Chapter 11 Pre-Confirmation Issues: Motions to Dismiss — Is *Phoenix Piccadilly* Still Alive?

Hon. Caryl E. Delano, Moderator
U.S. Bankruptcy Court (M.D. Fla.); Tampa

Stephenie B. Anthony
Anthony & Partners, LLC; Tampa, Fla.

W. Keith Fendrick
Holland & Knight LLP; Tampa, Fla.

David S. Jennis
Jennis & Bowen, P.A.; Tampa, Fla.

Jerry M. Markowitz
Markowitz Ringel Trusty + Hartog, P.A.; Miami.

Chapter 11 Pre-Confirmation Issues: Motions to Dismiss — Is *Phoenix Piccadilly* Still Alive? Single Asset Real Estate Cases Removal of State Court Proceedings to Bankruptcy Court Third Party Releases, Channeling Injunctions and Bar Orders

Presented by

Hon. Caryl E. Delano, Moderator
United States Bankruptcy Court
Middle District of Florida
Tampa and Fort Myers Divisions

Stephenie B. Anthony, Esquire
Anthony & Partners
Tampa, Florida

W. Keith Fendrick, Esquire
Holland & Knight LLP
Tampa, Florida

David S. Jennis, Esquire
Jennis & Bowen, P.A.
Tampa, Florida

Jerry M. Markowitz, Esquire
Markowitz Ringel Trusty + Hartog, P.A.
Miami, Florida

TABLE OF CONTENTS

BAD FAITH DISMISSALS

Head Start versus Fresh Start: Bad Faith Filing Considerations in Chapter 11 Cases

Prepared by Stephenie Biernacki Anthony and Dominic A. Isgro
Anthony & Partners, LLC
Tampa, Florida

INTRODUCTION

Though it has evolved over the years and has at times been either explicit or implicit, the requirement that a petition for reorganization in bankruptcy be filed in "good faith" or, at least, that it not be filed in "bad faith," is among the oldest and most enduring precepts of bankruptcy law in the United States. As one bankruptcy court explained,

> The provisions of the Code dealing with rehabilitation and reorganization must be viewed as direct lineal descendants of a legal philosophy solidly embedded in American Bankruptcy law. Review and analysis ... disclose a common theme and objective: avoidance of the consequences of economic dismemberment and liquidation, and the preservation of ongoing values in a manner which does equity and is fair to rights and interests of the parties affected. But the perimeters of this potential mark the borderline between fulfillment and perversion.... That borderline is patrolled by courts of equity, armed with the doctrine of "good faith": the requirement that those who invoke the reorganization or rehabilitative provisions of the bankruptcy law must do so in a manner consistent with the aims and objectives of bankruptcy philosophy and policy—must, in short, do so in "good faith".

Matter of Gilbert Broad. Corp., 54 B.R. 2, 4 (Bankr. D.N.J. 1984) (citing *In re Victory Const. Co., Inc.*, 9 B.R. 549, 558 (Bankr. C.D. Cal. 1981) *vacated on other grounds,* 37 B.R. 222 (B.A.P. 9th Cir. 1984). This discussion endeavors first to briefly recap the historical origins of

the good faith filing requirement and then to outline its contours in modern 11th Circuit jurisprudence.

THE PRE-CODE GOOD FAITH REQUIREMENT

Having its origins in Chapter X of the Bankruptcy Act of 1898, the good faith requirement originally directed the court to evaluate a debtor's bankruptcy petition at the threshold and permitted entry of an order for relief only if the court was satisfied "that [the petition] complies with the requirements of [Chapter X] and has been filed in good faith," failing which the court was required to dismiss the petition. 11 U.S.C. § 541 (1976) (repealed 1978). Pre-Code laws required a bankrupt to demonstrate his good faith by making a showing that his plan was reasonably possible or that there was a *prima facie* possibility that a successful reorganization could be accomplished. *See In re Plaza Towers, Inc.*, 294 F. Supp. 714, 719 (E.D. La. 1967). This explicit good faith filing requirement persisted as the *sine qua non* of reorganization in bankruptcy for nearly a century. *See Matter of Mogul,* 17 B.R. 680, 681-82 (Bankr. M.D. Fla. 1982) ("There is nothing in the legislative history which would indicate that Congress, by omitting the express requirement of 'good faith' intended to do away with the safeguard against abuse and misuse of the process, a safeguard which has been long established and accepted as part of the bankruptcy philosophy for almost a century. Accordingly good faith must be viewed as an implied prerequisite for a debtor's ability of obtaining relief under this Chapter.").

It was not until the early 1970s, as the Commission on the Bankruptcy Law of the United States (the "Commission") was in the process of drafting what would eventually become the modern Bankruptcy Code, that legal scholars and legislators reconsidered the propriety of a threshold good faith filing requirement. Frank R. Kennedy & Gerald K. Smith, *Postconfirmation*

Issues: The Effects of Confirmation and Postconfirmation Proceedings, 44 S.C. L. Rev. 621, 732, fn. 409 (1993). By that time, the good faith requirement had come to be seen as a font of needless, premature litigation, owing to the fact that it virtually required secured creditors to unnecessarily litigate the issue of good faith at the outset of a case in order to obtain relief from the stay against repossession or foreclosure remedies. *Id.* In its final draft of the Bankruptcy Code, the Commission adopted the recommendations of certain members to replace the good faith test with specific grounds for the dismissal or adjudication of a Chapter 11 case upon the motion of a creditor or by the court *sua sponte*. *Id.*

GOOD FAITH AFTER ENACTMENT OF THE BANKRUPTCY CODE

With the enactment of the Bankruptcy Reform Act of 1978, the Bankruptcy Code dispensed with the threshold good faith filing test. However, the requirement that a debtor file a petition in good faith (or at least not in bad faith) persisted, albeit in another form. See *Matter of Mogul,* 17 B.R. at 682. In place of the threshold test, the Code introduced the concept of dismissal or conversion of a Chapter 11 case "for cause" pursuant to § 1112(b). 11 U.S.C. § 1112(b)(1)-(9) (1978).

While a threshold showing of good faith was no longer explicitly required following the enactment of the Bankruptcy Code, courts were resistant to the notion that Congress had dispensed with the cornerstone doctrine of good faith altogether, and many thought that the new § 1112 of the Code was a reincarnation of the expired good faith test. See, e.g., *Matter of Nw. Recreational Activities, Inc.*, 4 B.R. 36, 39 (Bankr. N.D. Ga. 1980) (equating the pre-Code § 141 statement of good faith with the new § 1112, and discussing that dismissal for lack of good faith was not precluded by the new Code). With little exception, the generally accepted view quickly became that Chapter 11 bankruptcy petitions were subject to dismissal under § 1112(b) if not

filed in good faith. *See In re Albany Partners, Ltd.*, 749 F.2d 670, 674 (11th Cir. 1984) (discussing that equitable nature of bankruptcy court's discretion to determine circumstances giving rise to "cause" for purposes of § 1112 supports construction that debtor's lack of good faith may constitute cause for dismissal); *Matter of Little Creek Dev. Co.*, 779 F.2d 1068, 1071, fn. 2 (5th Cir. 1986) (stating that "[e]very bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings" and citing to a plethora of cases that found lack of good faith sufficient to constitute "cause" to lift the automatic stay or dismiss the petition); *In re Nat. Land Corp.*, 825 F.2d 296, 297 (11th Cir. 1987) (bankruptcy court had discretion to dismiss petition filed in bad faith prior to reviewing debtor's proposed plan for reorganization because the taint of a petition filed in bad faith would naturally extend to any subsequent reorganization proposal); *but see In re Victoria Ltd. P'ship*, 187 B.R. 54, 61 (Bankr. D. Mass. 1995) (rejecting good faith filing doctrine as contrary to the Bankruptcy Code, its legislative history, and Supreme Court precedent, and refusing to dismiss petition for cause).

BAD FAITH FILING & THE *PHOENIX PICCADILLY* FACTORS

While following enactment of the Code virtually every bankruptcy court agreed that a Chapter 11 petition filed without good faith is subject to dismissal under § 1112(b), determining whether a debtor had in fact filed a petition in bad faith was an exercise that did not admit of a bright-line test. Not long after the Code was enacted, though, the Eleventh Circuit provided significant guidance on this issue in the watershed case of *In re Phoenix Piccadilly, Ltd.*, 849 F.2d 1393 (11th Cir. 1988). Citing *In re Albany Partners*, *Natural Land*, and *Little Creek Development* – all cases under the Code in which courts had dismissed petitions for a lack of good faith – the Eleventh Circuit in *In re Phoenix Piccadilly* explained that while there is no

specific formulation of the test for determining whether a debtor has filed a petition in bad faith, courts may consider any factors evidencing "an intent to abuse the judicial process and the purposes of the reorganization provisions" or, in particular, the debtor's intent "to delay or frustrate the legitimate efforts of secured creditors to enforce their rights." *Id.* at 1394. To this end, the court set forth an illustrative, non-exhaustive list of factors indicative of a bad faith filing, including –

(i) The Debtor has only one asset, the Property, in which it does not hold legal title;

(ii) The Debtor has few unsecured creditors whose claims are small in relation to the claims of the Secured Creditors;

(iii) The Debtor has few employees;

(iv) The Property is the subject of a foreclosure action as a result of arrearages on the debt;

(v) The Debtor's financial problems involve essentially a dispute between the Debtor and the Secured Creditors which can be resolved in the pending State Court Action; and

(vi) The timing of the Debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the Debtor's secured creditors to enforce their rights.

Id. at 1394-95.

The *Phoenix Piccadilly* factors remain viable today despite some contention over the issue following the enactment of the Bankruptcy Reform Act of 1994 (the "Reform Act"), which revised §§ 101 and 362(d) with respect to single asset real estate cases. A few post-Reform Act cases raised doubts as to whether *Phoenix Piccadilly* and its predecessor *Albany Partners* had been legislatively overruled. *Compare In re Jacksonville Riverfront Dev., Ltd.*, 215 B.R. 239, 243 (Bankr. M.D. Fla. 1997) *abrogated by In re State St. Houses, Inc.*, 356 F.3d 1345 (11th Cir.

2004) (*Phoenix Piccadilly* no longer applicable in light of Bankruptcy Reform Act of 1994) and *In re Villamont-Oxford Associates Ltd. P'ship*, 230 B.R. 457, 463 (Bankr. M.D. Fla. 1998) *abrogated by In re State St. Houses, Inc.*, 356 F.3d 1345 (11th Cir. 2004) (same) *with In re Star Trust*, 237 B.R. 827, 833 (Bankr. M.D. Fla. 1999) (amendment of § 362(d)(3) does not preempt law regarding bad faith dismissal) *and In re Midway Investments, Ltd.*, 187 B.R. 382, 388 (Bankr. S.D. Fla. 1995) (concluding that the Reform Act did not limit the *Phoenix Piccadilly* line of cases). In 2004, the Eleventh Circuit resolved the uncertainty, however, in favor of the continued viability of *Phoenix Piccadilly*. *In re State St. Houses, Inc.*, 356 F.3d 1345, 1347 (11th Cir. 2004) (holding that guidelines set forth in *Phoenix Piccadilly* and *Albany Partners* for determination of whether petition was filed in bad faith were not modified by the Reform Act).

MODERN 11TH CIRCUIT BAD FAITH DISMISSAL CASES

Following the guidepost of *Phoenix Piccadilly*, courts passing upon the issue of bad faith filing have recognized factors which "show an intent to abuse the judicial process and the purposes of the reorganization provisions . . . these factors include the timing of the filing of the petition; whether the debtor is financially distressed; whether the petition was filed strictly to circumvent pending litigation; and whether the petition was filed solely to reject an unprofitable contract . . . ." In re Dixie Broadcasting, Inc., 871 F.2d 1023, 1027 (11th Cir. 1989); Cf. Singer Furniture Acquisition Corp. v. SSMC, Inc. N.V., 254 B.R. 46, 52-53 (M.D. Fla. 2000) (finding that the debtor had filed bankruptcy in an attempt to evade pending litigation in Virginia, after failing in three attempts to transfer venue); Dixie Broadcasting, 871 F.2d at 1027 (noting that the debtor was not in financial distress according to their own documents and filed bankruptcy to avoid a bad contract).

The following case law supplement provides a synopses of cases that illustrate the factors courts typically consider when passing upon the issue of bad faith and the manner in which courts conduct that analysis:

***In re State Street Houses, Inc.*, 356 B.R. 1345 (11th Cir. 2004)**	
Facts	• Debtor is a New York corporation and title holder of an apartment complex in Utica, New York subject to a secured lien held by a creditor. • The bankruptcy court found the evidence established the Debtor filed for Chapter 11 protection in bad faith; the district court affirmed; the Eleventh Circuit affirmed. • The Debtor has only one asset; has few unsecured creditors with small claims; few employees; the property is subject to foreclosure action as a result of arrearages; the financial problems are solely with the secured creditor; the timing of filing was intend to delay the secured creditor.
Holding	The guidelines set forth in *In re Phoenix Piccadilly, Ltd.* have not been modified by the Bankruptcy Reform Act of 1994.

***In re Phoenix Piccadilly, Ltd.*, 849 F. 3d 1393 (11th Cir. 1988)**	
Facts	• The Debtor is a limited partnership which owns an apartment complex in Louisville, Kentucky comprised of four phases (I, II, III, and IV). • Mortgage foreclosure proceedings were commenced in Kentucky against the properties in June, 1987 and an order was entered appointing a receiver for Phase III of the property. • Debtor filed its Chapter 11 petition the day before a hearing to appoint receivers to the other phases (which were appointed upon lifting of the automatic stay). • Bankruptcy court dismissed the case for bad faith; the district court affirmed; the Eleventh Circuit affirmed concluding the record properly supported the bankruptcy court's findings: o The Debtor's motives were to stall the foreclosure action; o Debtor had less the $250,000.00 in unsecured debt; o The Debtor had only 15 employees performing maintenance at the property under the supervisions of the Debtor's affiliated management company; o The venue was intended to cause further delay and inconvenience for creditors.
Holding	Because the bankruptcy court found that a bad faith filing had occurred, it properly did not change the consequences of that finding simply because of the debtor's possible equity in the property or potential for successful

	reorganization.

***Singer Furniture Acquisition Corp. v. SSMC Inc. N.V.*, 254 B.R. 46 (M.D. Fla. 2000)**	
Facts	• The Debtor was a defendant and compulsory counter claimant to a civil action brought by creditor, SSMC, alleging the Debtor had fraudulent circumvented SSMC's security interest in the Debtor to secure a $4,6000,000.00 debt owed by the Debtor to SSMC. • The Debtor had attempted to move the transfer the action to Florida three separate times. • The Debtor filed its Chapter 11 petition in Florida 13 days before the trial in Virginia and while motions for summary judgment were pending. • The bankruptcy court dismissed the case for bad faith finding the filing "a classic and gross misuse of Chapter 11…one of the worst bad faith cases I've seen…" • The Debtor appealed. • The district court affirmed the bankruptcy court finding support in the record for the bankruptcy court's conclusions that: o The Debtor was not a holding company not engaged in any business and without employees; o The Debtor had more than enough assets to pay its only two creditors other than SSMC; o The Debtor's financial problems dealt solely with SSMC; o The petition was filed on the eve of trial; o The Debtor attempted to invoke the automatic stay provisions in order to evade pending litigation in Virginia; and o There is no possibility of reorganization because there is nothing to reorganize.
Holding	The Bankruptcy Court did not abuse its discretion when it dismissed the petition because it was filed in bad faith.

***Colonial Daytona Ltd. P'ship v. Am. Sav. of Florida, F.S.B.*, 152 B.R. 996 (M.D. Fla. 1993)**	
Facts	• The Debtor is a single asset real estate debtor that owns a 208 unit apartment house complex. • The Debtor does not conduct any business other than ownership of the business and the property is managed and operated by a company owned by insiders of the Debtor. • The property is subject to a first mortgage with an outstanding balance of $7.2 million and a wrap-around second mortgage with an outstanding balance of $1.8 million. • The Debtor has no equity in the property and although the complex is fully rented, it does not generate sufficient revenues to services the two

	mortgages and have also been insufficient to pay the either the property taxes or the regular maintenance of the building. • The second mortgagor sought to foreclose its mortgage and obtained an order for the sequestering the rents of the property. • The Debtor filed days before the payment of the sequestered rents was due. • The Debtor's intent in filing its Petition was to avoid the upcoming hearing in the state court foreclosure case. • The Debtor is not able to pay even normal operating expenses, let alone service the debt on the complex, thus reflecting the Debtor's inability to operate as an on-going concern • The Debtor would not have been able to confirm its Plan and proceed through the steps of reorganizing.
Holding	The bankruptcy court's finding that the Debtor filed its case in bad faith is supported by the record.

***In re Lezdey*, 332 B.R. 217 (Bankr. M.D. Fla. 2005)**	
Facts	• The Debtors are brothers, Darren and Jarett, and controlling officers of AlphaMed formed in 1999 to develop bio-tech patents. • The Debtors filed separate Chapter 11 cases on the same day while both subject to a $17.4 million judgement from an Arizona state court held by Allen Wachter and two corporate affiliates. • The cases represent a two-party dispute between each of the debtors and Wachter. • The cases were filed on the eve of a deciding hearing—a Florida proceedings supplementary. • Debts listed owed to other creditors were incurred several years before the cases were filed and no effort has ever been made by those creditors to collect those debts. • Only Wachter filed a claim in both cases. • The Debtors could not articulate why they were in Chapter 11 and not Chapter 7. • The Debtors are not able to reorganize.
Holding	These cases were filed solely to delay and frustrate the efforts of their common creditor, Wachter.

***In re Double W. Enterprises, Inc.*, 240 B.R. 450 (Bankr. M.D. Fla. 1999)**	
Facts	• Debtor is in the business of real estate sales where W. William Ellsworth, II is listed as the owner of 100% of the Debtor's stock. • The only creditor schedules is Ellsworth, Jr. (the stock owner's father) holding a disputed, unsecured claim of $450,000.00.

	• The Debtor's schedules reflect it owns no real property and has a bank account holding $1,271.00. • The Debtor filed an adversary against Ellsworth, Jr. (and his related entities) on various state court issues including an accounting, slander, and breach of fiduciary duty. Ellsworth, Jr. sought to dismiss the filing. • The Debtor amended its schedules the day before a hearing on the motion to dismiss to add 79 entitles holding disputed unsecured claims in undetermined amounts. • The Debtor had no employees. • The Debtor received minimal income in 1995 and 1996 and no income in the two years prior to filing the petition or since filing the petition. • Debtor has no trade or business debt resulting from any traditional business operation. • The claims and potential claims listed would be resolved by the state courts. • The Debtor is seeking to preempt the state court process because it anticipates claims may be raised.
Holding	The case does not promote the policy of chapter 11 to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors and produce a return for its stockholders.

***In re Panache Development Company, Inc.*, 123 B.R. 929 (Bankr. S.D. Fla. 1991)**	
Facts	• The Debtor asserts it is a "developer of expensive homes". • The Debtor's only asset is real property subject to option to purchase the undeveloped ocean front tract. The property is valued at $1,500,000.00 subject to a mortgage in the amount of $800,000.00. • The Debtor lists 11 unsecured creditors upwards of $300,000.00, of which the vast majority are held by insiders. • The Debtor does not maintain on office and has no employees. • The Debtor has not taken on any construction projects and has no income from operations. • The Debtor has filed the petition in order to prevent the exercise of the option.
Holding	In the absence of any real possibility for reorganization, the Debtor's motives are a specific abuse of the Bankruptcy Court system.

***In re Prince Manor Apartments, Ltd.*, 104 B.R. 414 (Bankr. N.D. Fla. 1989)**	
Facts	• The Debtor is a single asset debtor whose principal asset is an apartment complex. • The apartment complex is subject to a foreclosure judgment entered in December, 1988 in favor of the secured creditor.

	• The Debtor last made a monthly mortgage payment to the secured creditor in April, 1988. • The filing of the Chapter 11 petition on January 11, 1989 stayed the foreclosure sale scheduled for January 23, 1989. • The Debtor has only $800.00 in unsecured debt. • The Debtor has no employees. • The Court found the property is incapable of generating sufficient income to pay the debt service and the substantial costs of renovation needed. • The Debtor has been attempting to reorganize since 1987 without success.
Holding	The Court finds that the Debtor filed the petition for reorganization in bad faith, for the principal purpose of delaying legitimate efforts of the creditor to enforce its rights, and without *any* realistic possibility of rehabilitation.

***In re U.S. Loan Co, Inc.*, 105 B.R. 676 (Bankr. M.D. Fla. 1989)**	
Facts	• The Debtor is a single asset debtor whose principal asset is real estate development consisting of 48 duplexes each encumbered by separate promissory notes. • Each of the 48 promissory notes is in default with an aggregate principle and interest balance of approximately $2,820,000.00 including $700,000.00 in past due interest and ongoing interest payment accruing at approximately $30,000.00 each month. • The Debtor has only one officer, Vincent Bekiempis. • The assets had been previously held by a limited partnership which filed a chapter 11 in New Jersey in 1987 in which Fannie Mae held a first mortgage and Bekiempis held a second mortgage on the property. • Bekiempis sought and was granted relief from stay in the New Jersey bankruptcy case to pursue a foreclosure action in Florida. • Bekiempis obtained an appointment of a receiver in February, 1989 and then assigned his interest in the second mortgage to the Debtor which purchased the property at the foreclosure sale by bidding his judgment. • The instant bankruptcy was filed days after the state court denied the Debtor's application to terminate the receivership.
Holding	The Debtor might need the relief, but its ability to effectuate a reorganization is highly questionable considering the entire facts surrounding this case…and the Petition was, in fact, filed in bad faith.

In Randy Homes Corporation, 86 B.R. 259 (Bankr. N.D. Fla. 1988)	
Facts	• The Debtor holds a portion of an interest in undeveloped real property jointly with two other individuals, husband and wife, conveyed by the Debtor's sole officer, director, and stockholder, Delores Crumpton. • The property was acquired from Crumpton pursuant to divorce proceedings. • The property was subject to a foreclosure action whereby the secured creditor had obtained a final judgment of foreclosure. • The chapter 11 petition was filed on the same day as the foreclosure sale and quit claims were also recorded that day transferring the married individuals'' interest in the property to the Debtor. • The Debtor's only asset is undeveloped real property, although the Debtor has $20,000.00 in its debtor in possession account. • The Debtor has no income, no employees, has never attempted to develop the property, and has no viable business entity to rehabilitate. • The petition was filed to forestall the foreclosure sale.
Holding	The Court is not required to retain cases which were not filed to achieve the valid, legitimate, purposes of the rehabilitative provisions of Chapter 11 and finds that cause exists warranting the dismissal of this case for bad faith filing.

Special Thanks to Alexis A. Leventhal, Law Clerk to the Honorable Arthur B. Briskman, United States Bankruptcy Court Middle District of Florida, for her case cite contributions.

SINGLE ASSET REAL ESTATE

Kendyl B. Tash
Holland & Knight LLP, Tampa, FL

W. Keith Fendrick
Holland & Knight LLP, Tampa, FL

BACKGROUND

The concept of the single asset real estate ("SARE") was formally introduced in the 1994 Bankruptcy Reform Act. The stated purpose of SARE was to curb the perceived abuse of Chapter 11 by real estate owners and developers who retained an equity interest in real estate without fairly treating the foreclosing mortgagee. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act") contained a number of changes to the provisions of the Code governing SARE cases, most notably the expansion of the definition of the SARE case.

Today, a SARE case is defined as "a single property or project, other than residential real property with fewer than four residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental." 11 U.S.C.A. § 101(51B). Notably, there is no secured debt limitation and the 2005 Act clarifies that the definition applies to all cases in which the debtor's primary business is the ownership or operation of a single piece of property, excepting family farmers. The 2005 Act, however, does not indicate the extent to which incidental business takes the debtor outside of the scope of SARE and, thus, decisions under prior law that marinas, golf courses, and hotels are not SARE cases, remain viable. The 2005 Act also does not address several other substantive and procedural issues, such as how a debtor provides adequate protection of rents or whether Section 362(d)(3) is the exclusive remedy for stay relief in such cases.

The principal effect of the status of a Chapter 11 case as a SARE debtor relates to relief from the automatic stay, which is mandated if certain elements are met. Section 101(51B) and Section 362(d)(3) of the Code codify a clear Congressional policy that SARE cases should not obstruct secured creditor rights unless the debtor strictly complies with the requirements thereof.

Section 362(d)(3) states:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--. . . (3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later --
>
> (A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
>
> (B) the debtor has commenced monthly payments that --

> (i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and
>
> (ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate….

The goal of this Section is to streamline SARE cases and provide a less burdensome method of lifting the automatic stay, thereby enablingthe mortgagee to foreclose if the debtor does not promptly move to reorganize.

Three criteria must be satisfied for a debtor to qualify as a SARE debtor: (1) the debtor must have real property or project, other than residential real property with fewer than four residential units, (2) which generates substantially all of the gross income of the debtor, and (3) on which no substantial business is conducted other than the business of operating the real property and activities incidental thereto. *In re Scotia Pacific Co., LLC*, 508 F. 3d 214, 220 (5th Cir. 2007). If any of these three criteria are not met, the debtor will not receive SARE status. *Id.*

The moving party bears the burden of proving by a preponderance of the evidence that a debtor is subject to the SARE provisions of the Bankruptcy Code. *In re Yishlam, Inc.*, 495 B.R. 328, 330 (Bankr. S.D. Tex. 2013). In determining whether a particular debtor is a SARE, "the court must look to current facts, not to those existing in the past, nor to Debtor's aborted plans for the future." *In re Hassen Imports P'ship*, 466 B.R. 492, 507 (Bankr. C.D. Cal. 2012).

I. The Statutory Definition of "Single Asset Real Estate."

The following section provides an overview of how courts have interpreted the three criteria a debtor must satisfy to qualify as a SARE debtor.

a) Single Property or Project.

To begin, a SARE debtor must involve a single property or project.

In *In re Alvion Properties, Inc.*, 538 B.R. 527 (Bankr. S.D. Ill. 2015), the debtor owned two parcels of real property (one a fee simple tract and the other a mineral tract), both of which were encumbered by a mortgage. Neither tract was the site of any active business operations as of the petition date. The lender sought a determination that the debtor was a SARE and, therefore, subject to the provisions of Section 362(d)(3). In response, the debtor argued that the first prong of the SARE test was not satisfied and, thus, it was unnecessary for the court to conduct further inquiry.

The court, agreeing that there were two properties at issue, analyzed whether there was a "single project." It noted that determining whether multiple properties constitute a single project required an examination of the facts. In particular, the court explained that the properties must

be linked together in some fashion by way of a common plan or scheme involving their use. The mere fact of common ownership, or even a common border, will not suffice. *In re Hassen Imports*, 466 B.R. 492 (Bankr. C.D. Cal. 2012). The court found the lender did not meet its burden as to the proof of a single project and denied the lender's motion.

In *In re Yishlam, Inc.*, 495 B.R. 328 (Bankr. S.D. Texas, 2013), the court similarly held that the creditor failed to meet its burden of showing that noncontiguous apartment buildings, which the debtor planned to convert to condominiums, were a single project. The court noted that the facts and arguments before it weighed heavily on both sides of a SARE determination. Specifically, the court explained that:

> On one hand, it is significant that: (a) all of the units are pledged as collateral for Great Central's loan; (b) Yishlam has a single bank account for all of its operations; (c) Yishlam has one contract to provide internet, garbage pickup, and electricity to all units; and (d) Yishlam has one real estate management contract for all of the units.
>
> On the other hand, the fact that the properties are non-contiguous, attract different clientele, were purchased and converted to condominiums at separate times and are organized and controlled differently, suggest that this should not be designated as a single asset real estate case.

Id. at 332. Because the factors were largely in equilibrium, the court found the creditor had failed to demonstrate by a preponderance of the evidence that the two properties constituted a single project.

In *In re Carolina Pediatric Eye Properties, LLC*, No. 15-50036, 2015 WL 1806047 (Bankr. M.D.N.C. 2015), the creditor sought an order designating the debtor as a SARE, arguing that the debtor fit the definition in Section101(51B) because (a) the debtor's only property was a commercial office building (and the lot on which it sits), (b) the property generated substantially all of the debtor's gross income, and (c) the debtor conducted no substantial business other than collecting rent and maintaining the property. The debtor responded with a "common entity" theory:

> Dr. McGriff is the sole owner and manager of both the debtor and CPES, the property requires active labor and effort in order to generate income, and the lease between the two companies is one which "'[n]o lessor or lessee would enter into . . . unless both were controlled by a common entity with a common purpose.'"

Id. at *2 (quoting *Commerce Bank & Trust Co. v. Perry Hollow Golf Club, Inc. (In re Perry Hollow Mgmt. Co),* Nos. 99-13373-MWV, CM 00-127, 2000 WL 33679447, at *1 (Bankr. D.N.H. April 6, 2000)). The debtor compared itself with the debtors in two cases – *Perry Hollow*, 2000 WL 33679447, and *In re Larry Goodwin Golf, Inc.,* 219 B.R. 391 (Bankr. M.D.N.C. 1997) – in which the courts found that the debtors were not SARE entities. The court

disagreed with the debtor. The court concluded that the debtor merely owned the land on which a separate entity runs a business. The court further noted that other courts had flatly rejected the "common entity" theory in cases where a holding company does not participate in its affiliates' business.

In *In re Kachina Village, LLC*, 538 B.R. 124 (Bankr. New Mexico 2015), the court held that a 1.259 acre parcel of undeveloped land located in a village and zoned for mixed use was a SARE. The debtor argued that, while the property qualified under the general test, it was not a SARE because it was residential real property with fewer than 4 residential units (the "Residential Exception"). The debtor argued, inter alia, that the property comes within the Residential Exception because it is unimproved and, therefore, has fewer than four residential units. The court disagreed. The court noted that, as an initial matter, it is not clear that the Residential Exception applies to undeveloped land. Residential real property is not defined by the Bankruptcy Code, and there is no legislative history addressing its meaning. The most natural reading of "residential real property with fewer than four residential units" is property zoned for residential development that is improved with houses, condominiums, apartments, or the like. The court was not convinced that a developer holding 100 unimproved residential lots could avoid the SARE designation because it had not commenced construction on the petition date. *Id.* at 128.

The court determined that excluding unimproved land from the Residential Exception is consistent with the case law, which generally holds that raw land intended for development constitutes SARE. *See, e.g. In re Mountain Edge LLC*, No. 10835t11, 2012 WL 4839784, at *3 (Bankr. D.N.M. Oct. 10, 2012) (generally accepted that raw land acquired or held for development is SARE); *In re Kkemko, Inc.*, 181 B.R. 47, 51 (Bankr. S.D. Ohio 1995) (applying concepts of real estate law to conclude that "single asset real estate" includes raw land); *In re Light Foot Group, LLC*, No. 11-17945PM, 2011 WL 5509025, at *4 (Bankr. D. Md. Nov. 10, 2011) (residential development was SARE despite incidental projected income from repairs); *In re Pensignorkay, Inc.*, 204 B.R. 676, 683 (Bankr. E.D.Pa. 1997) (undeveloped parcel held for development was SARE); *In re A-1 Management Corp.*, No. 11-30042-BKC-AJC, 2011 WL 5509262, *1 (Bankr. S.D. Fla. Nov. 10, 2011) (finding that the debtor was a SARE entity where "its sole asset is a vacant parcel of mixed use real property. . . .").

In *In re Webb MTN, LLC*, No. 07-32016, 2008 WL 656271 (Bankr. E.D. Tenn. March 6, 2008), the debtor purchased five separate parcels of real property with plans to construct a resort, a retail commercial center, a development of single-family homes, and condominiums. When the debtor filed for protection under Chapter 11, the secured creditor who financed the project moved for a determination that the debtor was a SARE. The creditor asserted that, even though the debtor had plans for development, at the time of the filing the property was a single project because it was largely undeveloped land producing no income. The court agreed with the creditor, finding that no development had actually begun and the only activities were those of owning the property and activities incidental thereto, including receiving rent and "mowing the grass waiting for the market to turn." *Id.* at 6.

In *In re Sargent Ranch, LLC*, No. 10-00046-PB11, 2010 WL 3189714 (Bankr. S.D. Cal. Aug. 6, 2010), the debtor had owned certain real property for several years. The primary plan for the property was a large residential development but the debtor also had plans to include sand

excavation, wildlife habitat mitigation, liquid asphalt extraction, and solar energy production. At the time the debtor filed its bankruptcy petition, the property remained undeveloped. The debtor argued that a "single property" was not involved since there were numerous parcels located in different counties. *Id.* at *2. The court agreed with the debtor, stating, however, that "separate properties can still constitute single asset real property if they are part of the same project" and that "*single asset real estate include[s] raw, undeveloped land." Id.* (emphasis added) (citation omitted). The court explained:

> Debtor attempts to avoid the single asset real estate label by trotting the numerous plans it has for developing the Property. However, *intentions do not constitute projects*. There is no disputing the fact that at the time the case was filed, as well as at the time of the hearing, every inch of every parcel of the Property, with the exception of a small portion being leased to third parties, is part of the same operation-namely, waiting and planning for future development.

Id. at *3 (emphasis added). The court concluded that because the debtor owned undeveloped real property on which no substantial business was being conducted, the debtor had "a single project." *Id.*

As already noted, Section 101(51B) provides that "single asset real estate" means real property constituting a single property or project." In other words, the drafters of Section 101(51B) defined SARE cases to include two separate classifications, single properties and single projects.

What constitutes a single property or project was at issue in *In re Philmont Dev. Co*., 181 B.R. 220 (Bankr. E.D. Pa. 1995). That case involved three limited partnerships and their common general partner. Each limited partnership owned between eight and ten semi-detached houses that had been built by the general partner. The limited partnerships argued that the semi-detached units were separate properties and, thus, these debtors did not fall within the statutory definition of SARE. The court disagreed. Although the semi-detached houses were separate "properties," each group of homes constituted a single "project." In particular, the court noted that each group was operated under a common design or plan. Further, the units owned by each limited partnership were contiguous, and each contained four or more residential units. Accordingly, the three limited partnerships were SARE debtors. The court held that the general partnership was not subject to the provisions of section 362(d)(3), however, because (1) its assets consisted of partnership interests in the limited partnerships, (2) the general partnership's purpose was not to operate the properties which were owned by the limited partnerships, and (3) the rental income was not a direct source of income.

Similarly, in *In re Tad's Real Estate Co., Inc.*, No. 97-11999, 1998 WL 34066143 (Bankr. S.D. Ga. Mar. 23, 1998), the debtor bought 65 lots for residential development, built and rented houses on five lots, then failed to make tax payments and faced foreclosure. Upon the debtor's filing of a Chapter 11 case, the court determined that the debtor's property constituted a SARE.

The court explained, "[The] debtor purchased the property to develop as a subdivision and intended for the property to be income producing through lot and house sales. The property is a single project with a common intended use, plan, or scheme, arising from [d]ebtor's intent to develop a residential subdivision on the property. The property does not have various amenities that require substantial daily activity to run. Rather [d]ebtor currently merely operates the property to produce rental income." Furthermore, there is no requirement that the single property or project must be owned by a typical real estate investment entity. Cooperative corporations or projects may qualify as SARE debtors if a single property or project is involved. *In re 83-84 116th Owners Corp.*, 214 B.R. 530 (Bankr. E.D.N.Y. 1997).

On the other hand, in *In re McGreals*, 201 B.R. 736 (Bankr. E.D. Pa. 1996), the court determined that the debtor's assets did not constitute a single property or project and, hence, the debtor did not qualify for SARE treatment. The undisputed facts revealed only that the debtor owned two parcels of real property from the same grantor, which shared a partially adjacent border – one parcel was rented, while the other parcel, raw land, was not. Additional facts demonstrated that the debtor had no plans to combine the properties in any way. Further, testimony established that after the debtor abandoned its plans to develop the parcel of undeveloped land into a "warehouse condominium," it sought to sell that parcel in order to concentrate its efforts on the operation of its income producing property. The court held that, although factors such as a common grantor and contiguity are relevant, they are not necessarily dispositive. The key point is that different properties must be operated under a common scheme or plan if they are to constitute a single project. In *McGreals*, the debtor had no immediate plans for the use of the undeveloped parcel. Accordingly, the court held, the first statutory criterion was not satisfied.

b) The Property Must Produce Substantially All of the Debtor's Gross Income.

The second criterion of Section 101(51B) is that the real property must generate substantially all of the debtor's gross income. This definitional feature was drawn from earlier SARE cases in which the debtor had no significant assets or income apart from one property or project. For instance, in *In re Philmont Dev. Co*., 181 B.R. 220 (Bankr. E.D. Pa. 1995), each of the three debtor limited partnerships owned only a single project, and each debtor had no significant income apart from its project. By contrast, the court ruled that the fourth debtor, the common general partner of the three limited partnerships, could not be considered a SARE entity. The general partner's assets consisted of its partnership interests and two parcels of raw land that it meant to develop in the future. This scarcely fit either the statutory definition or the traditional pattern of a SARE debtor.

The second criterion was also at issue in *In re Oceanside Mission Assocs*., 192 B.R. 232 (Bankr. S.D. Cal. 1996). There, the question was whether a debtor whose only asset was undeveloped land that produced no income qualified for SARE treatment. As a matter of logic, if the debtor has no income, then a single parcel of real property that generates no revenue does indeed produce substantially all of the debtor's income. The court acknowledged that the text of Section 101(51B) which referred to "gross income" could only be applied to raw land "awkwardly," since raw land is typically not producing any income. Nevertheless, the court concluded that in its view there was no apparent reason for Congress to exclude raw land from the purview of Section 362(d)(3) and that standard statutory construction dictated that such

property be included.[1] Specifically, the court stated:

> If Congress intended to exclude raw land from the definition they would have done so specifically or at least explained in the comments that the definition was meant to exclude raw land. Without such an express exclusion this court does not believe that Congress meant for "single asset real estate" to mean less than it did before the sections were enacted. Although it requires a bit of a tortured reading, based upon the statutory purpose of the new sections, the limited legislative history, the usage of the term "single asset real estate" in prior case law and the fact that excluding raw land would simply not make sense, this [c]ourt concludes that "single asset real estate" includes undeveloped real property which generates no income.

Id. at 236.

Courts have uniformly held that if a debtor's sole asset is undeveloped, "raw" land, it meets the criteria of a "single asset real estate" case. In *In re Pensignorkay*, Inc. 204 B.R. 676 (Bankr. E.D. Pa. 1997), the debtor's only significant asset was a 275-acre tract of undeveloped real property. The court, holding the debtor had a "single asset real estate," provided:

> First, the Property, a tract of undeveloped land consisting of two adjacent parcels of real property . . . that the Debtor acquired with the intention of creating subdivided parcels suitable for building and development . . . constitutes a "single property or project" within meaning of the statute. . . . Next, the fact that the real property is currently undeveloped and not generating any income for the Debtor is of little consequence for purposes of the inquiry here, since the [c]ourt is satisfied that Congress did not intend to excuse from compliance with the revised statute the class of debtors who hold undeveloped tracts of land for future development. . . . The third factor is also satisfied here since clearly the Debtor is not currently involved in any business activity on the Property other than its ownership of the realty.

---

[1] Prior to the 1994 Reform Act, courts had consistently treated debtors whose only asset was raw land as SARE entities, *e.g., In re Humble Place Joint Venture*, 936 F.2d 814 (5th Cir. 1991) (would-be commercial development property was partially developed - it was subdivided with identified streets, curbs, and basic utilities - but was referred to as "raw land" generating no income); *In re Nattchase Assocs. Ltd. Partnership*, 178 B.R. 409 (Bankr. E.D. Va. 1994) (a failed subdivision development effort); *In re Clinton Fields, Inc.*, 168 B.R. 265 (Bankr. M.D. Ga. 1994) (a failed subdivision development effort); *accord In re Kinard*, No. C/A01-03621-W, 2001 WL 1806039 (Bankr. D.S.C. Nov. 16, 2001) (vacant land producing no revenue fell within scope of single asset real estate).

See In re Syed, 238 B.R. 140 (Bankr. N.D. Ill. 1999) (property in disrepair that generated little or no income qualified for SARE treatment).**c) No Substantial Business Other Than Operating the Property.**

The third criterion of Section 101(51B) is that the debtor must not conduct any substantial business on the property apart from managing the real estate and activities incidental thereto. This fits the normal pattern of a SARE debtor as a largely passive owner or investor. Conversely, if the debtor is actively using the property to carry on business operations, then this criterion is not satisfied. For example, in *In re Kkemko, Inc*. 181 B.R. 47 (Bankr. S.D. Ohio 1995), the debtor was a marina. The major secured creditor argued that the case involved a SARE debtor because the marina rented out docking space. The court disagreed. The court explained that assuming the docks could be considered real property under the law of fixtures so as to otherwise qualify the marina for SARE treatment the debtor was clearly not a passive renter. There, the court determined:

> The evidence established that the business of the marina is something more than simply rental of moorings. It stores, repairs, and winterizes boats. The marina provides showers and a pool, as well as other activities for those boaters who use it to moor their boats. It sells gas, an activity which according to debtor's disclosure statement it intends to offer. Other amenities such as concessions also produce revenue for the debtor from the operation of the marina.

Based on the variety of services offered at the marina, which provided multiple sources of revenue, the court held that the marina was not a SARE entity.

SARE treatment was refused on similar grounds in *In re CBJ Dev., Inc*., 202 B.R. 467 (9th Cir. B.A.P. 1996). There, the debtor owned a full service hotel and operated a gift shop, bar, and restaurant on the premises. The court launched a two-prong attack on the contention that the debtor was "conducting no substantial business" apart from "the business of operating real property and activities incidental thereto." First, running a full service hotel, in the court's view, amounted to more than simply operating real property. Unlike the proprietor of an apartment or office building, a true hotelier or innkeeper furnishes substantial services to its guests on a daily basis. Indeed, patrons pay for the services at least as much as the room space. Second, the gift shop, restaurant, and bar were significant undertakings in their own right, and running such enterprises was not just operating real property. Although the restaurant and bar had been closed for renovations when the petition was filed, they had generated income previously, and the debtor apparently intended to reopen them. Both because of the full service nature of the hotel and because of the additional undertakings, the court concluded that the third criterion of Section 101(51B) was not satisfied.

Likewise, in *In re Whispering Pines Estate, Inc*., 341 B.R. 134 (Bankr. D.N.H. 2006), the court held that operating an 89-room hotel that provided room-cleaning and towel-laundering services, served continental breakfast, maintained a swimming pool, and provided telephone and high speed internet service was conducting substantial business "other than the business of operating the real property." Specifically, that business included a bar, restaurant, gift shop, and

bus tours, disqualifying the hotel from SARE status, as defined in Section 101(51B). The bankruptcy court relied on *CBJ*, in reaching its conclusion.

Although courts have generally found hotels to be outside the definition of a SARE entity, simply being involved in the hospitality industry may not preclude SARE treatment. For example, in *In re LDN Corp*., 191 B.R. 320 (Bankr. E.D. Va. 1996), the debtor owned a motel. Apparently there was no restaurant, gift shop, or similar business on the premises and it appears that the services provided to guests were not at the level of a full service hotel. At all events, there was no dispute that the motel owner was a SARE debtor.

Cases appear to uniformly hold that golf course are not SARE entities.

Driving home the point that an owner using the property for an active business is not a SARE debtor, the court in *In re Larry Goodwin Golf, Inc*., 219 B.R. 391 (Bankr. M.D.N.C. 1998), held that a corporation that operated a golf course did not fall within the scope of Section 101(51B). In addition to running the golf course, the debtor operated a pro shop, pool, cart rental, and concessions. The debtor, in short, was using the property to conduct an active business rather than holding it merely as an income-producing investment. In addition, the debtor owned adjacent land that was currently for sale, further casting doubt on the contention that there was only a single property or project at issue.

Similarly, in *In re Prairie Hills Golf & Ski Club, Inc*., 255 B.R. 228 (Bankr. D. Neb. 2000), the court held that the debtor was not a SARE entity. There, the debtor did not hold property simply as a passive real estate investment. Rather, the property was the site of various income-producing activities that the debtor conducted, including the development and sale of residential lots, the sale of alcoholic beverages at a clubhouse, and active farming operations, all in addition to leasing golf and ski facilities to a third party. Consequently, the secured creditor could not take advantage of Section 362(d)(3).

In *In re Club Golf Ptnrs., L.P*., No. 07-40096-BTR-11, 2007 WL 1176010 (Bankr. D. Tex. April 20, 2007), the bankruptcy court held that a golf course which conducted substantial business other than the operations of a the real property was not a SARE. The court adopted an active-versus-passive criterion that examined the nature of the revenue generation and whether that revenue "is the product of entrepreneurial, active labor and effort — and thus is not single asset real estate — or is simply and passively received as investment income by the debtor as the property's owner, and thus is single asset real estate." The court held that the debtor's golf course did not fall within the definition of a SARE entity under Section 101(51B) and was therefore not subject to Section 362(d)(3) because: (1) the debtor's business activities were variegated and multiple and were dependent on the entrepreneurial efforts and ongoing hard work of its principals and other employees, and (2) the debtor did not simply lease its property to tenants.

II. Passive vs. Active Considerations

Two major decisions in 2007 highlight the complexity involved in resolving whether a large, complex project qualifies as a SARE case. *In re Kara Homes, Inc*., 363 B.R. 399 (Bankr. D.N.J. 2007) was decided on March 12, 2007. Less than one month later, a Texas bankruptcy court held that a complex timber operation on vast acreage was not a single asset case, with much emphasis on the distinction between the passive and active creation of income. *In re*

Scotia Development, LLC, 375 B.R. 764 (Bankr. S.D. Tex. 2007), aff'd 508 F.3d 214 (5th Cir. 2007). When the lenders appealed the decision by the bankruptcy court in *Scotia*, they argued that the result was governed by *Kara Homes* but, as noted below, the Fifth Circuit found that the two cases were distinguishable, despite both involving large scale projects, with many employees, diverse operations, and potentially many creditors.

a) *Scotia* Development:

This recent case focuses on the distinction between a "passive" investment, which falls within the definition of a SARE case and an "active" investment, which does not, while providing an excellent summary of the various factors relevant to the SARE analysis.

Facts. The Scotia Pacific Company ("Scopac") was the owner of approximately 200,000 acres of private timberland on which it held the exclusive right to harvest timber on about 10,500 acres of private timberland owned by one of its subsidiaries. Scopac conducted its business in part over nine watersheds, each of which was a distinct geographical area with different environmental and business concerns. Each watershed is treated separately by the regulatory authorities. The day to day business of the debtor consisted of managing the entire life cycle, from the planning and layout of Timber Harvest Plans, the sale of logs resulting from the harvest of timber, the supervision and conduct of the harvest, and the site preparation, replanting and vegetation control of the harvest sites. The debtor had over 60 employees, including scientists and foresters, who address and deal with an array of federal and state regulatory laws. In addition, it employed registered professional foresters who engaged in a wide variety of activities including organizing and directing systems of control for forest fires, insect pests, and other related environmental issues. Further, the debtor operated other commercial operations including leasing space for cell phone towers and an FAA radio beacon, in addition to operating cattle ranches and grazing leases.

Issue. The Noteholders filed a motion seeking a determination that Scopac was a SARE company and that it was obligated to comply with the requirements of Section 362(d)(3).

Holding. The bankruptcy court made extensive findings of fact, and held that Scopac was not a SARE debtor because it had substantial business activities other than the operation of the business, and because it was not merely a "passive" investor. The court determined that Scopac was actively using property in its operations and hence the revenue was attributable to the operations and not just the property. Its revenue was the product of the efforts of management and workers conducted on the lands, bringing in the customers and selling services and goods to them.

The notion of "passive" investment: held for sale or rent. Another key distinction was that the property was not held for sale or lease primarily, but rather for the conduct of various operations and activities. The court noted:

> The property is not being held for resale or merely collecting rents and Scopac has owned the properties for many years. "[A] debtor that not only owns real estate but also operates a variety of revenue-producing activities on it, employs third-party employees,

> without whom nothing would happen on the property, enjoys revenues from a variety of active commercial activities on the property that are dependent on the entrepreneurial efforts and hard work of its principals and its other employees, and does not simply lease its property to tenants as the owner of true single asset real estate such as an apartment house does, does not fall within the scope of the definition of 'single asset real estate' in § 101(51b) and is not subject to § 362(d)(3)." Citing, *In re Club Golf Partners, L.P.*

Passive activities illustrated. The court emphasized that passive activities within the meaning of Section 101(51B) are limited to activities such as the mere receipt of rent and truly incidental actives such as arranging for maintenance or perhaps some marketing activity, or "mowing the grass and waiting for the market to turn."

Is a large real estate project not a SARE case? In further explaining the active-versus-passive test, the court seemed to suggest that some large scale real estate projects might fall outside the scope of a SARE case: "Real property that, for the generation of revenues, requires the active, day-to-day employment of workers and managers other than or additional to the principals of the debtor, and that would not generate substantial revenue without such labor and efforts, should not be regarded as single asset real estate." Citing *In re Club Golf Partners*. Nevertheless, the Fifth Circuit agreed that the debtor in *Kara Homes* was a SARE debtor, despite being a complex, large scale real estate development, which involved numerous employees, and engaged in such activities as the design, sale, and marketing of the real estate, as well as assuring compliance with numerous regulatory and environmental issues.

b) *Kara Homes*:

The decision in *Kara Homes* might be viewed as somewhat inconsistent with *Scotia* because the court there found that the debtor was a SARE debtor, despite widespread activities, across large acreage, and involving environmental and regulatory issues, marketing, design, and sales. Nevertheless, the cases are also consistent in that *Kara Homes* was only in the business of the development and sale of real property, and the real property was merely an adjunct to other business activities.

Facts: Kara Homes filed for voluntary bankruptcy protection in October of 2006. Later, 32 of its affiliates also filed for bankruptcy. The affiliated debtors owned separate real estate development projects for the construction of single family homes and condominiums. Kara Homes owned 90% of each of the affiliated debtors.

Issue: Two months after the case started, the Kara affiliates (but not the parent holding company) filed a complaint for declaratory judgment against the mortgage lenders on the various projects. The affiliated debtors sought a determination that they were not SARE entities as defined in Section 101(51B) and Section 362(d)(3). The affiliate debtors argued that they were engaged in numerous activities that went well beyond merely operating the real estate project. In particular, these activities included acquiring land to develop, designing homes and/or

condominiums suitable for the land, arranging for the construction of the homes or condominiums, and then marketing them to generate cash. The affiliated debtors argued further that they must obtain site plan approval, or register with the Department of Community Affairs and file a public offering statement. Moreover, the affiliated debtors build the common space, amenities, and roadways. All of this, they argued, went well beyond merely operating the real property.

Holding**:** The bankruptcy court held that, despite the broad range of business activities, the Kara affiliates were SARE entities. The court found that the business activities of the affiliates were "merely incidental" to the business operations of trying to sell the condominiums or homes. Significantly, however, the court held in dicta that the parent company, Kara, which performs the same activities for third parties – namely, its own affiliates – and which was not the fee simple owner of the real property, "cannot be classified as single asset real estate debtor." The significance of *Kara Homes* is that the court was willing to find that a debtor falls within the definition of a SARE case even where its business was not truly "passive" and where arguably its activities might be seen as falling outside of merely "operating" the real estate project. For example, the acquisition of the land, marketing, and design could have been found to be related business activities, as opposed to "operations" of the project.

III. Significant Issues Re: Section 362(d)(3):

Once a court has determined a debtor qualifies as a SARE debtor, the provisions of Section 362(d)(3) are triggered. This Section of the Code permits a secured creditor to obtain relief from the stay if there has been a failure to comply with the provisions of Section 362(d)(A) or (B). Importantly, a motion for relief from stay pursuant to Section 362(d)(3) should not be filed before the expiration of ninety days after petition for relief, presumably even if the hearing itself is more than ninety days after the petition for relief. *In re Hope Plantation Group, LLC*, No. 07-01171-HB, 2007 WL 3051533 (Bankr. D.S.C. June 14, 2007) (finding such a motion premature).

a) Ninety Day Filing Requirement:

i) Mandatory Termination of Stay:

Some courts have held that failure to file a plan of reorganization or commence interest payments prior to the expiration of the ninety-day period requires that the stay be terminated. For example, in *In re Land Preserve, LLC*, the court stated:

> The movant's argument that § 362(d)(3) mandates the granting of its motion, unanswered by the debtor, is persuasive. There is no dispute that (1) the debtor fits the description of a single asset real estate . . . and (2) that the debtor has failed to make interest payments or to file a plan within 90 days after it had filed its petition (or to date).

In re Land Pres., LLC, No. 06-21016, 2007 WL 1964064 (Bankr. D. Conn. July 2, 2007). Furthermore, the *In re Tad's Real Estate Co*. court provided:

> The stay of § 362(a) can be terminated under 11 U.S.C. § 362(d)(3) if no plan of reorganization is filed or the debtor has not commenced monthly payments to each secured creditor of the single asset real estate within 90 days of the case filing. Debtor failed to file a plan of reorganization within the 90 days and failed to commence monthly payments to [creditor]. Therefore, [creditor] is entitled to relief from stay.

In re Tad's Real Estate Co., Inc., No. 97-11999, 1998 WL 34066143 (Bankr. S.D. Ga. March 23, 1998). Finally, in *In re Kkemko, Inc*., the court explained:

> The purpose that § 362(d)(3) serves is, where there is a single asset real estate Chapter 11 case, to impose an expedited time frame for filing a plan. The plan in such a case must be filed within 90 days after the filing of the case. This requirement is noteworthy in two respects. First, it sets a time for filing a plan in this species of Chapter 11 case. There is no time requirement in the Code for the filing of a plan for any other kind of Chapter 11 case. Second, the consequence of not meeting that requirement is that the automatic stay of § 362 may be lifted without further ado.

Many of the cases that found the stay was required to be terminated at the end of ninety days were decided under the pre-2005 amendment to Section 362(d)(3); notably, that version of the statute did not include the phrase "or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later."

ii) Options Beyond Termination of Stay:

Other courts have held that the expiration of the ninety-day period without the filing of a plan of reorganization or the commencement of interest payments does not necessarily require that the stay be terminated. In *In re Archway Apartments, Ltd*., the court stated:

> Therefore, unless and until Congress limits this discretionary power of the [c]ourt to terminate, annul, modify or condition the stay, the court is free to fashion the relief appropriate for the creditor's failure to meet § 362(d)(3)(A) or (B). In this case, debtors' counsel admitted that it was simple, honest error that the plans were filed outside the 90 day period. There was no attempt by the debtors to deliberately inhibit, delay or abuse the rights of Condor One by filing the Plans late. To the contrary, the debtors thought they had complied with the requirements of § 362(d)(3). Further, the filing of the Plans were [sic] not precipitated by Condor One's Motions for Relief from Stay, but preceded it by a

> month.

In re Archway Apartments, Ltd., 206 B.R. 463, 465-66 (Bankr. M.D. Tenn. 1997). In *In re The Terraces Subdivision, LLC*, the court provided:

> [Creditor] says termination of the stay is mandatory under these circumstances. I disagree with his absolute interpretation of §362(d)(3). A debtor's failure to satisfy the requirements of § 362(d)(3) "mandates a termination, annulment, modification, or conditioning of the stay." The court retains discretion, even under §362(d)(3), to fashion less than absolute stay relief.

In re The Terraces Subdivision, LLC, No. A07-00048-DMD, 2007 WL 2220448, at *3 (Bankr. D. Alaska Aug. 2, 2007). Additionally, the *In re LDN Corp*. court held relief is mandatorybut may be in the form of terminating, annulling, modifying, or conditioning such stay.

b) Filing a Motion to Extend the Ninety-Day Period:

While there is no deadline for the actual filing of a motion to extend the ninety-day period to file a plan or commence payments, Section 362(d)(3) requires the order granting such an extension to be "entered within that 90-day period." It is therefore incumbent on the party seeking the extension of time to file the motion in sufficient time so a hearing may be held and an order entered within the original ninety-day period. *See In re Heather Apartments Ltd. P'ship*, 366 B.R. 45, 50 & n.7 (Bankr. D. Minn. 2007). Although obtaining an extension of time to comply with Section 362(d)(3)(A) or (B) may be a forlorn hope, filing the motion so an order cannot be entered in the ninety-day period is futile.

c) What Constitutes Cause for Extension of Ninety-Day Period:

There is a dearth of case law on what constitutes the cause necessary for an extension of the time to file a plan of reorganization or commence making the necessary interest payments. One court addressed this issue, stating:

> At least in the context of bankruptcy, in the absence of an express definition or prescription, the courts should measure the existence of cause for excusing compliance, by referring to the purpose of the underlying statutory requirement. Cause then would consist of something extraordinary in the circumstances, something that tips the equities of a case outside the balance that Congress envisioned and then reinforced by establishing the underlying requirement. If the requirement on its face protects a specific constituency, the cause should incorporate a viable alternative to address that constituency's specified entitlement. Where the structure of a particular requirement of the Code markedly reflects such an intent (or an intent to hamper the general latitude that another constituency would enjoy under the Code's more free-ranging provisions), the party seeking a departure must directly respond to

> the legislative intent. In this light, for the establishment of cause, it is not sufficient to rely solely on the more global goals of bankruptcy relief, even if those might otherwise be served by excusing compliance with the requirement.

In re Heather Apartments Ltd. P'ship, 366 B.R. at 47-48.

(d) Payments Required Under Section 362(d)(3)(B):

In explaining the statutory framework for compliance with Section 362(d)(3) in a SARE case, the court in *Heather Apartments* stated:

> This motion comes out of a statutory matrix, § 362(d)(3), in which a grant of relief from stay in favor of a mortgagee against single-asset real estate is presumptive, unless the debtor gives its lender very specific things. The scope of considerations under §§ 362(d)(1)-(2) is much more broad; there, the existence of substantial equity in pledged collateral is usually the main concern, and its proven existence is readily accepted as protection of a mortgagee's financial interests while the automatic stay prevents it from foreclosing. Under § 362(d)(3), however, the focus is entirely on an in-hand realization of cash by the creditor, during the pendency of the case, while the property remains in the debtor's hands. If a debtor is to be excused from having to surrender that cash right away, it must demonstrate a very substantial likelihood that the creditor would receive an equivalent value from another source, quickly enough to minimize its risks of recovering the time value of money.

In re Heather Apartments Ltd. P'ship, 366 B.R. at 51. In structuring its case for this motion, however, the debtor focused on the alleged equity in the property, and sometimes in a more abstract manner. That simply does not respond to Congress's specific concerns in enacting Section 362(d)(3). Thus, the debtor failed to make out cause for a deferral of its obligation to commence making payments to Fannie Mae. *Id.*; s*ee also, In re Larry Goodwin Golf, Inc*., 219 B.R. 391 (Bankr. M.D.N.C. 1997).

Inherent in most SARE cases is the debtor's belief that, with a little time, the real property would be able to be sold at a price sufficient to pay most, or all, of the claims. In light of this hope-springs-eternal attitude of real estate debtors, the promise of future payment upon sale in lieu of the statutorily required interest payments has been met with a less than enthusiastic reception from lien holders and courts. With respect to whether the prospective sale of real estate would obviate the need for interest payments under Section 362(d)(3), the court in *Heather Apartments* stated:

> This is not to say that a prospective sale of single-asset real estate could never qualify as a concrete substitution for the ongoing realization in money via payments of interest. However, if it were to be considered, the debtor should bear a heavy burden of production as to the likelihood that a sale will close promptly, and that there would be enough proceeds to serve the needs honored by

> the statute. At minimum, it seems, there should be a binding purchase agreement executed before the presentation of the motion under § 362(d)(3); a binding lending commitment in favor of the prospective purchaser; and demonstrated substantial progress in satisfying the ministerial minutiae for closing. Only then could a court feel assured that the protected mortgagee would receive a substantial equivalent of its expectancy under § 362(d)(3), so as to merit holding it off from foreclosing after the first 90 days of the case.

In re Heather Apartments Ltd. P'ship, 366 B.R. at 50.

e) Source of Payments Required Under Section 362(d)(3)(B):

Section 362(d)(3)(B)(i) states that the monthly payments "may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after date of the commencement of the case by or from the property." § 362(d)(3)(B)(ii). The use of the word "may" seems to permit, but not require, the payments to be made from income generated from the property, seemingly making allowance for payments to be made from loans to the debtor or trustee or other income, if a SAREdebtor has other income. The determination of the source of the payments seems to be left to the "sole discretion" of the debtor; whether a Chapter 7 trustee has the same authority is a matter which must be decided by the courts. This use of the pre-petition and post-petition income or rents from the property seems to supersede the limitations placed on the use of "cash collateral" by Section 363(c)(2), thus giving rise to the possibility that one secured creditor's cash collateral may be used to pay interest on a junior lien holder's debt.

f) Amount of Payments Required Under Section 362(d)(3)(B):

With respect to determining the amount of the payments required to be made, Section 362(d)(3)(B)(ii) states the payments should be "in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate." The phrase "creditor's interest in the real estate" is reminiscent of the language on valuing secured claims in Section 506(a) and would seem to mean the lesser of the amount of the claim or the amount of equity in the real estate available for application to secure the creditor's claim. It, therefore, appears as if interest need only be paid on the amount of the lien which is actually secured by equity in the real estate. Of course, by arguing that certain secured claims are really not fully secured, the debtor is acknowledging there is no equity in the property, thereby admitting one of the elements of relief from the stay pursuant to Section 362(d)(2) and satisfying the burden of proof of any creditor seeking relief under Section 362(d) in general. § 362(g)(1).

The applicable term – "nondefault contract rate of interest" – is confusing since the language in Section 362(d)(3)(B)(ii) excludes from parties entitled to payment "a claim secured by a judgment lien or by an unmatured statutory lien." The exclusion of an "unmatured statutory lien" would seem to require payment to a "matured" statutory lien (however that term is defined by case law). The definition of "statutory lien" in Section 101(53) excludes a "security interest"

which, according to Section 101(51), means "a lien created by an agreement." Since a contractual rate could only be one made by agreement, it appears as if the phrase "applicable nondefault contract rate of interest" may be inconsistent with the term "statutory lien."

Once again there is a dearth of cases on calculating the amount of the interest payment required under Section 362(d)(3)(B)(ii). With respect to the amount of the interest payment due on a mortgage debt of approximately $3,300,000.00, without much analysis, one court stated:

> Debtor filed for relief under Chapter 11 of the Bankruptcy Code on August 22, 2002. Debtor did not file a plan of reorganization within 90 days since the entry of the order for relief (the petition date). Debtor, however, has been making monthly cash collateral payments in the amount of Nineteen Thousand Two Hundred Fifty Dollars ($19,250.00) per month. Section 362(d)(3) does not provide that the debtor must make interest payments but payments that "are in an amount equal to interest at a current fair market rate . . . ." 11 U.S.C. § 362(d)(3)(B). This [c]ourt considers Debtor's adequate protection payments in the amount of Nineteen Thousand Two Hundred Fifty Dollars ($19,250.00) to be payments in an amount equal to interest at a current fair market value rate of Old West's interest in Woodbridge. Accordingly, Old West is not entitled to relief under § 362(d)(3).

In re Cambridge Woodbridge Apartments, L.L.C., 292 B.R. 832, 840 (Bankr. N.D. Ohio 2003). An interesting question arises in a situation where the holder of a "matured" statutory lien does not have a contractual rate of interest, nondefault or otherwise. Seemingly, from the language of the statute, such a creditor would not be entitled to receive interest payments under Section 362(d)(3)(B)(ii).

g) To Whom Must Payments Be Made:

As discussed above, the language in Section 362(d)(3)(B)(ii) excludes from parties entitled to payment "a claim secured by a judgment lien or by an unmatured statutory lien." The exclusion of an "unmatured statutory lien" would seem to require payment to a "matured" statutory lien. It would indeed be rare if a "statutory lien," which, by its very definition in Section 101(53), excludes a consensual lien, had a contractual rate because a contractual rate could only be one made by agreement and, as such, could not be a "statutory lien." Furthermore, a creditor who held a "statutory lien," but later reduced it to judgment, would arguably be the holder of a "judgment lien" and, as such, not entitled to payment. But in *In re 652 West 160th LLC*, the court held New York City taxes on which a judgment of foreclosure had been entered constituted a matured statutory lien, stating:

> The Debtor makes a series of arguments to cover its default. First, it argues that § 362(d)(3)(B) is applicable and benefits only consensual secured creditors. The words of the statute are to the contrary. The subsection excepts from the requirement of commencement of interest payments secured creditors whose debt

> is secured by a judgment lien or an unmatured statutory lien. But the Debtor's own position is that the City does not have a judgment lien because its foreclosure is not complete; whether it actually has a judgment lien as well, it appears from the record that the City does have a matured statutory lien.

In re 652 West 160th LLC, 330 B.R. 455, 462 (Bankr. S.D.N.Y. 2005) (citation omitted). The *652 West 160th* case was filed prior to the 2005 amendment to Section 362(d)(3), which, at the time, required payment to:

> [E]ach creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate.

11 U.S.C. § 362(d)(3) (2000) (prior to amendment effective October 17, 2005). The additional language in the 2005 amendment to Section 362(d)(3) requiring interest at the "then applicable nondefault contract rate of interest" raises a legitimate question as to whether creditors such as holders of tax liens or mechanics' liens without a contractual interest rate are entitled to interest at all under Section 362(d)(3)(B)(ii). It is possible that courts may find that a contractual creditor who later uses a statutory lien, such as a mechanics' lien, to further enforcement of his or her contract has cumulative rights and is, thereby, entitled to use the underlying contractual nondefault rate of interest as a basis for payments under Section 362(d)(3)(B)(ii) even though the creditor also holds a statutory lien.

h) Filing of a Plan of Reorganization:

The requirement that the debtor file "a plan of reorganization that has a reasonable possibility of being confirmed in a reasonable time" raises questions as to what constitutes "reasonable possibility of being confirmed" and what qualifies as a "reasonable time for confirmation." The language in Section 362(d)(3)(A) is similar to the case law interpreting the "necessary to an effective reorganization" requirement of Section 362(d)(2)(B). *See United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 376 (1988). At least two courts have adopted a similar view: the court in *In re The Terraces Subdivision, LLC*, No. A07-00048-DMD, 2007 WL 2220448, at *3 (Bankr. D. Alaska Aug. 2, 2007) and the court in *In re Heather Apartments Limited Partnership*.

An arguably confirmable plan, however, is not a cure all, and even a SARE debtor filing a plan is subject to greater scrutiny. As the court in *Terraces Subdivision* stated:

> In this case, [debtor] presented persuasive expert testimony early on which showed that it had the capability of presenting a feasible and workable chapter 11 plan. It was on this basis that I reached my initial finding that the debtor's liquidating plan had a reasonable possibility of confirmation within a reasonable time. Closer inspection has revealed that the current projected plan payments to [creditor] will not pass confirmation muster. However,

> based on the numbers in the Richter appraisal, there is still the promise that [debtor] can propose a plan that would not only pay [creditor] in full but provide substantial payments to its other creditors. I feel the debtor should be allowed a chance to proceed to confirmation. [Debtor]will be given a short fuse, however. The debtor must obtain confirmation of a plan by October 26, 2007. Failure to do so will result in termination of the stay without further action on the part of [creditor] or the court.

In an interesting twist on the requirement to file a plan, one court held the entry of a form order setting the time period for the debtor to file its disclosure and plan beyond the ninety-day period after the filing of the case resulted in the extension (albeit unintentionally) of the ninety-day period under Section 362(d)(3)(A) since no party objected or appealed the order. *In re Bouy, Hall & Howard & Assocs.*, No. 95-40676, 1995 WL 17006338, at *4 (Bankr. S.D. Ga. Dec. 4, 1995).

REMOVAL OF STATE COURT PROCEEDINGS

By:
Jerry M. Markowitz, Esq.
Timothy R. Bow, Esq.

Introduction

It is far from uncommon for a debtor in bankruptcy to also be a party in a state court proceeding. Occasionally, one of the parties to the litigation will remove the state court proceeding to bankruptcy court. This is sometimes done by debtors in order to delay litigation, such as foreclosure litigation. This tactic has mixed success for a number of reasons: first, the bankruptcy court may elect to remand the case back to state court, and second, the bankruptcy court may be in a position to rule on dispositive motions and conduct a trial more expeditiously than the state court.

Jurisdiction Over Removed Cases

Under 28 U.S.C. § 1452(a), that claims or cases filed in state court may be removed to federal court if they are related to bankruptcy proceedings. Interestingly, a party can remove some or all of the claims from the state court proceeding. *Id.*

Under 28 U.S.C. § 1334(a), the district courts have original and exclusive jurisdiction of all cases under title 11. Pursuant to 28 U.S.C. § 1334(b), the district courts have jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11. Further, bankruptcy courts have exclusive jurisdiction over "all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate." 28 U.S.C. § 1334(e)(1).

"Related To" Jurisdiction

The United States Supreme Court agreed with the Third Circuit that in enacting 28 U.S.C. § 1334(b), "Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate…and that the 'related to' language of § 1334(b) must be read to give district courts (and bankruptcy courts under § 157(a)) jurisdiction over more than simple proceedings involving the property of the debtor or the estate. We also agree with the [Third Circuit's] observation that a bankruptcy court's 'related to' jurisdiction cannot be limitless." *Celotex v. Edwards*, 514 U.S. 300, 307 -08 (1995) (citing *Pacor, Inc. v. Higgins*, 743 F2d. 984, 994 (3d Cir. 1984)); *See also Matter of Lemco Gypsum, Inc.*, 910 F.2d 784, 786 (11th Cir. 1990) ("In enacting [§ 1334(b)] Congress intended to grant comprehensive jurisdiction to the bankruptcy courts to allow for efficient disposition of all matters connected with the debtor's estate."); *In re Dow Corning Corp.*, 86 F.3d. 482, 489 (6th Cir. 1996) ("In addressing the extent of a district court's bankruptcy jurisdiction under Section 1334(b) over civil proceedings 'related to' cases under title 11, we start with the premise that the 'emphatic terms in which the jurisdictional grant is described in the legislative history, and the extraordinarily broad wording of the grant itself,

leave us with no doubt that Congress intended to grant to the district courts broad jurisdiction in bankruptcy cases.'") (citation omitted).

A majority of the circuits have adopted the test articulated by the Third Circuit to determine whether a bankruptcy court has "related to" jurisdiction over a proceeding. *Id.* at 788. The Third Circuit test is stated as follows:

> The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of the proceeding could conceivably have an effect on the estate being administered in bankruptcy. The proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.

Id. quoting *Pacor, Inc. v. Higgins*, 743 F2d. 984, 994 (3d Cir. 1984).

Arising In Jurisdiction

Federal courts have jurisdiction over "administrative matters that arise only in bankruptcy cases and have no existence outside of the bankruptcy proceedings." *In re Kaiser Grp. Int'l, Inc.,* 421 B.R. 1, 8 (Bankr.D.D.C.2009). "Arising in" jurisdiction is therefore limited to claims that are necessary to administer a bankruptcy estate. *In re Akl*, 397 B.R. 546, 554 (Bankr.D.D.C.2008). "[P]roceedings or claims arising in Title 11 are those that are not based on any right expressly created by Title 11, but nevertheless, would have no existence outside of the bankruptcy." *Capitol Hill Grp. v. Pillsbury, Winthrop, Shaw, Pittman, LLC*, 569 F.3d 485, 489 (D.C.Cir.2009) (internal quotation omitted).

Core Proceedings

Federal law determines which proceedings and functions are "core" to bankruptcy court jurisdiction. Core proceedings are those cases "under title 11." *See* 28 U.S.C. § 1334(a).

Section 157 of title 28 provides that "[b]ankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of [28 U.S.C. § 157], and may enter appropriate orders and judgments, subject to review under section 158 of this title." 28 U.S.C. § 157(b)(1).[1] Relevant to mortgage foreclosure issues, core proceedings include, but are not limited to, the following:

[1] Pursuant to 28 U.S.C. § 157(a), "[e]ach district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." Pursuant to the Order of Reference entered by the District Court of the Southern District of Florida, all cases arising under Title 11 of the United States Code, and proceedings arising in or related to cases under Title 11 of the United States Code, including notices of removal pursuant to 28 U.S.C. § 1452(a), have been referred to the Bankruptcy Judges for this District. *See* Rule 87.2, LOCAL RULES OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF FLORIDA.

(a) Matters concerning the administration of the estate – 28 U.S.C. § 157(b)(2)(A);

(b) Allowance or disallowance of claims against the estate – 28 U.S.C. § 157(b)(2)(B);

(c) Counterclaims by the estate against persons filing claims against the estate – 28 U.S.C. § 157(b)(2)(C);

(d) Determinations of the validity, extent, or priority of liens – 28 U.S.C. § 157(b)(2)(K);

(e) Orders approving the sale of property – 28 U.S.C. § 157(b)(2)(N); and

(f) Other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor relationship – 28 U.S.C. § 157(b)(2)(O).

In addition to the "core proceedings" specifically enumerated in section 157, other matters can be deemed to be core. Indeed, "[c]ore proceedings should be given a broad interpretation that is close to or congruent with constitutional limits…" *Mt. McKinley Ins. Co. v. Corning, Inc.,* 399 F.3d 436, 448 (2d Cir. 2005) (internal quotations omitted). For instance, proceedings can be core by virtue of their nature if either (1) the type of proceeding is unique to, or uniquely affected by, the bankruptcy proceedings, or (2) the proceedings directly affect a core bankruptcy function. *Id.* (internal quotations omitted). Claims and proceedings that are unique to bankruptcy are core proceedings. *Id.* at 448.

As a general matter, "related to" proceedings are usually considered to be "non-core." *Marah Wood Productions, LLC v. Jones,* 534 B.R. 465 (D. Ct. 2015).

Equitable Subordination – A Remedy Unique to Bankruptcy

In certain removed mortgage foreclosure cases, courts have held that the existence of an equitable subordination claim is sufficient to warrant against remand or abstention. Equitable subordination is most often helpful where a debtor can allege bad faith or other wrongdoing against a foreclosing creditor. One example is where a lender acts in such a way to increase its debt—and thus its chances of foreclosing on the subject property—with complete disregard and at the expense of other creditors. One could imagine a scenario where a lender requests a state court receiver, pre-petition, and works with the receiver to provide unnecessary "protective advances." In such cases, it could be argued that equitable subordination of part or all of the lender's claim would be an appropriate remedy.

In *CRD Sales and Leasing, Inc.,* the debtor brought an equitable subordination claim and a request to determine the validity, priority, and extent of a lien against a secured creditor in an adversary proceeding and the court held that that equitable subordination claim rendered the proceeding "core." *In re CRD Sales and Leasing, Inc.,* 231 B.R. 214 (Bankr. D. Vt. 1999). Prior to the bankruptcy, the secured creditor filed a foreclosure proceeding in state court. *Id.* The

debtor-defendant in the state court foreclosure action brought counterclaims against the secured creditor, alleging breach of contract, tortious interference with a contract, promissory estoppel, violations of the Equal Credit Opportunity Act, violation of 8 V.S.A. § 1211 7, and negligence. *Id.* In the bankruptcy case, on the secured creditor's motion to remand or abstain the removed foreclosure proceeding, the bankruptcy court noted that "generally, a foreclosure action could hardly be described as 'insignificant'. When compared to the equitable subordination claim, however, we think such a description is warranted. The equitable subordination claim predominates all of the state law claims here, because if we find Debtors are entitled to subordinate Bank's claim, Bank's right to foreclose may be overridden, regardless of any rights under state law." *Id.* at 219.

Equitable subordination is a "bankruptcy remedy peculiar to the equitable jurisdiction of the bankruptcy court and cannot be severed from, and exist independent of, a lien or claim which (sic) will not be determined in the bankruptcy court." *In re CRD Sales and Leasing, Inc.,* 231 B.R. 214, 219 (Bankr. D. Vt. 1999) (finding state court foreclosure action to be a "core proceeding" where the debtors had raised an equitable subordination claim). "Equitable subordination, for lack of a better term, is the proverbial 500-pound gorilla . . . the doctrine is not bound by state law, and it can trump the state law foreclosure, even if that foreclosure is legally valid." *Id.; see also Aetna v. Danbury Square Ass. Ltd. Partnership (In re Danbury Square Ass. Ltd. Partnership),* 150 B.R. 544, 547 (Bankr. S.D.N.Y. 1993) (noting that remanding foreclosure action to state court would deprive trustee of equitable subordination defense). In a few instances, state court foreclosure cases were allowed to remain in bankruptcy court because of the equitable subordination claims that were included by the debtor against the lender.

Proceedings that Affect a Core Bankruptcy Function

Proceedings that directly affect a core bankruptcy function are also "core proceedings" within the contemplation of section 157(b). *Mt. McKinley Ins. Co.,* 399 F.3d at 408. Specifically, section 157(b) provides that a proceeding is a core matter where "it invokes a substantive right provided by title 11." *See* 28 U.S.C. § 157(b)(2). Pursuant to section 157(b)(2)(O), "proceedings affecting the liquidation of the assets of the estate" are core proceedings.

Courts have considered certain removed foreclosure proceedings to be "core" where the removal availed the debtor of a right that would not exist outside of bankruptcy. *See In re Jackson Brook Institute, Inc.,* 227 B.R. 569 (1998) (holding a removed state court foreclosure proceeding to be core within the meaning of section 157 because a substantive right was available to the debtor within bankruptcy that was not available within the foreclosure proceeding); *C.f. Citicorp Savings of Illinois v Chapman (In re Chapman),* 132 B.R. 153, 157 (Bankr. N.D. Ill. 1991) (reasoning that it could be argued that removed foreclosure proceeding against property of the estate was a core matter under 28 U.S.C. § 157(b)(2)(O) because the property was a major asset of the estate and foreclosure would have a significant impact on reorganization). The court in *Chapman* found the foreclosure proceeding to be a core proceeding under 28 U.S.C. § 157(b)(2)(B) and (C) because Citicorp filed a claim for the amount owed to them under the mortgage, and the debtors filed the same affirmative defenses and counterclaims against that claim as they filed in an adversary proceeding. The court reasoned that the proof of claim and the debtors' counterclaim were one proceeding with the removed foreclosure case. The

court also noted that core jurisdiction could be established under § 157(b)(2)(O), as the debtors' house was the only major asset of the estate and foreclosure would have a significant impact on the debtors' reorganization.

Remand, Mandatory and Permissive Abstention

Courts often consider whether abstention doctrines are applicable in deciding whether to remand a removed state court case.

Mandatory Abstention Is Not Applicable If The Matter Is Core.

As a preliminary matter, if a proceeding is a core proceeding, mandatory abstention is not applicable. *See e.g., In re Dow Corning Corp.,* 86 F.3d 482, 497 (6th Cir. 1996) ("[f]or mandatory abstention to apply, a proceeding must . . . be a non-core proceeding"); *In re DBSI, Inc.,* 409 B.R. 720, 728 (Bankr. D. Del. 2009) (finding mandatory abstention inapplicable where a proceeding was a "core proceeding"). Accordingly, if a bankruptcy court is inclined to find a state court proceeding, for whatever reason, falls within its core jurisdiction, it is not subject to mandatory abstention.

Permissive Abstention.

Permissive abstention is another consideration. Bankruptcy courts have identified the following factors to consider in deciding whether permissive abstention is warranted under Section § 1334(c)(1):

(a) The effect or lack thereof on the efficient administration of the bankruptcy estate if a court abstains;

(b) The extent to which state law issues predominate over bankruptcy issues;

(c) The presence of a related proceeding commenced in state court or other non bankruptcy court;

(d) The jurisdictional basis of the action, if any, other than 28 U.S.C. § 1334;

(e) The degree of relatedness or remoteness of the proceeding to the main bankruptcy case;

(f) The substance rather than the form of an asserted "core" proceeding;

(g) The feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court;

(h) The burden on the bankruptcy court's docket;

(i) The likelihood that the commencement of the proceeding in bankruptcy court involved forum shopping by one of the parties;

(j) The existence of a right to jury trial; and

(k) The presence in the proceeding of non-debtor parties.

See In re United Container, LLC, 284 B.R. at 176; *see also Clegg v. Bristol-Myers Squibb Co.,* 285 B.R. 23 (M.D. Fla. 2002). No one factor is determinative; nor is any list considered exhaustive. *Mack v. Chambers (In re Mack),* 2007 WL 1222575, *6 (M.D. Fla. Apr. 23, 2007); *see also In re Resource Tech. Corp.,* 2004 WL 419918, *2 (N.D. Ill 2004).

As seen in a number of decisions, an analysis of these factors often weighs heavily in favor of remanding proceedings focusing on state law claims back to state court.

Remand Factors, Generally

Section § 1452(b) provides that a bankruptcy-related claim removed under § 1452 may be remanded "on any equitable ground." This standard represents "an unusually broad grant of authority . . . [i]t subsumes and reaches beyond all of the reasons for remand under non-bankruptcy removal statutes." *In re McCarthy*, 230 B.R. 414, 417 (B.A.P. 9th Cir. 1999). Indeed, § 1452(b) provides that orders to remand under that section are "not reviewable by appeal." As to the legal and equitable considerations, bankruptcy courts look to a number of factors, including the following, to determine whether remand is appropriate:

(a) duplicative and uneconomical use of judicial resources;

(b) prejudice to the involuntarily removed parties;

(c) forum *non conveniens*;

(d) a holding that a state court is better able to respond to a suit involving questions of state law;

(e) comity considerations;

(f) lessened possibility of an inconsistent result; and

(g) the expertise of the state court in which the matter was pending originally.

Citicorp Savings of Illinois v. Chapman (In re Chapman), 132 B.R. 153, 158 (Bankr. N.D. Ill. 1991).

Decisions Involving Removed Foreclosure Cases

In re Burrow, 505 B.R. 838 (Bankr. E.D. Ark. 2013)	State court foreclosure action involving property of LLC was removed to bankruptcy court.	Bankruptcy court abstained as case was based entirely on state law and only related to jurisdiction existed. Even if abstention was not required, bankruptcy court would decline to exercise discretion.
In re Laddusire, 494 B.R. 383 (Bankr. W.D. Wisc. 2013)	Chapter 11 debtor removed state court foreclosure case that was brought by bank. The bank moved for abstention, remand, or dismissal, and requested sanctions against the debtor.	The bankruptcy court held that counter claims that had not yet been plead did not cause removed action to become a core proceeding. The proceeding as it stood was a non-core proceeding. The court found that both remand and abstention were appropriate, but denied sanctioning the debtor.
In re Danbury Square Associates, LP, 150 B.R. 544 (Bankr. S.D.N.Y. 1993)	Chapter 7 trustee removed state court foreclosure action against debtor's real property and mortgagee moved for remand.	The bankruptcy court held, that despite the trustee's assertion of an equitable subordination claim, the matter had to be remanded to state court.
In re Canton, 2009 WL 981114 (Bankr. D. Mo. Mar. 17, 2009)	The debtor removed a state court foreclosure proceeding to bankruptcy court. The mortgagee sought to have the case remanded to state court.	The matter was remanded based upon discretionary abstention.
In re Mill-Craft Building Systems, Inc., 57 B.R. 531 (Bankr. E.D. Wis. 1986)	Debtor removed mortgage foreclosure proceeding to bankruptcy court.	Proceeding was remanded to state court. Even though there was related to jurisdiction, the bankruptcy court had the power to abstain from deciding, or to remand, the foreclosure proceeding.
In re CRD Sales and Leasing, Inc., 231 B.R. 214 (Bankr. D. Vt. 1999)	Chapter 11 liquidation case was filed and state court foreclosure proceeding was removed to bankruptcy court. The foreclosing creditors moved to remand the proceeding and dismiss the case alleging a bad faith filing	The foreclosure proceeding had to be regarded as a "core" proceeding, and abstention could never be mandatory, as there was a question as to propriety of state court foreclosure was intertwined with equitable subordination

	by the debtor.	claim. Additionally, the request for permissive abstention and remand were denied. Lastly, the court declined to dismiss the case for alleged "bad faith".
In re Chapman, 132 B.R. 153 (Bankr. N.D. Ill. 1991)	A state court foreclosure action was removed to bankruptcy court and the mortgagee moved to remand the case, or in the alternative, abstain.	Court abstained and remanded the foreclosure proceeding.
In re Ramada Inn-Paragould General Partnership, 137 B.R. 31 (Bankr. E.D. Ark. 1992)	A chapter 11 debtor sought to remove a state court foreclosure proceeding.	The court held that abstention was appropriate because the debtor removed a case that had already proceeded to judgment in the state court.

Recent District Court Decisions Involving Removal of Other State Claims to Bankruptcy Court

Orion Refining Corp. v. Fluor Enterprises, Inc., 319 B.R. 480 (E.D. La. 2004) (rejected by*, In re Guerrero*, 2013 WL 6834642 (Bankr. S.D. Tex. 2013))	Permissive abstention and equitable remand by District Court was warranted following removal based upon bankruptcy jurisdiction of action brought by Chapter 11 debtor-oil refinery against manufacturers and repairers of parts in delayed coker unit which had exploded in refinery, alleging negligence and products liability claims; location of explosion and majority of witnesses was in same Louisiana parish, so that state court was slightly more convenient, action involved parties other than oil refinery debtor and others involved in bankruptcy case, action presented state law claims, and there was no showing that all defendants consented to removal.
In re Sunset Marine of Puerto Rico, Inc., 495 B.R. 190, 58 Bankr. Ct. Dec. (CRR) 59 (Bankr. D. P.R. 2013)	Missouri state court action should have been removed, based on one party's filing of bankruptcy petition in Puerto Rico, only to the United States District Court in Missouri that served the same geographic area where state court action was pending, and not to the United States District Court for the District of Puerto Rico; cross-district removal was improper and necessitated remand to the United States District Court for the Western District of Missouri.
In re Laddusire, 494 B.R. 373 (Bankr. W.D. Wis. 2013)	Remand was appropriate with respect to debtor's prepetition state-court action against insurer that she had removed to bankruptcy court; there appeared to be certain procedural defects in debtor's attempt to remove the matter, as notice of removal was not accompanied by all pleadings and process filed and issued in state court and it was not clear that debtor served a copy on all parties to original state-court proceeding, basis for

	removal was simply debtor's bankruptcy filing, bankruptcy court had determined that permissive abstention was appropriate, and failure to remand would have left debtor's suit homeless. 28 U.S.C.A. §§ 1334(c)(1), 1452(b);
The Bank of New York Mellon v. ACR Energy Partners, LLC, 2015 WL 6773719 (D. N.J. Nov. 5, 2015)	Trustee for bondholders brought foreclosure and replevin actions in state court against borrowers, after borrowers defaulted on a $118 million loan to finance the construction of a power plant, which was additionally secured with a mortgage and security agreement. Following removal to federal district court, trustee moved for remand. The district court held: (1) that any relatedness between state court action and three federal actions did not establish federal subject matter jurisdiction over the state court action; (2) that the state court action did not arise under the Bankruptcy Code; and (3) that the state court action was not related to a prior bankruptcy action.
Firefighters' Retirement System, et al. v. Consulting Group Services, LLC, 541 B.R. 337 (M.D. La. 2015)	Public employee pension plans petitioned for damages in state court against independent auditor retained by plans to audit Cayman Islands-based fund that subsequently filed for bankruptcy and against investment advisor after plans lost $100 million investment in shares issued by fund, asserting claims against auditor for violation of Louisiana Securities Act and Louisiana Unfair Trade Practices Act ("LUTPA"), detrimental reliance, negligence, negligent misrepresentation, and third-party beneficiary, and asserting claims against for advisor for breach of contract and violation of LUTPA. Following removal, plans moved to remand. The district court held that the claims fell within the "related to" bankruptcy jurisdiction and that neither mandatory, nor permissive, abstention applied. The case was not remanded to state court.
UDX, LLC v. Heavner, 533 B.R. 511 (M.D.N.C. 2015)	A lender brought an action in state court against various limited liability companies and manager of one LLC, relating to loans allegedly guaranteed by manager. LLCs filed voluntary petitions seeking relief under Chapter 11, and subsequently removed the action to the district court. Lender voluntarily dismissed its claims against LLCs. Manager then filed motion to refer the case to the bankruptcy court. The lender then moved for abstention and remand. The district court held that mandatory abstention was not applicable and that the equitable considerations of the case did not warrant remand. As the action was a "related to" case under Title 11, the court held referral to the bankruptcy court was warranted.
Reedquist v. McKay, 540 B.R. 388 (D. Minn. 2015)	Owner of house brought action in state court against debtor co-owner, seeking order granting her sole ownership of house through partition following debtor coowner's Chapter 7 bankruptcy filing. Debtor removed action to federal court and sought remand to federal bankruptcy court. The District Court

	denied request and remanded to state court, and debtor moved for reconsideration. The district court held that the action was not a "core proceeding," and thus it did not have jurisdiction, and the partition action was non-core.

Chapter 11 Pre-Confirmation Issues

Third Party Releases, Channeling Injunctions, Bar Orders, Oh My!

Prepared by David S. Jennis and Kathleen L. DiSanto
Jennis & Bowen, P.A.
Tampa, Florida

A. Overview

Regardless of the focus of your practice, having a working knowledge and an understanding of the fundamentals with respect to releases, channeling injunctions, and bar orders is essential. While at first blush, non-debtor releases, channeling injunctions, and bar orders may seem like issues that are only important to attorneys who regularly represent chapter 11 debtors, that is far from the truth. Those who focus their practice on creditors' rights or represent trustees often litigate over the scope or necessity of these release and injunctions. Releases, channeling injunctions, and bar orders can impact upon pending state court litigation in which you may be involved. In sum, releases, channeling injunctions, and bar orders are something that almost any attorney could come into contact at some point during their practice. To effectively advocate your client's position, a basic understanding of what non-debtor releases, channeling injunctions, and bar orders are, when they should be used, and the mechanics of obtaining such relief is critical.

B. What are non-debtor releases, channeling injunctions, and bar orders and how are they different?

While the effect is ultimately that a non-debtor entity is relieved of some liability, there are important differences among releases, channeling injunctions and bar orders. It is important to appreciate the subtle, but critical differences.

- **Non-debtor/third party injunctions and releases:** includes both preliminary injunctions entered during the pendency of the case and permanent injunctions or releases in connection with plan confirmation
  - Not expressly authorized by the Bankruptcy Code, although courts who approve injunctions, releases, and bar orders typically rely on Sections 105 and 1123(b)(6) of the Bankruptcy Code. Section 105 empowers bankruptcy courts to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title," while Section 1123(a)(6) provides that a plan of reorganization may "include other appropriate provisions not inconsistent with the applicable provisions of this title."
  - Circuit split as to whether Section 524(e) of the Bankruptcy Code bars non-debtor or third party injunctions and releases entirely

	Circuits	Case Citations
Circuits Refusing Non-Debtor Releases	5th, 9th, and 10th	*Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229, 257 (5th Cir. 2009). *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401-02 (9th Cir. 1995); *American Hardwoods, Inc. v. Deutsche Credit Corp. (In re American Hardwoods, Inc.)*, 885 F.2d 621, 625-26 (9th Cir. 1989). *Landsing Diversified Props.-II v. First Nat's Bank & Trust Co. of Tulsa (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592, 601-02 (10th Cir. 1990), *modified*, 932 F.2d 898 (10th Cir. 1991).
Circuits Allowing Non-Debtor Releases	2d, 3d, 4th, 6th, 7th, and 11th	*Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 141-42 (2d Cir. 2005); *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 292 (2d Cir. 1992). *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 211 (3d Cir. 2000). *Menard-Sanford v. Mabey (In re A.H. Robins Co., Inc.)*, 880 F.2d 694, 702 (4th Cir. 1989). *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002). *Airadigm Commc'ns, Inc. v. FCC (In re Airadigm Commc'ns, Inc.)*, 519 F.3d 640, 655-58 (7th Cir. 2008); *Matter of Specialty Equip. Co., Inc.*, 3 F.3d 1043, 1047 (7th Cir. 1993). *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070 (11th Cir. 2015); *Munford v. Munford, Inc. (In re Munford, Inc.)*, 97 F.3d 449, 454-55 (11th Cir. 1996).
Circuits Not Directly Addressing Issue (but aligning with pro-release circuits)	1st and D.C.	*Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 980 (1st Cir. 1995). *In re AOV Indus., Inc.*, 792 F.2d 1140 (C.A.D.C. 1986).

Circuits Not Addressing Issue	8th	

- While non-debtor releases and injunctions require extraordinary circumstances, certain factual scenarios typically support the issuance of an injunction or release. Courts are more likely enjoin actions against non-debtors where (i) the guarantors are funding the reorganization and the litigation will detrimentally impact upon their financial contribution to the bankruptcy case, *see Otero Mills, Inc. v. Sec. Bank & Trust (In re Otero Mills, Inc.*), 21 B.R. 777 (Bankr. D.N.M.), *aff'd* 25 B.R. 1018 (D.N.M. 1982); (ii) the efforts of corporate officers are essential to the reorganization; and (iii) enjoining an action against partners brought by a creditor of the partnership, which the court viewed as an "end-run" around the automatic stay that would result in a destructive race-for-assets among creditors of the partnership, all of whom would have equal claim to the assets of general partners. *Old Orchard Inv. Co. v. A.D.I. Distribs., Inc. (In re Old Orchard Inv. Co.*), 31 B.R. 599, 602 (W.D. Mich. 1983).

- **Channeling injunction**: type of permanent third party release, which typically arises where the third party has derivative liability for claims against the debtor. Generally, a channeling injunction directs all suits against certain non-debtor third parties to a settlement fund funded by the third parties to satisfy the claims. *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89, 94 (2d Cir. 1988).

- **Bar order:** often arise in the context of settlement approval in a liquidation, bar order prevents claimants from pursuing non-debtor entities in exchange for a settlement payment to the bankruptcy estate.

C. When do you use them?

a. Non-debtor parties will sometimes obtain temporary injunctive relief during the pendency of a bankruptcy case. Permanent injunctive relief is generally provided through a non-debtor release or injunction in connection with plan confirmation
b. Non-debtor releases and channeling injunctions most frequently arise in the context of plan confirmation
c. Bar orders are typically litigated in connection with Rule 9019 motions in chapter 7 or 11 liquidations
    i. Use of bar orders in Rule 9019 motions can either be express (*e.g. In re HWA Props., Inc.*, 2016 WL 67786 (Bankr. M.D. Fla. Jan. 6, 2016) (Delano, J.); *In re GunnAllen Fin., Inc.*, 443 B.R. 908, 917-18 (Bankr. M.D. Fla. 2011) (Williamson, J.)) or disguised in a

manner where the terms of the bar order are not clear and the inclusion of the bar order creates due process issues (*e.g. Overton's, Inc. v. Interstate Fire & Cas. Ins. Co. (In re SportStuff, Inc.)*, 430 B.R. 170 (B.A.P. 8th Cir. 2010)).

ii. Rule 7001(7) and (9) provides that a proceeding to obtain an injunction or other equitable relief, except when a chapter 9, 11, 12, or 13 plan provides the relief and a proceeding to obtain a declaratory judgment must be brought as adversary proceedings, triggering the various procedural protections afforded by the incorporation of portions of the Federal Rules of Civil Procedure made applicable by the Part VII Rules.

iii. Rule 3017(f) requires creditors to be given 28 days' notice of the time the time for objecting to a plan and the hearing on confirmation where the plan provides for an injunction that enjoins conduct not otherwise enjoined under the Bankruptcy Code and an entity is subject to the injunction is not a creditor or equity security holder.

iv. If a plan provides for an injunction of conduct not otherwise enjoined by the Bankruptcy Code, Rule 2002(c)(3) requires the notice of hearing on confirmation of the plan to:
    1. Include in conspicuous language (bold, italic, or underlined text) a statement that the plan proposes an injunction;
    2. Briefly describe the nature of the injunction; and
    3. Identify the entities that would be subject to the injunction.

v. If the bar order provides declaratory or injunctive relief, parties may attempt to sidestep the procedural safeguards provided by Bankruptcy Rules 2002(c)(3), 3017(f) and 7001 by using a Rule 9019 motion as a vehicle for obtaining approval of the bar order. This is particularly problematic where the declaratory or injunctive relief impacts on the rights of third parties who are not party to the settlement and such parties are not afforded the appropriate due process protections. *See In re SportStuff, Inc.*, 430 B.R. 170, 181.

D. <u>How do you use them?</u>

a. Evidentiary support and burdens of proof largely depend on context
b. If the release is sought in conjunction with plan confirmation, the debtor must prove the elements of plan confirmation by preponderance of the evidence, in addition to establishing the appropriate circumstances and need for the release through the *Transit* or *Dow Corning* factors.
    i. Seven *Transit* or *Dow Corning* Factors
        1. Whether there is an identity of interests between the debtor and the third party (against whom the claim would be barred), such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate;

2. Whether the non-debtor has contributed substantial assets to the reorganization;
3. Whether the injunction is essential to the reorganization (i.e., whether the reorganization hinges on the debtor being free from indirect suits by parties who would have indemnity or contribution claims against the debtor);
4. Whether the impacted class or classes of creditors has overwhelmingly voted to accept the plan;
5. Whether the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;
6. Whether the plan provides an opportunity for those claimants who choose not to settle to recover in full; and
7. Whether the bankruptcy court made a record of specific factual findings that support its conclusions.

ii. *Transit* (or *Dow Corning*) factors create a lot of interesting evidentiary issues
   1. What constitutes a substantial contribution of assets?
   2. If the third party will pull its funding of the plan absent a release, does that mean the release is necessary to reorganization?
   3. Is overwhelming acceptance of a plan determined by amount of claims or numerosity, or both?

iii. Not enough for bankruptcy court to state that *Dow* factors satisfied, must make specific factual findings
   1. *Behrmann v. Nat'l Heritage Foundation, Inc.*, 663 F.3d 704 (4th Cir. 2011) (confirmation order vacated because bankruptcy court failed to make requisite findings to support non-debtor releases);

iv. Adequate disclosure of release in plan and disclosure statement is critical
   1. *In re Lower Bucks Hospital*, 571 Fed. Appx. 139, 144 (3d Cir. 2014). (affirmed the bankruptcy court's excision of a release from a plan based on the failure to conspicuously and adequately disclose terms of a non-debtor release.

c. Courts evaluate bar orders based on the factors established by the Eleventh Circuit in *Munford v. Munford, Inc. (Matter of Munford, Inc.)*, 97 F.3d 449 (11th Cir. 1996).
   i. Interrelatedness of the claims that the bar order precludes
   ii. Likelihood of barred parties to prevail on barred claims
   iii. Complexity of the litigation
   iv. Likelihood of depletion of the resources of the settling parties

d. Because bar orders usually arise in the context of approval of settlements, courts also must ensure the settlement satisfies *Wallis v. Justice Oaks II, Ltd. (In re Justice Oaks II, Ltd.)*, 898 F.2d 1544 (11th Cir. 1990).

i. Four *Justice Oaks* Factors
1. Probability of success in the litigation
2. Difficulties in collection
3. Complexity of the litigation, and the expense, inconvenience, and delay
4. Paramount interests of the creditors and proper deference to their reasonable views in the premises

e. Note overlap between *Munford* factors and *Justice Oaks* factors
f. *Van Diepen* – Eleventh Circuit seems to collapse analyses given the substantial overlap – does the ability to obtain a bar order in some ways hinge on creditors' support (the fourth *Justice Oaks* factor)

E. Impact of *Stern v. Marshall*?

The majority of published opinions appear to suggest that *Stern* has little impact upon bankruptcy courts' authority to enter releases, channeling injunctions, or bar orders and focus on the fact that these extraordinary remedies arise in the context of extending the automatic stay, confirmation, or approval of a settlement under Rule 9019, which are entirely predicated on federal law (much like a preference action).

a. *In re Safety Harbor Resort & Spa*, 456 B.R. 703 (Bankr. M.D. Fla. 2011) (Williamson, J.).
i. In adopting the narrow view of Stern, the bankruptcy court held that imposition of "lock-up" restrictions on non-debtor guarantors who were the beneficiaries of a plan injunction was within the court's "core" jurisdiction as part of the chapter 11 plan confirmation process.
b. *In re Okwonna-Felix*, 2011 WL 3421561, at *4 (Bankr. S.D. Tex. Aug. 3, 2011).
i. *Stern* has no impact on bankruptcy court's ability to approve settlements because Rule 9019 is based entirely on federal bankruptcy law and has no state law counterpart.
c. *In re Ambac Fin. Group, Inc.*, 457 B.R. 299, 308 (Bankr. S.D.N.Y. 2011).
i. "*Stern v. Marshall* has become the mantra of every litigant who, for strategic reasons, would rather litigate somewhere other than the bankruptcy court."

Notwithstanding the current trends in the case law, *Stern* may re-define the constitutional core jurisdiction in a way that divests bankruptcy courts of jurisdiction to enter a final order which essentially disposes of state law causes of action.

F. Equitable Mootness

The dismissal of bankruptcy appeals based on equitable mootness is a reemerging issue that can impact on non-debtor releases and bar orders. The doctrine of equitable mootness was intended to protect third parties who have justifiably relied on plan

confirmation, although it is not always clear who those third parties are and to what extent they are entitled to protection. A trilogy of recent cases from the Third Circuit Court of Appeals have distinguished outside investors who make equity investments in a reorganized debtor from insider equity investors, suggesting that the former are entitled to greater protection than the latter in relying on plan consummation through the doctrine of equitable mootness. *See In re One2One Commc'ns, LLC*, 805 F.3d 428, 436-37 (3d Cir. 2015); *Samson Energy Res. Co. v. SemCrude, L.P. (In re SemCrude, L.P.)*, 728 F.3d 314, 321 (3d Cir. 2013); *In re Philadelphia Newspapers, LLC*, 690 F.3d 161, 171 (3d Cir. 2012); see also *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996). As a result, inside investors or former equity holders who contribute value to a debtor's reorganization in exchange for releases or a bar order may not enjoy the same protections afforded to an outside investor under the equitable mootness doctrine and should be prepared for the possibility that a confirmed plan may be unwound through the appellate process even if the inside investors have already contributed property to the plan.

Moreover, if an appellant seeks to invalidate a non-debtor release and plan remains confirmable even if the release is subsequently excised, the appeal is likely not equitably moot. *See Aurelius Cap. Mgmt, L.P. v. Tribune Media Co. (In re Tribune Media Co.)*, 799 F.3d 272, 279 (3d Cir. 2015); *see also In re PWS Holding Corp.*, 228 F.3d 224, 236-37 (3d Cir. 2000). Again, it is key for attorneys who represent inside parties, particularly inside investors and former shareholders, to ensure their clients understand that merely funding a confirmed plan of reorganization may not be sufficient to block an appeal from an unstayed confirmation order through the doctrine of equitable mootness, meaning that the appellate courts will necessarily have to resolve the appeal on the merits.

G. Key Local Opinions and Recent Case Law Developments

Circuit Courts of Appeal

SE Prop. Holds., LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.), 780 F.3d 1070 (11th Cir. 2015).
In expressly joining the "pro-release" circuit courts of appeal, the Eleventh Circuit affirmed a bankruptcy court's approval of a bar order proposed under chapter 11 plan because the bar order was fair and equitable and was essential to the debtor's continued operation due to the highly litigious nature of the case. The Eleventh Circuit rejected the proposition that Section 524(e) of the Bankruptcy Code prevents a bankruptcy court from exercising its authority to issue a bar order under Section 105 and commended the bankruptcy court's application of the seven *Dow Corning* factors, noting that the bankruptcy court should have discretion to determine which of the *Dow Corning* factors apply and that the factors should be viewed as a nonexclusive list that are applied flexibly, but cautioned the frequent use of releases and bar orders.

Munford v. Munford, Inc. (Matter of Munford, Inc.), 97 F.3d 449 (11th Cir. 1996).
The debtor sued multiple defendants on account of breach of fiduciary duty claims arising from a leveraged buyout. One of the defendants reached a settlement with the debtor, but the settlement was conditioned on the issuance of a bar order that would

prevent the co-defendants from pursuing contribution and indemnification claims against the settling defendant. The bankruptcy court approved the settlement, concluding that the settling defendant's insurance policy funding the settlement was the only substantial asset that would have been available to the co-defendants to the extent they sought to later pursue contribution and indemnification claims against the settling defendant. In evaluating whether the bar order is appropriate, the Eleventh Circuit considered (i) the interrelatedness of the claims that the bar order precludes, (ii) the likelihood of barred parties to prevail on barred claims, (iii) the complexity of the litigation, and likelihood of depletion of the resources of the settling parties. In affirming the bankruptcy court and approving a release of non-debtor claims for the first time, the Eleventh Circuit held that Section 105 authorized the bar order because it was integral to the settlement.

District Courts

Realan Inv. Partners, LLLP v. Meininger (In re Land Resource, LLC), 505 B.R. 571 (M.D. Fla. 2014).
Bankruptcy court had constitutional authority to approve proposed settlement containing bar order.

Bankruptcy Courts

In re HWA Props., Inc., 2016 WL 67786 (Bankr. M.D. Fla. Jan. 6, 2016) (Delano, J.).
Chapter 11 debtor sought approval of its plan of reorganization which was predicated on a compromise with several creditors that contained a bar order inuring to the benefit of the debtor's two shareholders and various entities controlled by the shareholders, including at least one entity that was not a creditor of the debtor. The bankruptcy court applied the seven *Dow Corning* factors and declined to approve the bar order because each of the factors militated against the entry of the bar order or were inapplicable.

Estate of Juanita Jackson v. Gen. Elec. Cap. Corp. (In re Fundamental Long Term Care, Inc.), 527 B.R. 497 (Bankr. M.D. Fla. 2015) (Williamson, J.).
Notwithstanding the rejection of a similar bar order in connection with the case a year earlier, Judge Williamson approved the bar order contained in the chapter 7 trustee's settlement of the estate's remaining successor liability claims which enjoined probate estates from pursuing state court litigation. The bankruptcy court also noted that its authority to grant permanent injunctive relief did not arise solely under Section 105 of the Bankruptcy Code. The All Writs Act also provided the court with the requisite authority, as the permanent injunction was not proscribed by the Anti-Injunction Act, which only authorizes a bankruptcy court to enjoin a state court proceeding if (i) it has been authorized by Congress, (ii) it is necessary to aid its jurisdiction, or (iii) it is necessary to protect or effectuate its judgments.

In re Marshall Creek Retail Invs., LLC, 2015 WL 3485996, at *4 (Bankr. M.D. Fla. May 18, 2015) (Glenn, J.).

Bankruptcy court approved injunction included in chapter 11 plan which prohibited actions against non-debtor guarantors contributing to the funding of the plan, provided that debtor was not in default under the plan.

In re Scrub Island Dev. Group Ltd., 523 B.R. 862, 876 (Bankr. M.D. Fla. 2015) (Williamson, J.).
Bankruptcy court entered order confirming chapter 11 plan of reorganization, and lender moved for a stay pending appeal. Chapter 11 plan contemplated that debtors would acquire partially constructed villas from the owners, free and clear of liens, with the exception of the lender's lien, and the debtor would be substituted in place of the owners on account of the lender's loans secured by the villas. Because the owners remained liable on the lender's loans, the plan also provided for an injunction that enjoined the lender from pursuing the owners. Court concluded that the *Transit* factors overwhelmingly supported the entry of a bar order.

Colony Beach & Tennis Club Ass'n, Inc. v. Colony Lender, LLC (In re Colony Beach Tennis Club, Inc.), 508 B.R. 468 (Bankr. M.D. Fla. 2014) (May, J.).
While confirmation was denied on other grounds, the scope of the discharge, release, and channeling injunction provision which purported to release certain non-debtor entities from any all claims and causes of actions held by "all Holders of claims," including those claims "based on any act, omission, document, instrument, transaction, or other activity … that occurs in connection with implementation of the … Plan" appeared to be impermissibly broad, as the provision could reasonably be interpreted to release non-debtor guarantors and unit owners from obligations owed to third parties.

In re Fundamental Long Term Care, Inc., 515 B.R. 352 (Bankr. M.D. Fla. 2014) (Williamson, J.).
The (i) chapter 7 trustee, (ii) state court receiver, and (iii) six probate estates that sued the entity in the state court receivership and the debtor's wholly owned subsidiary reached a settlement resolving all claims among them. The settlement contemplated a bar order prohibiting third parties from suing the state court receiver for withdrawing its defense of the entity in the receivership. The bankruptcy court concluded that the bar order was not fair and equitable to the enjoined parties because the bar order deprived the shareholders, investors, and lenders of their bargained for right to defend the entity in the receivership against liability and the enjoined parties did not receive any benefit under the proposed compromise.

In re J.C. Householder Land Trust #1, 501 B.R. 441, 457-60 (Bankr. M.D. Fla. 2013) (Williamson, J.).
Unlike *GunnAllen Financial* and *Fundamental Long Term Care*, which addressed bar orders as part of a motion to compromise, chapter 11 plan included a bar order enjoining lender from pursuing its claims against non-debtor on account of personal guaranties, provided that the debtor was current on its plan payments Chapter 11 plan included a bar order enjoining lender from pursuing its claims against non-debtor on account of personal guaranties, provided that the debtor was current on its plan payments. Judge Williamson concluded that all of the *Transit* factors weighed in favor of approving the bar order, as

among other things, absent the bar order, the guarantors would likely be forced into their own bankruptcy cases, resulting the needless consumption of resources and preventing the guarantors from rehabilitating their credit, which would be essential to the debtor's ability to successfully reorganize.

In re Cello Energy, LLC, 2012 WL 1192784, at *18 (Bankr. S.D. Ala. Apr. 10, 2012) (Mahoney, J.).
In the absence of any objections, the bankruptcy court determined that the non-debtor release of a purchaser did not satisfy the *Transit* factors.

In re GunnAllen Fin., Inc., 443 B.R. 908, 917-18 (Bankr. M.D. Fla. 2011) (Williamson, J.).
Bankruptcy court declined to approve settlement which contained a bar order precluding securities claimants from pursuing claims against dealer's employees in exchange for less than 25 cents on the dollar.

In re Rothstein Rosenfeldt Adler, PA, 2010 WL 3743885, at *6 (Bankr. S.D. Fla. Sept. 22, 2010) (Ray, J.).
The trustee proposed a compromise to resolve adversary proceeding involving preferential and fraudulent transfers. The avoidance defendants offered to turn over virtually all of their assets, but requested a bar order relating to claims arising from their involvement in the debtor's Ponzi scheme as condition to the settlement. The bankruptcy court concluded it had subject matter to bar the claims and that the bar order was interrelated to the trustee's claims and arose out of the same facts as the trustee's claims against the defendants.

In re Mercedes Homes, Inc., 431 B.R. 869, 878-79 (Bankr. S.D. Fla. 2009) (Hyman, J.).
In approving non-debtor release precluding certain creditors from asserting independent causes of action against the directors and officers of the debtor, the bankruptcy court made very specific factual findings for each of the *Dow Corning* factors.

In re Winn-Dixie Stores, Inc., 356 B.R. 239, 250-51 (Bankr. M.D. Fla. 2006) (Funk, J.).
Bankruptcy court considered *Justice Oaks* factors in overruling United States Trustee's objection to release of (i) non-debtor subsidiaries, (ii) directors, officers, employees of the debtor or non-debtor subsidiaries, (iii) professionals of the debtor, (iv) the lender and its advisors, and (v) the creditors' committee.

In re Transit Group, Inc., 286 B.R. 811, 816-18 (Bankr. M.D. Fla. 2002) (Jennenmann, J.).
The court held that Section 524(e) of the Bankruptcy Code does not act as a bar to non-debtor releases if the releases are necessary to effectuate the provisions of the Bankruptcy Code. To obtain a non-debtor release or injunction, the debtor must establish that unusual circumstances exist, and that the release is fair and necessary. In determining whether appropriate circumstances exist to issue an injunction or release, the court looked to seven factors, including (i) whether the debtor and third party share an identity of interest, (ii) whether the non-debtor contributed substantial assets to the reorganization,

(iii) whether the injunction is necessary to the reorganization, (iv) whether the impacted class overwhelmingly voted to accept the plan, (v) whether the affected classes will be paid under the plan, (vi) whether the plan provides an opportunity for claimants who choose not to settle to recover in full, and (vii) whether the bankruptcy court made a record of specific factual findings to support its conclusions.