(a)(9)(D).[10] The plan provided the sole secured tax claimant with full payment (including interest) over five years, which was more favorable than the plan treatment for the general unsecured class: quarterly payments until the earlier of payment in full without interest or five years after the petition date.[11] The tax claimant voted to accept the plan. Without discussing how the plan violated § 1129(a)(9)(D) or applicable nonbankruptcy law, the *Trenton Ridge* court found the secured-tax class to be an impaired accepting class.

Texas Grand Prairie is another case that does not articulate how the secured-tax class was impaired.[12] The debtors' plan in *Texas Grand Prairie* appeared to comply with all applicable law on secured tax claims. The plan provided full payment of secured tax claims (with interest as determined under nonbankruptcy law) in two installments: the first payment within 10 days after the plan effective date (which occurred on June 7, 2011), and the second payment by June 30, 2011.[13] This treatment was more favorable than the 25 percent distribution provided to general unsecured claims. The plan also expressly incorporated, in the event of an uncured plan default, the secured-tax claimants' rights to pursue collection as they existed under nonbankruptcy law. The bankruptcy court assumed that impairment existed without addressing how the plan altered any of the tax claimants' rights and instead considered whether there was artificial impairment.[14] But even artificial impairment requires some amount of alteration of the claimants' rights. With no identified alteration of the tax claimants' rights, it is not clear how the secured-tax class was impaired.

The *Texas Grand Prairie* bankruptcy court, relying on the secured-tax class (with about $800,000 in total claims) as the sole impaired accepting class, confirmed the debtors' plan over the objection of the largest creditor (with a $39 million secured claim and a $12 million deficiency claim). In November 2011, the district court affirmed the bankruptcy court's confirmation ruling, which is on appeal to the Fifth Circuit. By now, the debtors have paid the tax claims in full and filed a motion to dismiss the appeal for equitable mootness, which the Fifth Circuit took under advisement subject to briefing on the merits of the appeal.[15] How the tax-impairment issue will be addressed on appeal remains to be seen.

Plan proponents and objecting creditors should carefully consider which scenario applies to the proposed plan treatment of secured-tax claims and clearly identify the applicable rights altered by the plan.

Another case from 2011 illustrates additional confusion on the secured-tax impairment issue. In *Greenwood*, the debtor's plan proposed paying the sole secured-tax claimant in full by paying (10 days after the plan effective date) the principal amount owed and paying (over the subsequent two months) the interest owed.[16] The treatment was more favorable than the proposed 15 percent distribution to general unsecured claims, and the tax claimant voted to accept the plan. The *Greenwood* court found the secured-tax class to be an impaired accepting class. Unfortunately, the court offered several unsatisfying explanations for why the secured-tax class was impaired.

The court's first explanation focused on applicable state law requiring payment of the secured taxes in May and November of each year. The court suggested that impairment existed because § 1129(a)(9)(D) altered the tax claimant's payment rights under state law: "To suggest that this Congressionally-allowed treatment [§ 1129(a)(9)(D)] does not impair the rights of the [secured tax claimant] is directly in conflict with Section [1129(a)]."[17] The court's statement is difficult to parse because impairment arises from plan treatment, not from potentially conflicting statutes.[18] Assuming that the state law did conflict with the Bankruptcy Code, the Supremacy Clause of the U.S. Constitution also decides the outcome of that conflict.[19]

The *Greenwood* court's next explanation for finding impairment pointed to the plan treatment as "more favorable than that set forth in Section 1129(a)(9)(D)."[20] While the plan treatment (paying the principal amount shortly

7 11 U.S.C. § 1129(a) ("The court shall confirm a plan *only if all of the following requirements are met* [including § 1129(a)(9)(D)].") (emphasis added).

8 *In re EQK Bridgeview Plaza Inc.*, 2011 WL 2458068, at *2 (Bankr. N.D. Tex. June 16, 2011) ("[A]ssuming [that] such claims are receiving the treatment statutorily prescribed by Section 1129(a)(9)(D)...the tax claimants cannot object to such treatment....").

9 Scenario 3 is perhaps the most difficult category to understand. Plan treatment falling within scenario 3 arguably results in an unimpaired class for several reasons. First, scenario 3 assumes that the claimant's state law rights are left unaltered. Second, the claimant's rights under § 1129(a)(9)(D) includes the right to accept different treatment. 11 U.S.C. § 1129(a)(9) ("Except to the extent the [claimholder] has agreed to a different treatment."). Unlike other Code sections that specify mandatory treatment of certain claims—such as §§ 502(b)(6) and 510(b)—§ 1129(a)(9)'s preliminary clause allows a plan to still comply with § 1129(a)(9)(D) while deviating from § 1129(a)(9)(D)'s specified-claim treatment, so long as the claimant agrees to the different treatment. *See Am. Solar*, 90 B.R. at 821 (statutory construction requires interpreting statutes "in a fashion which gives substantive effect to all of its provisions"). Because a tax claimant's agreement to treatment other than the specified range of treatments in § 1129(a)(9)(D) still complies with the Bankruptcy Code, there is no alteration of the claimant's bankruptcy rights and hence no impairment. *See In re Polytherm Indus. Inc.*, 33 B.R. 823, 837 (W.D. Wis. 1983) ("According to 11 U.S.C. § 1123(a)(4), the holder of a claim may agree to less-favorable treatment than that afforded the claim by its terms. Section 1124 identifies this election as an exception to the impairment characterization.").

10 *In re Trenton Ridge Investors LLC*, 461 B.R. 440, 478 (Bankr. S.D. Ohio 2011).

11 *Id.* at 454.

12 *In re Tex. Grand Prairie Hotel Realty LLC*, Case No. 10-43242 (Bankr. N.D. Tex.).

13 *Id.* at § 4.5.2 of docket # 294 (confirmed plan) *and* docket # 351 (notice of plan effective date).

14 *Id.* at docket # 306 (transcript of court's confirmation ruling).

15 *See* Fifth Circuit Court of Appeals docket # 11-11109.

16 *In re Greenwood Point LP*, 445 B.R. 885, 892 (Bankr. S.D. Ind. 2011).

17 *Id.* at 907.

18 11 U.S.C. § 1124 ("[A] class of claims...is impaired *under a plan* unless....") (emphasis added).

19 *Gonzales v. Raich*, 545 U.S. 1, 29 (2005) ("The Supremacy Clause unambiguously provides that if there is any conflict between federal and state law, federal law shall prevail.").

20 *Greenwood*, 445 B.R. at 907.

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after the effective date and paying the interest owed within two months) is certainly more favorable than the least-favorable treatment option under § 1129(a)(9)(D) (*i.e.*, regular cash installments over a five-year period), that does not necessarily mean that the plan treatment *alters* the claimant's rights under § 1129(a)(9)(D). Section 1129(a)(9)(D) allows—but does not require—the payments to extend as far as five years after the bankruptcy filing, and it does not require the installment payments to include both principal and interest components.[21] The *Greenwood* plan treatment for secured taxes easily fits within § 1129(a)(9)(D)'s broad range of permissible payment arrangements.

The court's last explanation for impairment was more persuasive. The *Greenwood* plan vested property in the reorganized debtor free and clear of the tax lien prior to full payment, but instead of identifying the state law right altered by the plan, the court pointed to § 1129(b)(2)(A)'s lien-retention requirement even though § 1129(b)(2)(A) was irrelevant because the claimant accepted the plan.[22]

21 *Compare* § 1129(a)(9)(D) (requiring "regular installment payments in cash") *with* § 1325(a)(5)(B)(iii) (requiring payments "in equal monthly amounts"); *see also In re F.G. Metals Inc.*, 390 B.R. 467, 473-75 (Bankr. M.D. Fla. 2008).

22 *Greenwood*, 445 B.R. at 907. The court also does not address whether the state law right to a tax lien includes the right of the tax claimant to release its lien prior to full payment. *See* n. 9.

Conclusion

Plan proponents and objecting creditors should carefully consider which scenario applies to the proposed plan treatment of secured-tax claims and clearly identify the applicable rights altered by the plan. Parties litigating the impairment issue should also identify who bears the burden of proof.

Generally, the burden of proving that a cramdown plan complies with all confirmation requirements—including the requirement for an impaired accepting class—falls on the plan proponent,[23] but some courts start with a presumption of impairment, which suggests that the burden is improperly shifted from the plan proponent (to establish an impaired accepting class) to the objecting creditor (to establish a non-impaired class whose acceptance is irrelevant).[24] Finally, secured-tax claimants should probably insist on plan provisions that expressly incorporate and adopt all applicable nonbankruptcy rights of the tax claimants.[25] abi

23 *See Epic Metals Corp. v. Condec Inc.*, 232 B.R. 806, 809 (M.D. Fla. 1999) ("As a proponent of the plan... [the debtor] had the burden of showing the plan meets all statutory requirements.... This includes compliance with § 1129(a)(10).... [The bankruptcy court] erred in ruling that [certain classes] were impaired without the presentation of evidence. The debtor...had the burden of showing the classes were indeed impaired, even if no objections existed."); and *In re Snedaker*, 32 B.R. 29, 31 (Bankr. S.D. Fla. 1983) ("The plan enjoys no presumption that it meets all the statutory requirements....").

24 *See PPI Enters.*, 324 F.3d at 203 ("The Bankruptcy Code creates a presumption of impairment.").

25 One wonders why a secured-tax claimant would knowingly vote for a plan that eliminates or degrades the claimant's state-law rights.