LJN LAW JOURNAL NEWSLETTERS

The Bankruptcy Strategist®

An incisivemedia publication

Volume 26, Number 6 • April 2009

Strategy for the Secured Creditor In a Single Asset Real Estate Case

What Creditor's Counsel Should Know

By William M. Hawkins

The Bankruptcy Code § 362(d)(3) provides unique grounds for stay relief by permitting a creditor secured by a bankruptcy debtor's "single asset real estate" to pursue an act against the property as early as 90 days after the case's filing. To take full advantage of this provision, however, secured creditors should carefully manage the dual time frames set forth in this Bankruptcy Code section.

Background

Section 362(d)(3) of the Bankruptcy Code states that a "creditor whose claim is secured by an interest" in "single asset real estate" "shall" obtain relief from the automatic stay under § 362(a) of the Bankruptcy Code upon the creditor's request, to the extent that the stay impedes "an act" against the debtor's real property. 11 U.S.C. § 362(d)(3). Under the Bankruptcy Code, "single asset real estate" means "real property constituting a single property or project, other than residential real property with fewer than 4 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. § 101(51B). Accordingly,

> [t]hree requirements emerge from this definition which must all be met for a debtor to be considered a SARE [*i.e.*, single asset real estate] debtor: (1) the debtor must have real property constituting a single property or project (other than residential real property with fewer than 4 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. If a debtor fails to meet any prong, it is not a SARE.

AD HOC Group of Timber Noteholders v. Pac. Lumber Co. (*In re Scotia Pac. Co. LLC*), 508 F.3d 214, 220 (5th Cir. Tex. 2007).

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Assuming the factual preconditions of § 362(d)(3) are met, a debtor can only avoid stay relief under this paragraph following the secured creditor's request by either filing "a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time" or beginning monthly payments to the creditor which are "equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate" and otherwise meet the statute's requirements. 11 U.S.C. §§ 362(d)(3)(A) and (B). Prior to the 2005 amendments to the Bankruptcy Code, § 362(d)(3) set the deadline for the debtor to file an appropriate plan or commence qualifying payments as "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 [have] determine[d] for cause by order entered within that 90-day period)." 11 U.S.C. § 362(d)(3). The 2005 amendments added another possible date, however, so that the deadline for the debtor's filing an appropriate plan or commencing qualifying payments (on the pain of stay relief if it fails to comply) now falls on the later of the end of the 90-day period described above (as the bankruptcy court might extend it "for cause") or "30 days after the court determines that the debtor is subject to this paragraph [*i.e.*, § 362(d)(3)]." *Id.*

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The Perils of Waiting

A secured creditor should act quickly upon a bankruptcy case's filing to take full advantage of any potential benefit under § 362(d)(3). Though 90 days is the earliest date to obtain the section's benefits, a creditor should consider prompt action after a case's filing to avoid the 30-day period effectively adding time to the 90 days for debtor compliance. If the secured creditor's collateral is single asset real estate, but the creditor still believes that the debtor will challenge the case's "SARE" status, the creditor should consider immediately bringing the controversy before the court for determination. The creditor should not simply wait to make a single motion for stay relief timed at or near the ninetieth day after the case's commencement. Though at first blush it might seem logical for a secured creditor to hold off in order to see if the debtor files a plan or begins monthly payments as contemplated by § 362(d)(3), this approach dangerously ignores the section's 30-day provision. In fact, a debtor could have solid grounds to oppose a motion brought by a secured creditor at the 90-day mark where the creditor only bases its request for relief on the debtor's failure to file an appropriate plan or commence proper payments. The debtor could simply argue that the court had not yet "determine[d] that the debtor [was] subject to this paragraph" and, therefore, the later of the two possible deadlines of § 362(d)(3) had not yet transpired.

At this juncture, adjudication by the bankruptcy court could yield one of two negative outcomes for the secured creditor. First, the court could conclude that the creditor's motion did not request a determination that the debtor is subject to § 362(d)(3), but only asked for stay relief based on the passage of 90 days. Under this outcome, the creditor would not only lose the motion, but would also have no determination of the paragraph's applicability to start the 30-day clock ticking. Stay relief would be indefinitely delayed. Alternatively, the bankruptcy court could conclude that the secured creditor's motion encompassed a request for determination that the debtor is subject to § 362(d)(3), and further determine that the debtor was so subject. Even in this case, however, the mechanism of § 362(d)(3) would still give the debtor 30 more days to meet the section's requirements, thereby increasing a best-case 90-day time for debtor compliance to more than 120 days.

What a Secured Creditor Should Do

How can a secured creditor determine if there is any potential controversy concerning "SARE" status? First, the secured creditor should review the debtor's petition. The official petition form requires the debtor to indicate under "nature of business" whether the case qualifies for treatment as "Single Asset Real Estate as defined in 11 U.S.C. § 101(51B)." If the corresponding box is checked, the secured creditor can conclude that the debtor effectively admits that its bankruptcy is a single asset real estate case. If the debtor has failed to check any box or indicated another status, the creditor should assume that the debtor will challenge the "SARE" designation.

The secured creditor should also review the "Schedule A" filed in the case. The debtor sets forth the real property in which it has an interest on this schedule. Obviously, if Schedule A does not include the real property in question as a debtor asset, there is a significant issue to address. (A debtor's failure to include the real estate on Schedule A might actually favor the secured creditor, however, since the omission indicates that the debtor may not consider this collateral as property of the bankruptcy estate. If not estate property, an act against the real estate would not by itself constitute a stay violation.)

If the creditor's review of the petition and Schedule A indicates a potential challenge to the "SARE" designation, the secured creditor should also review the debtor's Statement of Financial Affairs. The debtor must describe its income and other financial information for the period immediately prior to the petition date on this form. Thus, the statement can give the secured creditor significant, pertinent information as to whether the debtor's real property generates substantially all of the debtor's gross income and if there is any substantial business conducted on the property other than its operation and management. Armed with this data, a secured creditor can better craft its arguments for single asset real estate status in the case (or at least can better understand the challenges it may face to this determination). The secured creditor will also likely possess or have access to other documents and information which could further aid in assessing the chances of obtaining the "SARE" determination.

After reviewing available in–formation, if the secured creditor still believes that "SARE" status applies, it should seriously consider seeking the bankruptcy court's determination under § 362(d)(3). The creditor's decision to act should be made quickly, because a motion under Federal Rule of Bankruptcy Procedure 9014(a) for a determination as to whether the debtor qualifies for "SARE" treatment plus the 30 days provided by the statute after this determination will consume significant time. In fact, if it appears that the creditor might not obtain this determination before the 90-day mark in the case, it should consider a different approach: the creditor could make a motion requesting stay relief under § 362(d)(3) or, in the alternative, that the court: 1) determine that § 362(d)(3) applies to the debtor; 2) set a deadline 30 days later for debtor compliance with § 362(d)(3)(A) or (B) (*i.e.*, plan filing or payment initiation); and 3) provide for stay relief if the debtor does not so comply. Assuming that the hearing on this motion would only occur on or after the 90th day, a motion of this type will position the secured creditor for any decision that the bankruptcy court might reach. Whether the court rules that the requirement of a determination of § 362(d)(3)'s applicability has been met by a debtor admission, collapses this determination into a single hearing together with the consideration of stay relief, or otherwise simply dispenses with the requirement of this

determination, the creditor would have made all of the necessary requests in its motion to support the court's approach. On the other hand, if the court were to deny the stay relief as premature, the creditor's request in the alternative for determination of § 362(d)(3)'s applicability would assure that the debtor got no extra "wiggle room," because the court would presumably make the determination that this section applies and thereby start the 30-day time running.

Of course, despite the foregoing reasoning, a secured creditor might still delay seeking a determination from the bankruptcy court on the applicability of § 362(d)(3). Reasons for doing so might include economic considerations (*e.g.*, the real property may not have significant value, or the secured creditor may not have the economic wherewithal to pay for the litigation) or strategy (the creditor may have other sources of repayment, making it unnecessary to pursue recovery in the bankruptcy, or the creditor might harbor concerns about whether the "single asset real estate" moniker will apply to the facts and prefer not to "test" the issue).

Whatever the reason for the delay, however, other potential methods to address the secured creditor's potential rights under § 362(d)(3) exist and should be explored. For example, the secured creditor's counsel could simply ask the debtor's attorney what was the basis for the debtor's decision to exclude itself from "SARE" status. This inquiry will likely yield more information and might even lead the debtor to reconsider the failure to self-categorize as a single asset real estate case — especially if the decision was a close call. The creditor could also seek to exploit another potentially useful source of information on matters relating to § 362(d)(3): the meeting of creditors pursuant to § 341 of the Bankruptcy Code. This meeting generally occurs at a relatively early date in the case. Here, a representative of the debtor must answer creditor questions under oath, so the secured creditor may be able to examine the debtor. Answers received could help the creditor in subsequently seeking the determination described in § 362(d)(3) of the Bankruptcy Code and in obtaining stay relief.

Conclusion, a Comment and a Caveat

The central message of this article is to secured creditors: if you hope to maximize any advantage under § 362(d)(3), do not permit the 90-day time frame described in this provision to lull you into delaying a careful review of the section's requirements. The other time frame established by § 362(d)(3) — the 30-day period after a determination of whether the debtor is subject to this statutory provision — demands early analysis to preserve a secured creditor's greatest possible advantage and keep the time available to the debtor for compliance as short as possible. Holding the tightest possible reins on the debtor will likely lead to the best results, or at least the best negotiating position, for the creditor.

While this article focuses on relief from the automatic stay pursuant to § 362(d)(3) of the Bankruptcy Code, secured creditors and their counsel should bear in mind that stay relief on other grounds may also be available. Motions discussed in this article could also include a request for stay relief under § 362(d)(1) of the Bankruptcy Code (based on, for example, a "lack of adequate protection") or under § 362(d)(2), based on a lack of debtor equity in the property and the debtor's inability to reorganize. Moreover, a secured creditor should consider seeking the case's dismissal under § 1112 of the Bankruptcy Code as a bad faith filing, especially since the ownership of only one asset (here, the "single asset real estate") and limited business operations are two factors that courts review in deciding if a debtor has improperly sought bankruptcy protection (though these characteristics alone are not likely to suffice in obtaining a "bad faith" ruling). Before including other bases for relief in any motion, however, the secured creditor should carefully consider how they might affect the request for relief under § 362(d)(3) of the Bankruptcy Code. The determination of whether a case qualifies for "SARE" treatment will often be a more clear-cut question than many of the issues that can arise in seeking to establish other grounds for stay relief or dismissal. Adding more complicated or tenuous arguments to a relatively simple motion could cause delay.

Finally, it is possible that, even in a situation where the debtor has effectively agreed that the factors triggering § 362(d)(3)'s application are present, the bankruptcy court could still view the 30-day clause as requiring a separate determination by the court that the factors are present — *i.e.*, that the debtor's admission alone does not suffice or take the place of the court's adjudication. While it seems hard to imagine that a debtor could argue for this interpretation in the face of its acknowledgement of "SARE" status, other parties-in-interest, including unsecured creditors, an official committee, or a lessee who desires to remain in possession of the real property, could pursue such an argument. The more it appears that such a party might fight the debtor's acquiescence to the single asset real estate designation, the more a secured creditor should consider moving for the court's determination of § 362(d)(3)'s applicability even though the debtor does not oppose it.

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