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Feature

By Damian S. Schaible, Jonah A. Peppiatt and Matthew B. Masaro[1]

Partial "Dirt-for-Debt" Plans: A Risk for Secured Creditors in Oil and Gas Cases?

Damian S. Schaible
Davis Polk & Wardwell LLP; New York

Jonah A. Peppiatt
Davis Polk & Wardwell LLP; New York

Matthew B. Masaro
Davis Polk & Wardwell LLP; New York

Under § 1129(b)(2)(A)(iii) of the Bankruptcy Code, if a secured creditor receives the "indubitable equivalent" of its claim, then a plan is "fair and equitable" to such creditor. While much ink has been spilled on the risk of "cram up" plans under § 1129(b)(2)(A)(i)'s deferred cash-payment mechanic, less has been devoted to understanding how courts have permitted secured creditors to be crammed up by a full or partial surrender of collateral under the Code's indubitable-equivalent standard — colloquially, a "dirt-for-debt" plan.

In the limited number of cases addressing dirt-for-debt plans, litigation has centered, unsurprisingly, on the limits of the indubitable-equivalent standard.[2] Courts have routinely found that if a debtor surrenders all of a secured creditor's collateral, then such creditor received the indubitable equivalent of its secured claim and § 1129(b)(2)(A)(iii) has been satisfied.[3] In some cases, debtors have pushed the indubitable-equivalent standard further and attempted to satisfy secured creditors by surrendering only a portion of the collateral securing such creditors' claims by arguing that the value of such partial collateral exceeds the amount of such claims. While courts have confirmed these "partial dirt-for-debt" plans, they are more cautious in doing so, and they engage in a fact-intensive analysis to understand the value of the collateral surrendered and the certainty that a secured creditor will be able to realize such value.

Most partial dirt-for-debt disputes have involved real property developments and land parcels. Given that oil and gas restructurings have played an outsized role in the chapter 11 landscape for the better part of the past decade, it is perhaps surprising that debtors have not more frequently sought to cram up secured creditors with a partial collateral tender of oil and gas assets, which in most jurisdictions constitute real property interests of a value perhaps no more or less volatile than other types of real estate.

In the recent *In re Tenrgys LLC* cases,[4] the debtors attempted to do just that: proposing to provide their secured lender with only some of the oil and gas rights securing its loan. While the *Tenrgys* debtors ultimately pivoted to an alternative and consensual plan that did not include a dirt-for-debt component, this article examines Tenrgys's proposed partial dirt-for-debt plan[5] as an example of how debtors in future oil and gas bankruptcies might seek to impose partial dirt-for-debt plan treatments on secured lenders, as well as strategies for secured creditors to mitigate the risk of such treatment.

Indubitable-Equivalent Standard in Partial Dirt-for-Debt Cases

Traditionally, "indubitable equivalent" means "that the treatment afforded the secured creditor must be adequate to both compensate the secured creditor for the value of its secured claim and also ensure the integrity of the creditor's collateral position."[6] In practice, courts have further

1 This article represents the views of its authors, and the statements made herein are not those of their firm or its clients.
2 Peter Janovsky, "'Dirt for Debt' in Bankruptcy Plans of Reorganization," *N.Y. L.J.* (Oct. 10, 2019).
3 *See, e.g., In re Arnold & Baker Farms*, 85 F.3d 1415, 1423 (9th Cir. 1996) ("[A] creditor necessarily receives the indubitable equivalent of its secured claim when it receives the collateral securing that claim, regardless of how the court values the collateral.").
4 No. 21-01515 (JAW) (Bankr. S.D. Miss.).
5 *See* First Amended and Restated Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (ECF No. 273), No. 21-01515 (Bankr. S.D. Miss. 2021).
6 7 *Collier on Bankruptcy* ¶ 1129.04 (internal citations omitted).

interpreted "indubitable equivalent" to permit debtors to "surrender ... the creditor's collateral to the creditor in full or partial satisfaction of the claim, which is known as a 'dirt-for-debt' or 'eat dirt' plan."[7] Commentators reviewing dirt-for-debt case law have noted that while some debtors have successfully confirmed partial dirt-for-debt cases, such plans are "more difficult for the court to confirm."[8]

In partial dirt-for-debt scenarios, courts must be assured that the value of the surrendered collateral sufficiently exceeds the value of the creditor's claim,[9] and that partial surrender does not increase the creditor's risk exposure or unduly jeopardize the creditor's invested principal.[10] Accordingly, courts focus on determining the *risk-adjusted* value of the collateral proposed to be surrendered in order to ensure that "the secured creditor *will* realize the indubitable equivalent of its claim."[11] The burden is on plan proponents to prove that the surrendered collateral will "provide ... the creditor the indubitable equivalent" of its claim,[12] which a dueling expert is permitted to rebut. Therefore, partial dirt-for-debt plans can easily result in full-blown valuation fights.

There are no bright-line rules or tests for when partial dirt-for-debt plans are permitted, as they are instead analyzed on a case-by-case basis. For example, several courts have confirmed partial dirt-for-debt plans when the surrendered collateral is valued conservatively (with transaction costs accounted for) and there is sufficient equity cushion in the collateral to hedge against valuation uncertainties.[13] Conversely, courts have refused to confirm partial dirt-for-debt plans when there are substantial, unresolved uncertainties within a proposed valuation or disparities between competing valuations.[14]

Damian Schaible is a partner with Davis Polk & Wardwell LLP in New York and a past member of ABI's Board of Directors. Jonah Peppiatt and Matthew Masaro are associates in the same office.

Consequently, while partial dirt-for-debt plans are possible, they are highly fact- and expert-intensive. When they *are* successfully used, it is typically where a debtor surrenders collateral with an ample equity cushion and proffers valuation evidence supported by conservative assumptions, such that the court may conclude that the debtor is not unduly increasing a creditor's bargained-for risk exposure or jeopardizing the creditor's invested principal without appropriate compensation.

The *Tenrgys* Dirt-for-Debt Plan

The recent *Tenrgys* cases appear to be one of the first instances that a debtor has sought to consummate a partial dirt-for-debt plan utilizing oil and gas interests as consideration. Tenrgys LLC (collectively, with certain of its affiliates, "Tenrgys") is an oil and natural gas operator with operating fields in Mississippi and Louisiana, as well as certain drilling concessions in Colombia (the "Colombian rights"), which are owned by Tenrgys's wholly owned nondebtor affiliate, Telpico LLC. Tenrgys's pre-petition capital structure included a reserve-based lending (RBL) facility of approximately $71 million outstanding and an unsecured term loan of approximately $122 million outstanding, each held by a single lender.

The RBL was secured by substantially all of Tenrgys's assets, including the Telpico equity. Shortly after filing, Tenrgys proposed a plan that purported to treat the RBL as satisfied in full through the surrender of, at the RBL lender's option, the Colombian rights or the Telpico equity, but none of Tenrgys's domestic assets.

In support of the plan, Tenrgys filed two expert valuation reports, one for Tenrgys's domestic assets (valued at approximately $117 million to $163 million) and the other for Tenrgys's international assets (effectively, the value of the Colombian rights, valued at approximately $97 million to $121 million), each on a risk-adjusted basis. Based on these valuations, the RBL lender's $71 million secured claim was substantially oversecured. In light of the aforementioned case law, Tenrgys's partial dirt-for-debt plan was presumably permissible — as long as the valuations held up — since the surrender of the Colombian rights would provide the RBL lenders with a risk-adjusted equity cushion of at least $26 million.

However, valuation and equity cushion do not end the inquiry in determining whether a dirt-for-debt plan passes muster. Rather, the proposed plan must demonstrate that such purported value will actually be realized by the secured creditor. The RBL lenders argued, *inter alia*, that *that* requirement could not be satisfied for the following reasons: (1) The Colombian rights were subject to expiration if Telpico did not begin exploration activities by a date certain; (2) the RBL lender lacked relevant expertise; (3) no oil had yet been drilled from the

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7 *See* J.M. Nies, "Partial Surrender of Collateral ('Dirt-for-Debt') as Providing Secured Creditor with 'Indubitable Equivalent,' Under 11 U.S.C.A. § 1129(b)(2)(A)(iii), of Secured Claim or Portion Thereof," 41 A.L.R. Fed. 3d 1.

8 *See id.*

9 *See, e.g., In re CRB Partners LLC*, 2013 WL 796566 (Bankr. W.D. Tex. 2013) (denying confirmation of partial dirt-for-debt plan that provides equity cushion of less than $3 over value of property to be surrendered).

10 *See In re Arnold & Baker Farms*, 85 F.3d at 1422 ("[T]o the extent [that] a debtor seeks to alter the collateral securing a creditor's loan, providing the 'indubitable equivalent' requires that the substitute collateral not increase the creditor's risk exposure.") (internal citations omitted); *In re CRB LLC*, 2013 WL at *6 (noting that partial dirt-for-debt plan needs to "[e]nsure the safety of or prevent jeopardy to the [loan's] principal"); *see also In re Atlanta S. Bus. Park Ltd.*, 173 B.R. 444 (Bankr. N.D. Ga. 1994) (confirming plan that conservatively valued assets to account for, among other things, cost of sale process and attendant risk of value-realization).

11 *See* Nies, *supra* n.7 (emphasis added).

12 *See id.* (also discussing relevant burdens of proof).

13 *See, e.g., In re Simons*, 113 B.R. 942, 947 (Bankr. W.D. Tex. 1990) (noting that "valuation is not an exact science, and the chance for errors always exists"); *In re Investors Lending Grp. LLC*, 489 B.R. 307, 315 (Bankr. S.D. Ga. 2013); *In re Bannerman Holdings LLC*, 53 Bankr. Ct. Dec. (CRR) 251 (Bankr. E.D.N.C. 2010); *In re Bath Bridgewater S. LLC*, 2013 WL 968154, at *22 (Bankr. E.D.N.C. 2013) (stating that "any valuation to determine satisfaction of the indubitable equivalent test must be conservative").

14 *See, e.g., In re Legacy at Jordan Lake LLC*, 448 B.R. 719, 729 (Bankr. E.D.N.C. 2011) (holding that indubitable-equivalent standard is not satisfied when there was no "expert evidence of the value of the property to be surrendered, testimony as to the impact of Capital and the Debtor competing as sellers in the Project, and the lack of funding for the construction of amenities"); *In re Walat Farms Inc.*, 70 B.R. 330, 335 (Bankr. E.D. Mich. 1987) (finding that court could "profess no greater certainty as to the value of such land than [creditor]. Therefore, if [creditor] is not satisfied by an increase in the number of acres offered, we will be unwilling to force it to take it in return for a release of its lien on the remainder of the land."); *In re Arnold & Baker Farms*, 85 F.3d at 1422 (noting that "[t]he large disparity in parties' valuation of the same property illustrates the obvious uncertainty in attempting to forecast the price at which real property will sell").

Colombian rights; and (4) the assignment of the Colombian rights to the RBL lender could put the concessions at risk.[15] Further, the lenders' risk profile under the RBL was originally balanced between the "proven producing oil and gas interests in Mississippi and Louisiana" and the speculative Colombian rights.[16]

Tenrgys's proposed plan was materially changing that risk profile by only surrendering the Colombian rights (although the increased risk exposure was arguably mitigated by a sizable equity cushion). In other words, even though the value of the assets proposed to be surrendered to the RBL lender would, if realized, provide the indubitable equivalent of the RBL lender's secured claim, the RBL lender argued that the path to value-realization was far from certain.

Ultimately, a global settlement was reached among all interested parties, and an alternative plan for Tenrgys was approved. Nonetheless, Tenrgys's proposed dirt-for-debt plan and the arguments around it remain instructive for secured lenders who may find themselves being crammed up with only a portion of their collateral.

Fighting a Dirt-for-Debt Plan as a Secured Lender

Secured oil and gas lenders in distressed situations should be prepared to defend against a partial dirt-for-debt plan. At a minimum, such lenders should be ready and willing to fight on valuation, and work to ensure that they have the most robust and reputable valuation for all of their collateral. As previously noted, when a fight over a dirt-for-debt plan devolves, it devolves into a valuation fight. Therefore, the party with the better valuation will likely have greater sway when litigating whether the proposed plan consideration satisfies the indubitable-equivalent standard. Even if the proposed plan is inherently permissible, and the secured creditor can be crammed up with only *some* of its collateral, a strong valuation fight may mean that the lender receives *more* of the collateral in question.

Part of that fight will be a focus on the secured lender's negotiated risk profile. When a debtor proposes to provide a creditor with only some of the collateral securing its loan, a creditor's risk profile should not be materially changing — at least not without sufficient compensation. In many of the cases where partial dirt-for-debt plans have been confirmed, the collateral surrender was approved by the court because the creditor was receiving the same type of collateral, just less of it. Contrast this with the *Tenrgys* case, where the RBL lender's risk profile was purportedly changing dramatically — from being secured primarily by proven domestic reserves to receiving only unproven international drilling concessions. If a debtor is attempting to modify the secured creditor's "asset mix," they should, at a minimum, have to show a substantial equity cushion to compensate the lender for the additional risk to principal.

Finally, as evidenced by the *Tenrgys* case, a secured lender's arguments against a dirt-for-debt plan may be substantially enhanced where there is doubt about a lender's ability to actually realize the collateral's value. Successful partial dirt-for-debt plans have generally involved assets that could be easily sold, rather than operated.[17] With *Tenrgys*, the RBL lender asserted many unknown variables that called into question whether significant value could be realized from the Colombian rights. Similarly, some ways in which even domestic oil and gas assets might not be easy to realize when in the hands of their secured lenders could include (1) lenders not being in the business of operating certain sets of mineral interests; (2) potential expiration of oil-and-gas leases; (3) risks associated with governmental regulation (*e.g.*, Bureau of Ocean Energy Management compliance or unfavorable state government postures toward drilling, such as in California); and (4) whether wells have been proven, drilled or are actively producing (though in many cases, debtor valuations will take this last factor into account *ex ante*). Still, even where value *can* be realized, secured lenders should advocate for increased equity cushions and additional collateral in exchange for the associated transaction costs or additional work they will have to do to realize the value of the proffered collateral.

Conclusion

Section 1129(b)(2)(A)(iii) provides debtors with significant flexibility in fashioning a plan over the will of their secured creditors. The *Tenrgys* cases, alongside extant case law, provide some important lessons.

First, partial dirt-for-debt plans are possible only if a secured creditor is oversecured. Second, such plans provide debtors with at least the hypothetical ability to cherry-pick the collateral they want to keep versus give away in satisfaction of their debts. Third, a debtor's valuation may be subject to attack not only on the value of applicable collateral in the debtor's hands, but also for a failure to risk-adjust for realization of that value in the creditor's hands. Finally, the *Tenrgys* cases suggest that partial dirt-for-debt plans could be used against oil and gas lenders in the future. Secured creditors should be aware of this risk, as well as how to best prepare to litigate against debtors trying to cram them up using only *some* of their collateral. abi

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15 *See* Objection to Disclosure Statement, at 4, 7-10 [ECF No. 263], No. 21-01515 (Bankr. S.D. Miss. 2021).
16 *See id.* at 2.

17 *See, e.g., In re Nat'l Truck Funding LLC*, 588 B.R. 175 (Bankr. S.D. Miss. 2018) (selling semi-trucks); *In re Investors Lending Grp. LLC*, 487 B.R. 307 (selling rental properties).