

**HYPOTHETICAL FACT SITUATION**

Danny Developer has come into your office for a first meeting. He has been a developer and builder for twenty years. For fifteen of those years, he built ten to fifteen houses a year and made a good but not prosperous living. However, in the last five years, he got caught up in the residential building frenzy. He now has thirty two houses in various stages of construction, one subdivision with forty lots under development but only 40% complete, and has purchased and additional twenty five lots in other subdivisions for future development. He has financed these acquisitions with loans from four banks and is doing business under three Limited Liability Companies and Corporations. A quick UCC search reveals that one lender holds a perfected security interest in all of his equipment. He also thinks he may have pledged his ownership interests in one of the LLC's to one of the lenders. He owes the banks approximately \$32 Million dollars and most of the loans are now in default. A review of the bundle of letters he brought with him reveals that many materialmen and mechanics liens have been filed on the various projects.

In the last five years he has done well. He has bought two condominiums at the beach, a lake house, and a log cabin in the mountains. He has a beautiful house in the suburbs that has approximately \$200,000.00 in equity over and above his first mortgage of \$750,000.00. He also has a forty foot yacht moored at the nearby beach marina. His wife, Doris, is a co-obligor on the home mortgage and has guaranteed a number (but not all) of the bank loans and maybe some of the trade credit (but he is not sure). He thinks he has personally guaranteed some but not all of the trade credit principally building supply companies. He called you because he has not sold a house or lot or closed a sale in four months, is out of cash and his accountant who has been helping him do a "workout" with his creditors has referred him to you for a bankruptcy. He owes trade creditors \$3.2 million and they are hounding him. Over the past five years he has taken virtually all of the construction loan proceeds and proceeds from the sale of property and deposited them into one central corporate account and made all disbursements on the bills of all the entities from this one account. He has also paid many of his personal expenses and purchased many of his personal assets using funds in the corporate account.

**CONSIDERATIONS FOR DEBTOR'S COUNSEL**

**I. FIRST MEETING**

- A. Documents to ask for
  - a. Financial Information
  - b. Copies of loan documents
  - c. Copies of current Personal Financial Statements
  - d. Copies of all past PFS given to lenders
  - e. Copies of all Personal Guaranties (Husband, wife and third parties)
  - f. List of Secured and Unsecured Creditors
  - g. Estimates of FMV or Appraisals of Lender Collateral
  - h. Corporate Information and documentation
  - i. Statement of amounts due Lenders
  - j. Lists of all assets of Debtor
- B. Who is the accountant?
- C. UCC search information (usually done by counsel)
- D. Who should attend
  - a. Spouse
  - b. Interest holders
  - c. Accountant
  - d. Confidentiality issues

**II. ISSUES TO BE ADDRESSED AT FIRST MEETING**

- A. Transfers of personal and corporate property
- B. Personal Guaranties
- C. Personal Financial Statements
- D. Possibility of orderly liquidation
- E. Possibility of Chapter 11 and/or continuation of business
- F. Use of loan proceeds
- G. Insurance coverage of property of Debtor
- H. Status of Cash Collateral and use of AR
- I. Issues related to wind down or continuation
  - a. Meeting with Lenders
  - b. Information required for lender meeting
    - i. Financial Projections
      - 1. wind down
      - 2. continuation
    - ii. Lists of assets and possible disposition
    - iii. Updated PFS

III. WHAT TO DO

- A. Prepare projections
  - a. Wind down budget
  - b. Going forward or Chapter 11 Budget
- B. Review lender documentation and perfection
- C. Review PFS (Past and Present)
- D. Review Personal Guaranties
  - a. Possible defenses
- E. Prepare and review documentation for bank meeting
  - a. Projections
  - b. List of assets
  - c. PFS
  - d. Copies of any purchase offers
  - e. Business Plan for either continuation in business or liquidation

IV. TRUSTEE ISSUES

- A. Sale of assets
  - a. Coordinate with Lenders
- B. Perfection issues
- C. Valuation issues
- D. Conflicts
- E. Insurance issues
- F. Books and records
- G. Necessity for attorney or accountant or realtor
- H. How is property held?
  - a. LLC
  - b. Corporation
  - c. Individually
- I. Bank Accounts
- J. Practical issues
  - a. Who has possession of assets?
  - b. Preservation and marshalling of assets
  - c. Collection of accounts receivable
- K. Evaluation of case

V. CHAPTER 11 ISSUES

- A. Reorganization
- B. Liquidation

VI. Who files Bankruptcy? Chapter 7 or Chapter 11?

**CONSIDERATIONS FOR LENDER'S COUNSEL**

I. **FIRST CLIENT MEETING**

A. Documents to ask for:

Notes, renewal notes, security agreements, construction loan agreement, security deeds, financing statements, modifications, forbearance agreements, guarantees, financial statements, appraisals, payoff and payment history printouts.

B. Issues to discuss with Lender:

1. What is the value of the collateral versus the loan balance.
2. Appraisals.
  - a. If no recent appraisal, order one now.
  - b. Does the Lender engage the original appraiser or find a new appraiser?
  - c. Should the attorney engage the appraiser?
3. What will it cost to complete the project?
4. Can or will the Lender advance additional funds to complete the project?
5. Is pressure from the FDIC or state regulators impacting what you can do with this loan?
6. Is the collateral adequately insured? Is the Lender the loss payee? When does the policy expire?
7. What is being done to protect the collateral from deterioration?
8. Is this a participation loan?
  - a. Is the Lender the administrator?
  - b. If yes, what are the demands and expectations of the participants?
  - c. Will the participants authorize renewals or additional funding?
9. What workout discussions occurred and where were the parties when the discussions broke off?
10. Has the borrower made any lender liability claims?

11. What are the Lender's expectations?

- a. Commence foreclosure?
- b. Sue guarantors?

II. ATTORNEY'S "TO DO" LIST

- A. Determine if there are any loan document deficiencies.
- B. Confirm perfection of liens.
- C. Order title search.
- D. Order appraisal.
- E. Sue guarantors.
- F. Communicate with loan participants.
- G. Communicate with Borrower's attorney.
- H. Borrower files Chapter 11.
  - 1. Analyze notice of filing, schedules, calendar all important dates, deadlines and bar dates.
  - 2. Review dockets.
  - 3. File an entry of appearance.
  - 4. File the motion for stay relief asap.
  - 5. Order appraisal (if not done so in Step (D))
  - 6. Call Debtor's counsel.
  - 7. File proofs of claims.

III. CHAPTER 11 ISSUES

- A. Secured creditor carve-out, must you pay to play?
- B. Care and preservation of collateral.
  - 1. Use of cash collateral

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2. Use of sales proceeds
  3. Budget
- C. Construction completion to finish.
1. Utilization of sales proceeds
  2. DIP financing
- D. Waiver of interest payment requirement in single asset real estate cases.
- E. §363 Sales.
1. Its consent by all lienholders required
  2. Credit bidding
  3. Utilization of special purpose entity to receive title
- F. Liquidation Plans – Avoidance of Intangible and Transaction Taxes

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**ABI SOUTHEAST BANKRUPTCY WORKSHOP  
“Dead Dirt”**

**SELECTED ISSUES ARISING IN CHAPTER 11 REAL ESTATE CASES**

**BY: JUDGE ROBERT A. MARK  
SOUTHERN DISTRICT OF FLORIDA**

- I. Single Asset Real Estate (SARE) Designation
  - A. Significance - If filed as or determined to be a SARE, the debtor faces the 90 day deadline in §362(d)(3) to file a plan or begin paying adequate protection on secured claim at contract rate
  - B. Factors considered by courts to determine whether debtor is a SARE
  - C. Cause for extension of §362(d)(3) deadline
  
- II. Substantive Consolidation
  - A. Significance - where individuals own multiple projects and the business affairs are entangled and difficult to unwind, substantive consolidation of the assets and liabilities may be of general benefit to creditors
  - B. Various circuit tests for approving substantive consolidation
  - C. Affect of substantive consolidation
    1. Lower cost of administration
    2. Potential prejudice to creditors of more solvent estates
    3. Waiver (generally) of constructive fraudulent transfer actions based on prepetition payments by one entity to satisfy debt of another
  - D. Case Study - In re Puig, Case No. 07-14026, (S.D. Fla. - Judge Mark)  
[Brief outline of facts and findings to be added]
  
- III. Courts' View of §363 Sales or Sale Plans Where Secured Creditor is Undersecured
  - A. Benefits to secured creditor - sale may be faster and less expansive than foreclosure

- B. Benefits to Estate - allows some recovery for unsecureds and, in some instances, funds for a liquidating trustee or plan administrator to pursue claims
- C. Court considerations - many, if not most courts will approve if there is a carve-out for administrative expenses and for unsecureds.

IV. Priming Liens Under §364(d)

A. Rarely proposed or approved, but may become more common because of existing lender's inability or unwillingness to provide further financing

B. Adequate protection of existing lender

1. Will existing lender consent if new money will greatly enhance project value, for example, by completing common area facilities?
2. Factors in proving adequate protection if existing lender objects
  - (a) enhancement in value in excess of amount of priming lien
  - (b) likelihood of a successful reorganization
3. Published Decisions
  - (a) In re Timber Products, Inc., 125 B.R. 432 (Bankr. W.D.Pa. 1990)
  - (b) In re Stoney Creek Technologies, LLC, 364 B.R. 882 (Bankr. E.D.P.a. 2007)
  - (c) In re Strug-Division LLC, 380 B.R. 505 (Bankr. N.D. Ill. 2008)

4. Adequate Protection - Conclusion

It is difficult to obtain court approval of priming liens over the existing lender's objection. Even if the added value to the project may exceed the amount of the priming loan, the debtor will have to prove the likelihood of success in its reorganization. Absent such a showing, the risk that the priming lien will impair the existing lender's collateral will probably result in disapproval. In short, courts are, and should be, unwilling to gamble the existing lender's recovery on a risky plan.

V. Cancellation of Contracts Litigation

- A. Sharply declining condominium values have induced many buyers to seek cancellation of their purchase contracts. Developers seek to enforce the contracts and obtain forfeiture of the deposits if buyers fail to close
- B. Litigation primarily occurs in state court, but a Chapter 11 Debtor may remove the cases or file adversary proceedings in the Chapter 11 case
- C. Faster resolution of the litigation in the bankruptcy court may enhance reorganization prospects since most of these deposit disputes are settled by partial return of the deposit or a negotiated reduction in the purchase price.

VI. Prepetition Stay Waivers

- A. Cases Enforcing
- B. Cases Not Enforcing
- C. Cases Applying Case by Case Approach
- D. Significance