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Feature

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How Inconsequential Is "Inconsequential Value"?

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The stagnant economy has resulted in a depressed real estate market. In many hard-hit areas, most notably Arizona and Florida, the value of real estate has dropped to levels far below the debt that encumbers the property. Lenders and borrowers remain optimistic that property values will appreciate once the economy turns the corner. Given that backdrop, § 1111(b)(2) of the Bankruptcy Code provides an undersecured lender with the opportunity to capture that potential future appreciation in value by electing to have its claim treated as fully secured under a chapter 11 reorganization plan.

The § 1111(b)(2) Election

Subject to certain conditions, § 1111(b)(2) permits an undersecured creditor to elect to have its entire claim treated as secured. In § 1111(b)(2), Congress sought to give secured creditors the opportunity to capture future appreciation in the value of their collateral.[2] However, under § 1111(b)(1)(B)(i), a creditor may not elect to have its claim treated as secured if "the interest on account of such claims of the holders of such claims in such property is of *inconsequential value*."[3]

Inconsequential Value vs. No Value

The Bankruptcy Code does not define the term "inconsequential value." Therefore, bankruptcy courts must determine what constitutes "inconsequential value." Two bankruptcy courts that have addressed the issue have reached differing results.[4] In fact, the overwhelming majority of courts that have confronted the issue have interpreted "inconsequential value" to mean "no value"[5] (the "no-value cases").

Standing Alone: *In re Wandler*

At least one bankruptcy court has found that "inconsequential value" does not mean "no value."[6] In *Wandler*, the debtors moved to set aside a secured creditor's § 1111(b) election on the grounds that the creditor's interest in the collateral was of inconsequential value. The secured creditor was owed $394,155.15 and held a lien against collateral with a value of only $15,000. In other words, the value of the collateral in relation to the claim was approximately 4 percent.[7] In parting ways with the decision by the bankruptcy court in *In re Baxley* that held that "inconsequential value" means no value, the bankruptcy court in *Wandler* stated that "[i]f the inconsequential value language of section 1111(b) was meant to mean no value, then Congress would have so stated under the language of that section. To interpret inconsequential value differently would be to discriminate against other unsecured creditors, which is clearly not allowed under section 1129 of the Bankruptcy Code."[8]

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2 *See* 124 Cong. Rec. 32392, 32408 (1978) (Statement of Rep. Edwards).

3 11 U.S.C. § 1111(b)(1)(B)(i) (2010) (emphasis added).

4 *See In re Baxley*, 72 B.R. 195, 198 (Bankr. D.S.C. 1986) ("inconsequential value" means "no value"), and *In re Wandler*, 77 B.R. 728, 733 (Bankr. D.N.D. 1987) ("If the inconsequential value language of section 1111(b) was meant to mean no value, then Congress would have so stated under the language of that section.").

5 *See In re 500 Fifth Avenue Associates*, 148 B.R. 1010 (Bankr. S.D.N.Y. 1993) (completely unsecured junior lien cannot make § 1111(b)(2) election); *Butters v. Mountain Side Holdings Inc. (In re Mountain Side Holdings Inc.)*, 142 B.R. 421 (D. Col. 1992) (junior lienholder's claim was of inconsequential value when collateral was worth $4.886 million and was subject to senior lien of $5.090 million, leaving junior lienholder's claim of $1.5 million unsecured); *In re Cook*, 126 B.R. 575, 581 (Bankr. D.S.D. 1991) ("A junior creditor's claim has inconsequential value where the collateral's value does not exceed the senior liens."); *In re Rosage*, 82 B.R. 389, 390-91 (Bankr. W.D. Pa. 1987) ("If a 'secured claim' attached to property of no market value, the inconsequential value term of Section 1111(b)(1)(B)(i) denies the election to that class of claims."); *In re Baxley*, 72 B.R. 195, 198 (Bankr. D.S.C. 1986) ("inconsequential value" means "no value").

6 *In re Wandler*, 77 B.R. 728 (Bankr. D.N.D. 1987).

7 While the bankruptcy court in *Wandler* referred to the value-to-claim ratio, it did not rely on this ratio in finding that the claim of was inconsequential value. Rather, the *Wandler* decision was based on the bankruptcy court's reading of § 1111(b) in conjunction with § 1129.

8 *Id.* at 733.

In contrast, the bankruptcy court in *In re Baxley*[9] allowed the secured creditor to make a § 1111(b)(2) election despite the fact that the value of the collateral in relation to the claim was only approximately 8 percent. In reaching this conclusion, the court placed great weight on a passage from *Colliers on Bankruptcy* when it determined that "property securing the claim must be of *no* value for a creditor to be ineligible to make the election under section 1111(b)(2)."[10] Specifically, the court relied on the following example cited in *Colliers*:

> Thus, if the creditor has an allowed claim for $1,000,000, which is secured by a third lien on property [that] is worth approximately $5,000,000 and... is encumbered by a first mortgage of $3,000,000 and a second mortgage of $4,000,000, the holder of the third mortgage cannot exercise the section 1111(b)(2) election since his interest in the property securing his claim is of inconsequential value.[11]

The Problem with the No-Value Cases

The no-value cases ignore not only the plain meaning of § 1111(b)(1)(B)(i) but also the entire statutory scheme of the Code. Congress used the term "inconsequential value" in § 1111(b)(1)(B)(i). Courts should give deference to Congress's apparent conscious decision to use this specific language and should not equate "inconsequential value" with "no value."

In addition, the meaning of "inconsequential value" cannot be determined in a vacuum. Viewing § 1111(b)(1)(B)(i) in isolation offends the basic principle underlying statutory construction that when a court views the meaning of a particular statute, it is required to look at the entire statutory scheme, not just at the particular statute. When viewed in this context, the meaning of "inconsequential value" can only be discerned by looking at the entire Code and, specifically, at how the section relates to § 1129(b)(2)(A)(i).

Viewed in isolation, a secured creditor's § 1111(b)(2) election represents a waiver by the creditor of its unsecured deficiency claim in consideration for the possibility that the creditor's collateral may appreciate in value post-confirmation.[12] When viewed in this isolated fashion, a creditor's deficiency claim would never be inconsequential since the § 1111(b)(2) election preserves the possibility that the creditor may realize the full amount of its claim, regardless of the relationship between the value of the creditor's interest in its collateral and the total amount of its claim.

However, § 1111(b)(2) must be viewed in the larger context of the Bankruptcy Code as a whole, and in conjunction with § 1129(b) in particular. Indeed, "[t]he significance of the § 1111(b)(2) election becomes apparent when the treatment required by § 1129(b)(2) of the respective claims of the electing and nonelecting undersecured creditors are compared."[13]

When §§ 1111(b) and 1129(b)(2)(A) are read together, it is clear that an interest in collateral is of inconsequential value if the value of the interest is so proportionately small in relation to the total amount of the claim that the debtor would be incapable during the reasonable life of a plan of making payments to the secured creditor equal to the total amount of the claim without exceeding the present value of the collateral and without discriminating against other creditors.

9 *In re Baxley*, 72 B.R. 195 (Bankr. D.S.C. 1986).
10 *Id.* at 198 (emphasis in original).
11 *Id.* at 199.
12 *See, e.g., In re Tuma*, 916 F.2d 488, 491 (9th Cir. 1990).
13 *First Federal Bank of California v. Weinstein (In re Weinstein)*, 227 B.R. 284, 293 (9th Cir. B.A.P. 1998).

Wandler Got It Right

Congress Intentionally Used "Inconsequential Value"

Section 1111(b)(1)(B)(i) uses the specific term "inconsequential value," not the term "no value," when describing the circumstances under which a secured creditor is precluded from making the § 1111(b)(2) election. The no-value cases cannot be relied on in situations where some value exists. Stated differently, the no-value cases are the easiest to decide, for if there is no value securing the creditor's claim there is nothing to protect. However, in those situations where some value exists, the court must determine what constitutes "inconsequential value."

Statutory interpretation of § 1111(b)(1)(B) "must begin... with the language of the statute itself."[14] In relevant part, § 1111(b)(1)(B) reads as follows:

> (B) A class of claims may not elect application of paragraph (2) of this subsection if—
>
> > (i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value.

When "Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress act[ed] intentionally and purposely" in doing so.[15] In using the term "inconsequential value," Congress acted intentionally. The Bankruptcy Code is replete with examples wherein the word "value" is used in other Code sections.[16] If Congress intended to use the term "no value" in § 1111(b)(1)(B)(i), it could have done so. By choosing not to, it must be presumed that Congress acted intentionally and purposely in using the term "inconsequential value."

Section 1111(b) Must Be Read in Conjunction with § 1129(b)(2)(A)

To determine the meaning of "inconsequential value," it is necessary to read § 1111(b) in conjunction with § 1129(b) because "[t]he purpose of statutory construction is to discern the intent of Congress...[t]o determine the plain meaning of a particular statutory scheme, and thus congressional intent, the court looks to the entire statutory scheme."[17] In fact, "[s]tatutory construction of the Bankruptcy Code is 'a holistic endeavor' requiring consideration of the entire statutory scheme."[18] The legislative history for § 1111(b) expressly supports this notion: "A discussion of section 1111(b) of the House Amendment is best considered in the context of confirmation and will therefore be discussed in connection with section 1129."[19]

In general, an undersecured creditor has two choices when faced with a possible cramdown of its claim. Pursuant to § 506(a), the creditor may have its claim split

14 *United States v. Ron Pair Enters. Inc.*, 489 U.S. 235, 241 (1989).
15 *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 452 (2002) (citing *Russello v. United States*, 464 U.S. 16, 23 (1983)) (internal quotations marks omitted); *see also Tang v. Reno*, 77 F.3d 1194, 1197 (9th Cir. 1996) (stating same principle).
16 *See* 11 U.S.C. §§ 362(h)(2) (consequential value), 363(f) (aggregate value), 502(b)(4) (reasonable value), 506(a)(2) (replacement value), 547(a)(2) (new value) and 548(a)(1)(B)(i) (reasonably equivalent value).
17 *United States v. Daas*, 198 F.3d 1167, 1174 (9th Cir. 1999).
18 *Einstein/Noah Bagel Corp. v. Smith (In re BCE West LP)*, 319 F.3d 1166, 1171 (9th Cir. 2003) (citing *United Sav. Ass'n of Tex. v. Timbers Inwood Assocs.*, 484 U.S. 365, 371 (1988)).
19 H.R. Rep. 95-595 (1977), *reprinted in* U.S.C.A.N. 5936.

into a secured claim equal to the value of the collateral and an unsecured claim for the remaining balance of the debt. Alternatively, pursuant to § 1111(b)(2), the creditor can elect not to split its claim and, by doing so, have the entire amount of the claim treated as secured by the collateral. In effect, by electing to have its claim bifurcated pursuant to § 506(a) or treated as fully secured pursuant to § 1111(b)(2), the creditor has elected the treatment the claim will receive under a reorganization plan.

As it relates to § 1129(b)(2)(A)(i), the secured creditor can only be "crammed down" if it receives deferred cash payments equal to the full amount of its allowed claim and equal on a present-value basis to the value of the collateral. In the scenario where the undersecured creditor makes the election under § 1111(b)(2), the creditor is entitled to have the entire allowed amount of the debt related to the property secured by a lien even if the value of the collateral is less than the amount of the debt. Under this scenario, § 1129(b)(2)(A)(i) requires that the plan provide for the creditor to receive payments, either present or deferred, equal to the total amount of its claim but with a present value equal to the value of the collateral.

A More Reasoned Approach to Determine "Inconsequential Value"

Reading § 1111(b) in conjunction with § 1129(b) informs the bankruptcy court on how to interpret and apply the term "inconsequential value." If an undersecured claim cannot be paid in full, either by amortizing the claim over a period of time or paying the claim in full, without exceeding the present value of the collateral, then the claim is likely to be of inconsequential value.[20] In *Wandler*, the secured creditor's interest in its collateral was valued at $15,000 whereas the total amount of its claim was $390,000. The court found that under these circumstances, the value of the creditor's interest was inconsequential in relation to the total amount of the claim and precluded the creditor from making an election under § 1111(b)(2). In reaching this conclusion, the bankruptcy court found as follows:

> The Debtors, within a reasonable life of a plan, could not make payments to Liberty National totaling approximately $390,000.00 with a present value of $15,000.00. Payment in consequence of such proportionally small value of collateral could simply not be amortized in such a manner. If larger payments were made other unsecured creditors would be discriminated against in consequence of Liberty's windfall, as Liberty would be receiving more than the present value of its claim. *This court believes that when a claim cannot be paid in full, either amortized annually or in a lump sum payment at the end of a specified period of time (*i.e.*, thirty to forty years), without exceeding the present value of the collateral, the creditor's claim is probably of inconsequential value and an 1111(b) election should not be allowed.*[21]

Thus, where an undersecured claim cannot be paid in full, either by amortizing the claim over a period of time or paying the claim in full, without exceeding the present value of the collateral, then the claim is of inconsequential value.

Conclusion

As long as the real estate market continues to suffer, bankruptcy courts will be left to determine just how inconsequential "inconsequential value" is. The no-value cases are the easiest to decide. However, in those cases were some value exists, the more reasoned approached would appear to require that § 1111(b)(1)(B)(i) be read in conjunction with the entire statutory scheme of the Bankruptcy Code and, in particular, § 1129(b)(2)(A)(i). abi

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20 *In re Wandler*, 77 B.R. 728, 733 (Bankr. D.N.D. 1987).
21 *Id.* at 733 (emphasis added).