

## 2009 HOSPITALITY LAW CONFERENCE

### “Look Before You Leap!”

Owner and Lender Considerations before  
pursuing Workouts, Restructurings,  
Receiverships or Bankruptcy Filings



Jerry Herman

DLA Piper LLP (US)

February 2009



# Presenters



- **Jerry H. Herman**
- Of Counsel, DLA Piper LLP (US), Washington, D.C.  
jerry.herman@dlapiper.com
- 20 year veteran on legal and business sides of industry
- Lead role in more than \$2 billion hotel transactions, including acquisitions, management arrangements, new developments, ventures and distressed transactions



# The Storm Has Fully Arrived

The “STORM” of a significant economic and industry downturn, combined with a drastic liquidity crunch, has fully arrived and will likely be with the industry for the next 9-??? months

## INDUSTRY WIDE DOWNTURN

- REVPAR declines have been significant ... drops of 7% or more per month since September, 2008 which are forecasted to continue through at least the end of 2009
- Hotel values are forecasted by many industry experts to decline by as much as 20-30% - so that many financed transactions with value or debt service covenant requirements, or close-in maturity dates, will be at significant risk
- Recently underwritten loans (i.e., last 2-3 years) involving new construction or substantial conversions, or acquisition loans or refinancings where leverage greater than 75%, are also at heightened risk
- Hotel and real estate loan delinquencies could exceed 3-4%, per many experts, in a market where commercial real estate debt has grown to \$3.4 trillion dollars over the last several years
- Unknown bottom of cycle due to precipitous GOP and REVPAR drops, lack of consumer confidence, liquidity crisis and many other factors untested since the significant industry and economic downturn of the early 90's

## LIQUIDITY CRISIS

- Near total absence of capital, including from CMBS and traditional debt markets, and for debtor in possession funding, vastly exacerbates the industry's fiscal condition
- Borrower lines of credit subject to cancellation, or introduction of new underwriting restrictions which impact: amount and cost of capital; scope of collateral or guarantees; and other required terms
- Has been a major cause for 70-85% decline in 2008 in hotel sale transactions > \$10 million



## “Look and Know Before Lender or Borrower Leaps!!!”

YET – Before Lenders implement actions on hotel asset(s) leading to potential Deed in Lieu, Foreclosure or Receivership or Bankruptcy Outcomes, or alternatively before Borrowers begin pursuing Loan Default or Bankruptcy Scenarios, the parties should understand:

- the hotel and its competitive market position
- the hotel’s financial results and its current valuation
- the ability to achieve a loan modification, based on the capacity of the Borrower and other “interested parties” to provide needed financial game plan
- the quality of hotel management, and the substance and depth of initiatives by hotel ownership and/or management to “confront” the downturn and/or distress
- a comparison of the projected cost of a hotel “workout” versus the loss to a lender in asset value due to prolonged restructuring or bankruptcy



## Assessing the Ability of the Asset to “Weather The Storm”

Critical to understanding the capacity of ownership and management to proactively respond to an industry, economic and asset downturn is an analysis of hotel’s plans for:

- Maximizing Market Share through Affirmative Revenue Action
- Controlling Operating Expenses
- Tackling Fixed Expenses
- Enhancing Leadership and Focus
- Dealing with Possible or Likely Shortfalls



## Critical Initiatives for Hotels During a Downturn

### **Maximizing Market Share thru Affirmative Revenue Actions**

- Practice proactive revenue management, as well as utilize all effective franchise, third-party or other revenue management tools
- Analyze the tradeoffs between rate and occupancy. Too often, owners and operators reduce rates prematurely or unnecessarily
- Closely monitor booking pace and seek out underutilized customer segments such as social, military, educational, religious, fraternal organizations
- Assess and implement, if justified after cost-benefit analysis, revenue enhancements or incentives, such as use fees, hotel packages or amenity offerings



## Critical Initiatives for Hotels During a Downturn

### Tackling Fixed Expenses

- Undertake real estate tax appeals, especially in markets where real estate values have declined for more than the local jurisdiction's tax year
- Quantify all capital improvement plans and brand upgrades needed, and undertake adjustments to those budgets. Develop a deferral plan for non-essential capital improvements and brand standards, and secure needed approvals from ownership, manager, brand or lender
- Alternatively, if a directly competitive hotel is opening nearby within the next two years, consider essential additional improvements so that market-share isn't lost, and the feasibility/sources/availability of funding for such improvements



## Critical Initiatives for Hotels During a Downturn

### **Controlling Operating Expenses**

- Use zero-based budgeting, including identifying all discretionary expenses
- Increase labor scheduling and productivity reports in accordance with accurate occupancy forecasting
- Competitively re-bid all major vendor and supplier contracts
- Pursue utility purchasing options through non-traditional means like energy cooperatives





## Critical Initiatives for Hotels During a Downturn

### Enhancing Leadership and Focus

- All responsible parties (owners, managers, employees, etc.) should build a list of the critical variables, including the most important revenue, operational, market, brand, financial and owner actions to be implemented
- Leadership should implement an early warning system to quickly respond to external or internal factors impacting such critical variables
- Focus needs to be on a hotel's most important "ASSETS" ... its employees and guests



## Planning for Shortfalls by Borrower

**If a hotel must refinance or “modify” its existing debt, or is likely to encounter other financial challenges, it is essential for Borrower to achieve an understanding of the following:**

- The projected operating income or cash flow needs of Hotel for next 12-24 months, including an assessment of the amounts, sources and duration of an expected working capital, debt, equity, or other shortfall
- A realistic current valuation of the asset
- All debt covenants, including debt service coverage ratio requirements and other owner financial condition representations and warranties
- The rights of senior and mezzanine debt holders upon any workout, loan default or similar “triggering” event
- The terms of all guarantees provided by the borrower, manager and/or guarantor, and the exposure by borrower or guarantor to non-loan third party liabilities
- The rights or capital call requirements of equity or preferred equity participants in the ownership group upon a workout or default



# Planning for Shortfalls by Borrower

- The pricing and terms of capital from existing or new stakeholders, which might be available to address the shortfall, including the availability of equipment/lease financing and new mezzanine debt
- The rights and responsibilities of franchise company, the management company, and hotel lessors, lessees or other significant contractual users upon a loan default, receivership or other similar event
- The approvals needed from lender, servicer, or trustee to any workout or modification, especially if loan has been securitized, and the expected time period for, and feasibility of, securing such approvals
- The other Hotel operating business impacts caused by any economic shortfall, such as: vendor payments; license, permit and user agreement requirements; employee benefits and economic termination issues; and upcoming franchise or other quality assurance requirements, standards or inspections
- The need for a Pre-Workout Agreement with lender



# Proactive Lender Analysis Plan

**If a Lender believes a hotel asset will be on its “yellow or red list”, it is critical to undertake a Complete Comprehensive Analysis, including an evaluation of:**

- Quality and professionalism of “Owner Plan” and downturn actions, as described above
- Loan history
- Asset performance and valuation
- Owner, borrower and guarantor financial condition, integrity and skills
- Updated physical inspection results and capital expenditure needs
- Hotel or lender reserves and their needed or available uses
- Cost of workout, if feasible, vs. costs and other issues of pursuing or encouraging “change” through deed in lieu, foreclosure, bankruptcy, or receivership
- Comfort level with borrower and/or manager controlling the asset and the Hotel’s cash flow



# Proactive Lender Analysis Plan

- Loan document terms, including confidentiality, estoppel, and SNDA provisions in documents; and evaluations of potential Borrower defenses/counterclaims
- Potential lender liability claims, and possible diminution of Senior Lender's collateral from claims of "Junior Lenders"
- Need for Pre-Workout Agreement
- Hotel rebranding and management change opportunities, and impact of future capital improvements on Hotel's market position in short, mid and long range time horizons
- Value of Hotel upon sale as a hotel, or alternatively for a higher and better use
- Capacity, skills, and legal exposure of lender managing the asset
- Impact of any workout or other triggering event on Lender's financial and regulatory requirements and covenants
- Other activities of Borrower if not SPE, and of managing entity of Borrower



## Warning Signs-Lender and Borrower Beware

Negative cash flow resulting in late payments, and/or non-payments of loan or other critical operating agreement defaults

Covenant defaults under loan or franchise or management agreements

Excessive CAPEX deferrals

Unwillingness or inability of Borrower and Guarantor to provide updated asset or other collateral valuations, or updated financial statements of Hotel's performance

Real estate tax arrears

Investors or other interested parties unwilling to infuse capital



## Warning Signs-Lender and Borrower Beware

Subordinate liens and judgments occurring

Sharp declines in Hotel inventories or in sales/marketing or maintenance expenses

Significant loss of future advanced hotel bookings and precipitous drop in REVPAR or “Fair Share” of Hotel’s Competitive Market

Untimely or poor quality reporting, budgets and business plan

Loss of subsidy or regulatory defaults under Hotel agreements

Defaults by Borrower affiliates under other loans not related to Hotel

Loss of retail tenants or other non-hotel income sources

Securitized loans requiring “multiple” approvals; or if servicer or trustee is claiming lack of authority to pursue loan workout

2009 HOSPITALITY LAW CONFERENCE

## Workouts, Lender Negotiations and Bankruptcy Filings: What You Need To Know



Karol K. Denniston  
DLA Piper LLP (US)  
February 2009





# Presenters



## Karol K. Denniston, Head of West Coast Restructuring Practice

- **Karol Denniston's practice focuses on international and domestic corporate restructuring, both in and out of court. When not directly involved in Chapter 11 cases and international restructurings representing secured creditors, debtors and equity holders, Ms. Denniston provides bankruptcy analysis and advice in connection with structured finance transactions to manage credit risk by utilizing appropriate debt and equity structures.**
- **Ms. Denniston frequently represents lenders and borrowers in distressed commercial real estate restructuring transactions and often advises secured lenders on enforcement and bankruptcy strategies.**
- **Recently, while serving as debtor's counsel, Ms. Denniston confirmed a plan of reorganization for a large US-based public utility company, liquidated the European and Australian subsidiaries of a privately held US debtor, and closed a large out-of-court European restructuring requiring resolution of secured lines of credit with a large Dutch bank, as well as unsecured creditor claims in six countries. Ms. Denniston is frequently retained as independent counsel to boards of directors of public and private companies involved in the restructuring process.**

550 South Hope Street,  
Suite 2300  
Los Angeles, California 90071  
(213) 330-7850 T  
(213) 330.7650 F  
[karol.denniston@dlapiper.com](mailto:karol.denniston@dlapiper.com)



# Preliminary Steps- Lender's Perspective

## Collateral review

- Confirm security documents complete, filed and in order
  - Title
  - Insurance
  - Cash control/management
- Property Condition: construction completion, deferred maintenance
- Environmental considerations
- Valuation-marketability of collateral
- Evaluate borrower, project finances and cash flow



# What Should You Do When You See The Warning Signs – Preliminary Steps

## Review legal documents

- Completeness
- Defects
- Perfection of liens and assignments
- Determine if notices or consents are needed
- Evaluate recourse and carve-outs

## Evaluate post-closing loan administration

- Communications among clients and lawyer
- Course of conduct (waivers)
- Representations and assurances (oral and written)
- Memos, letters, e-mails in file



# What Should You Do When You See The Warning Signs – Preliminary Steps

## Define business goals and capabilities

- Benefits of modification (short term, long term)
- Lender's capacity to own, manage or liquidate
- Evaluate long term market conditions
- Explore asset sale prospects



# Special Issues In Connection with Hotels

## Special Issues

- Employee wages, union contracts, and other labor issues
- Licenses, permits and other agreements including cabaret and business licenses, liquor licenses, “use agreements” that provide access to hotel guests for golf, tennis, spa or other facilities
- Management and Franchise Agreement issues
- Brand protection and preservation issues
- Subordination, Non-Disturbance and Attornment (SNDA) issues (frequently encountered with branded hotel management agreements)
- Receiver issues (i.e., will appointment of receiver breach existing management or franchise agreements?)



# Management Agreements

- Management agreements govern the relationship between hotel owners and operators in the operation and management of the hotel.
- Subordination and SDNAs are frequently encountered with branded hotel management agreements and may affect the lender's rights. Typically, subordination clauses or SNDAs will contractually obligate the lender to the terms of the management agreement, by providing that if the lender or anyone succeeding to the property by foreclosure, deed-in-lieu or otherwise ever comes into possession of the hotel, the lender or its successor shall immediately be bound by the agreement.
- The use of a court-appointed receiver will generally not constitute a breach of a SNDA by the lender.
- Hotel Management Agreements will generally be viewed as executory contracts that can be rejected in bankruptcy. See In re Holly's, Inc., 140 B.R. 643 (Bankr. W.D.Mich. 1992).



## Hotels As Single Asset Real Estate?

In re 5877 Poplar, L.P., 268 B.R. 140 (W.D. Tenn. 2001) – Court finds that a 126-room Comfort Inn is a single asset.

In re CBJ Development, Inc., 202 B.R. 467 (9th Cir.BAP (Cal.) 1996) – Court finds that a 63-room full service hotel did not qualify as a single asset. In addition to various hotel services (room cleaning, phone service, laundering, etc.) the gift shop, restaurant and bar, included in the operation of the hotel constituted other "substantial business" than the operation of real property.



## Options for Distressed Hotels

- Consensual negotiated agreement for out of court workout to correct operational and financial flaws while maintaining control over brand.
- Terminate franchise or management agreement for cause prior to the filing of bankruptcy (this should only be used as a last resort). Removing existing management can be costly and time consuming and risks damaging the business (may be more successful if mutual). Timing is critical. If filed too close to a bankruptcy, court may not recognize it.
- Appointment of a receiver under state law.
- Retaining professional fiduciaries as interim management, either out of court or with court supervision.
- Sale of the hotel or other strategic alliance.
- Possible bankruptcy filing.





# Identify the Borrower's Issues/Limitations

## Understand borrower's goals and capabilities

- Cash flow
- Valuation of collateral
- Tax considerations
- Management skills
- Reputation, honesty
- Capital infusion
- Sponsor/Guarantors' commitment to transaction or business and ability to perform thereunder
- Borrower's ability to refinance or sell



# Defaults and Acceleration - What kind of default are you dealing with?

## Material defaults

- Maturity
- Non-payment of debt service
- Non-payment of real estate taxes/escrows
- Non-payment of insurance premiums
- Material breach of debt service coverage ratio covenant
- Loss or diminution of or change in insurance coverage
- Damage to mortgaged property
- Prohibited transfer of mortgaged property or entity interests
- Violation of environmental indemnity
- Contractor failure
- Junior loan default
- Loss of subsidy, take-out, tax-exempt status of bonds in jeopardy, regulatory default



# Defaults and Acceleration

## Other defaults

- Failure to deliver financial statements (timely, at all)
- Breach of loan-to-value covenant
- Entry of minor monetary judgment
- Death of guarantor
- Erosion of cash flow
- Material adverse change in financial condition



# Defaults and Acceleration: Will Acceleration Trigger a Bankruptcy filing?

## **Election to accelerate**

## **Notice of acceleration**

- Clear
- Overt
- Unequivocal

## **Mechanics and effect of acceleration**

- Imposition of default rate of interest
- No obligation to accept partial tender or borrower's cure of its default
- Entire debt is due -- acceleration as maturity



# Communicating with Defaulting Borrowers

## Pre-workout agreement/standstill agreement

- Preserves status quo
- Sets ground rules for discussions
- Either party can terminate discussions at any time
- Protects lender against waiver, oral modification arguments
- No oral agreements can be made
- Lender's goal: obtain borrower's acknowledgement of debt, enforceability of loan documents and waiver of defenses (difficult to accomplish in a pre-workout agreement);
- Bankruptcy planning and related considerations



## Considerations in Dealing with Borrowers -- Lender Liability Risks

### **Lender has the right to protect and preserve collateral**

- Inspections and investigations
- Protective advances-what treatment if there is bankruptcy?
- Important for Lender to consider plan for bankruptcy filing
  - Smooth filing vs. free fall
  - Single v. multiple assets
  - DIP financing/cash collateral use
  - Valuation early on-impact on secured lender and debtor



# Considerations in Dealing with Borrowers -- Lender Liability Risks

## **Impermissible interference with borrower's business affairs**

- Offering business advice
- Participating in management of borrower's business
  - Compelling borrower to execute contracts
  - Hiring contractors
  - Renegotiating existing contracts
  - Requiring approval for payments of operations
- Communications with others
- Labels for interference



# Remedies

## Consensual

- Forbearance agreement
  - Specified time period of “forbearance” to cure identified business problem (suspension or reduction of debt service payments)
  - Waiver of covenant defaults
  - Waiver of defenses, acknowledgement of debt, release of claims-how will bankruptcy court treat waivers?
  - Remedies included in forbearance agreement
    - Consent to foreclosure
    - Stipulated appointment of receiver
    - Stipulated cash collateral agreement





# Remedies

- Repayment Agreement
  - Tied to market conditions, lender's business objectives, target market
  - May be discounted payoff
  - Include remedies
  - Address default and potential bankruptcy filing after the fact
  - Negotiate appropriate waivers and expedited relief if post agreement default



# Remedies

## Other substantive loan restructures

- Restructure loan to conform to market (lower interest rates, change or eliminate amortization, less burdensome financial covenants)
- Incorporate remedies (consent judgment of foreclosure, consent to asset turnover, liquidation, guarantor's confession of judgment)
- Split notes: performing/non-performing
- Change non-recourse to recourse



# Remedies

- Other substantive loan restructures (cont.)
  - Additional collateral included in forbearance agreement
  - Increasing number of guarantors or scope of guaranty
  - Accrual of default rate or interest shortfall, with waiver upon performance
  - Consider bankruptcy implications if there is a filing after closing on restructuring
  - Importance of appropriate and reliable valuation information



## Remedies: Assessing Bankruptcy Risk

- Deed in lieu of foreclosure
  - Business decision to take back or market the collateral
  - Predictability
  - Speed
  - Finality
- Lender's sale of loan to a third party
  - Speed, certainty, finality, elimination of further risk of loss
  - The third party purchaser bargains for long term upside value
  - Ready marketplace for purchasers of distressed debt
  - Avoid any representations
  - Check the loan docs to make sure that a sale can be done



# Remedies: State Law Governs-Example CA

## Coercive

- Non Judicial Foreclosure or “Trustee’s Sale”
  - Private auction of the real property collateral
  - Usually conducted by title company with legal review
  - Timing: 120 days
  - No recourse against Borrower under anti-deficiency statutes
  - Borrower has no right of redemption
  - Lender can “credit” bid the defaulted debt
  - No collusion with potential bidders
  - Unified Sale



## Remedies: State Law Governs

- Judicial Foreclosure
  - Court supervised auction of the real property collateral
  - Timing: 6-14 months
  - Conducted by Court agent, such as a probate referee or receiver
  - Full recourse against Borrower for loan deficiency
  - Borrower has a one-year right of redemption



## Remedies: Potential Bankruptcy Trigger

- Receiver
  - Court-appointed agent to take control of collateral
  - Purpose to protect and preserve collateral (particularly rents and profits) pending foreclosure
  - Under certain circumstances, can be used to complete construction project, perform environmental investigation, even sell collateral
  - Requires filing of lawsuit (usually for judicial foreclosure and specific performance)
  - Appointed based upon noticed motion (16 business days) or ex parte (1-2 business days), if exigency
  - Appointment discretionary by Court, viewed as a drastic remedy



# BANKRUPTCY

## Filing:

### 1. First Day Motions:

- a. Cash collateral use/DIP financing
- b. Employees and related operational matters

### 2. Stay and Stay Relief

- a. When to file stay relief motion
- b. Has receiver been appointed, taken oath and has bond been filed?
- c. Who has jurisdiction?
- d. Valuation: what arguments support stay relief?
- e. Distinction between single asset and multiple asset cases?





# Bankruptcy

## Operating in Bankruptcy

- a. Proceeding with stay relief
- b. Is conversion from Chapter 11 to 7 appropriate?
- c. Importance of financing, cash flow, and administrative expense on lift stay and conversion.
- d. Review of debtor's first day affidavits, petition, statement of financial affairs and schedules



# Bankruptcy

## How does it end?

What is the Debtor's exit plan?

Is financing available?

Is valuation realistic/reasonable?

Is the absolute priority rule complied with?

Who gets hurt? If there is an equity cushion, what is the impact?

When does a lender need to seek adequate protection?



## In Anticipation of Bankruptcy

### Loan Document and Collateral Review

Importance of appraisal and valuation

Understanding Debtor's cash flow needs and requirements both in and out of bankruptcy

What exits are available?

What maximizes the return to the lender?

Are there alternative financing options?

Are there any defects in collateral/security?

Have all the notices required by the loan documents been given in terms of exercising rights?

Does the lender have a list of defaults?

Can the lender provide an accurate accounting of advances and payments made?



# Ipso Facto Clauses and Waivers of Bankruptcy Rights

**General Rule:** Prohibitions against the filing of bankruptcy are unenforceable.

## What can be enforced:

Prepetition waiver of single benefit of Bankruptcy Code - for example:

- waiver of automatic stay in exchange for creditor's forbearance

- prohibition of involuntary petition by creditors-  
prepetition consent by junior lienholder to  
foreclosure by senior lienholder required

- dismissal of junior lienholder's involuntary petition



# Ipsso Facto Clauses and Waivers of Bankruptcy Rights

## **Other examples of Prepetition Waivers that may be enforceable:**

Appointing independent directors or partners whose vote is required for a voluntary filing;

Adding provisions to governing charter documents that restrict access to voluntary filing;

Use of non-business trust that is not eligible for relief;

Designating where to file; forum selection clauses.



# Ipso Facto Clauses and Waivers of Bankruptcy Rights

**Must be in exchange for valid consideration and appropriate to the circumstances:**

Removal of manager of limited liability company upon filing

Naming of independent director required to approve potential bankruptcy filing

Partnership dissolution upon partner filing for relief

Business operations/cessation of business

Change in control trigger

Default based on expiration of time

Springing guaranties

Cross defaults

Agreement regarding timing and process for sale of assets



# Assessing Bankruptcy Risks to Lender Recovery

## Pre-bankruptcy workouts/restructuring

- a. Borrower waiver of bankruptcy remedies
- b. Importance of valuation and reasonable business judgment
- c. Potential fraudulent transfer/preference: debt exchanges, deeds in lieu and other structures
- d. Recharacterization and subordination: when is lender at risk
- e. Single v. multiple asset cases
- f. Lift stay and motions for dismissal
- e. Cramdown and 1111 election



## Single Asset Real Estate Cases, Assignment of Rents, and Pre-petition Waivers of Automatic Stay

### Single Asset Real Estate Cases

- Definition Under 11 U.S.C. § 101(51B)
- Automatic Stay Timing

### Assignment of Rents in California

- Perfection
- Enforcement

### Pre-petition Waivers of the Automatic Stay Claims under 11 U.S.C. § 1111(b)





# Single Asset Real Estate Cases

## Defining single asset real estate under 11 U.S.C. § 101(51B)

- Definition prior to the 2005 BAPCPA
  - Real property constituting a single property or project
  - Not residential property with fewer than 4 units
  - Generating substantially all of the gross income of the debtor
  - On which no substantial business is being conducted by debtor other than the business of operating the real property and incidental activities
  - \$4M or less in aggregate, noncontingent, liquidated secured debts
- Definition after the 2005 BAPCPA
  - \$4M cap is eliminated



# Single Asset Real Estate Cases

## Automatic Stay Timing

- 11 U.S.C. § 362(d)(3) fast-tracks single asset real estate cases by allowing secured creditors to proceed with foreclosure action within 90 days of entry of order for relief unless the debtor:
  - Filed a Chapter 11 plan that had a reasonable possibility of being confirmed within a reasonable time; or
  - Began making regular monthly payments to each creditor whose claim was secured by the single asset



# Assignment of Rents in California

**Interest of a beneficiary in rents and profits of property owned by bankrupt trustor is a question of state law**

## **Perfected assignment of rents**

- In California, the assignment of rents is perfected upon recordation
- Where the assignment is a perfected security interest prior to bankruptcy, the beneficiary is entitled to all of the rents collected after the trustor's default despite the trustor's bankruptcy



# Assignment of Rents in California

**California Civil Code § 2938 provides four methods of enforcement:**

- Appointment of a receiver
- Lender obtaining possession of rents
- Delivery of demand to tenants
- Delivery of demand to borrower

**An assignment of rents gives no interest in sales proceeds**



## Pre-Petition Agreements

Courts have held that pre-petition waivers of discharge are void as against public policy. *Hayhoe v. Cole (In re Cole)*, 226 B.R. 647 (B.A.P. 9th Cir. 1998).

But distinguish pre-petition waivers of discharge from waivers of the automatic stay. See, e.g., *In re Atrium High Point Ltd. Partnership*, 189 B.R. 599, 607 (Bankr. M.D.N.C. 1995); *In re Cheeks*, 167 B.R. 817, 818-19 (Bankr. D.S.C. 1994) (pre-petition agreements waiving the automatic stay “are distinguishable from an agreement which precluded the debtor from filing a bankruptcy petition in that the debtor has elected to forego only a single benefit of the Bankruptcy Code in exchange for the creditor’s forbearance”).



## Claims Under 11 U.S.C. § 1111(b)

When plan of reorganization is filed, an undersecured creditor must decide whether to elect plan treatment in accordance with 11 U.S.C. § 1111(b)

If an undersecured creditor elects treatment under § 1111(b), its allowed claim is a secured claim to the extent that the claim is allowed

Election must be made by the conclusion of the disclosure statement hearing

Claimant must consider many factors, including the nature of the collateral, the financial condition of the debtor, and the potential treatments proposed for both secured and undersecured creditors under the plan

2009 HOSPITALITY LAW CONFERENCE

# Legal Issues For Receiverships



**Morris A. Ellison**

**Buist, Moore, Smythe & McGee PA**

**5 Exchange Street**

**Charleston, South Carolina 29402**

E-mail: [mellison@buistmoore.com](mailto:mellison@buistmoore.com)



# Presenter



- **Morris A. Ellison - Principal with South Carolina Law Firm of Buist Moore Smythe McGee**
- **Fellow of the American College of Real Estate Lawyers**
- **Past Chair of the Hotel, Resorts and Tourism Committee of the American Bar Association**
- **Listed in Best Lawyers in America, Chamber's USA Leading Lawyers and Super Lawyers**





# Presenter



- **President & /CEO Trigild Inc.**
- **REO management, receivership, bankruptcy, workouts.**
- **Author of over 100 articles on hospitality, banking, receivership and related topics**
- **Hosts the annual Trigild Lenders Conference.**

# Options



## ❖ Bankruptcy

- Well developed body of law
- Involuntary Chapter 11 Petition
  - Potential Liability of petitioning creditors

## ❖ Receivership

- Less well established body of law
- Federal Court Receivers

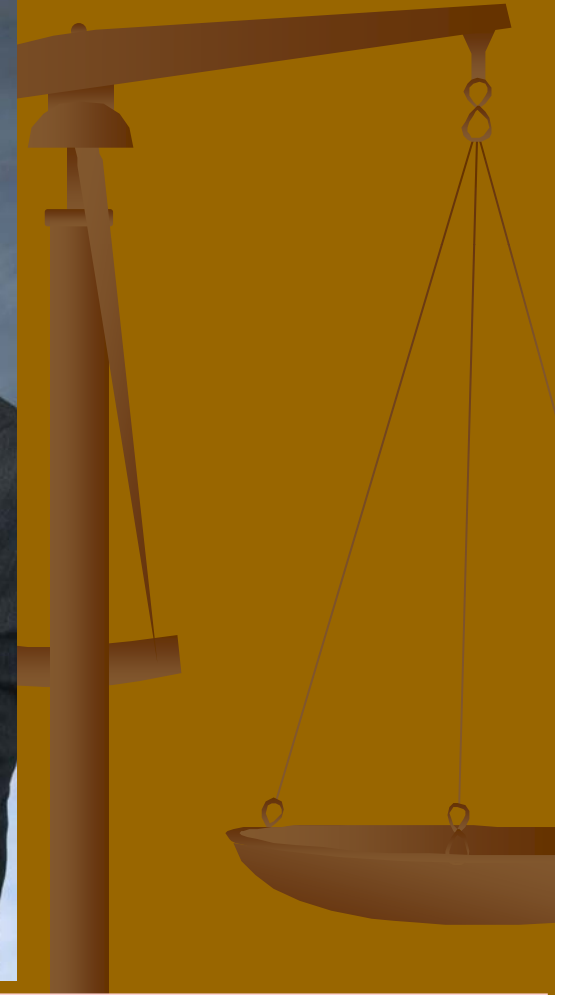
# Types of Receivers

- ❖ General or Liquidating Receiver
- ❖ Special or limited Receiver

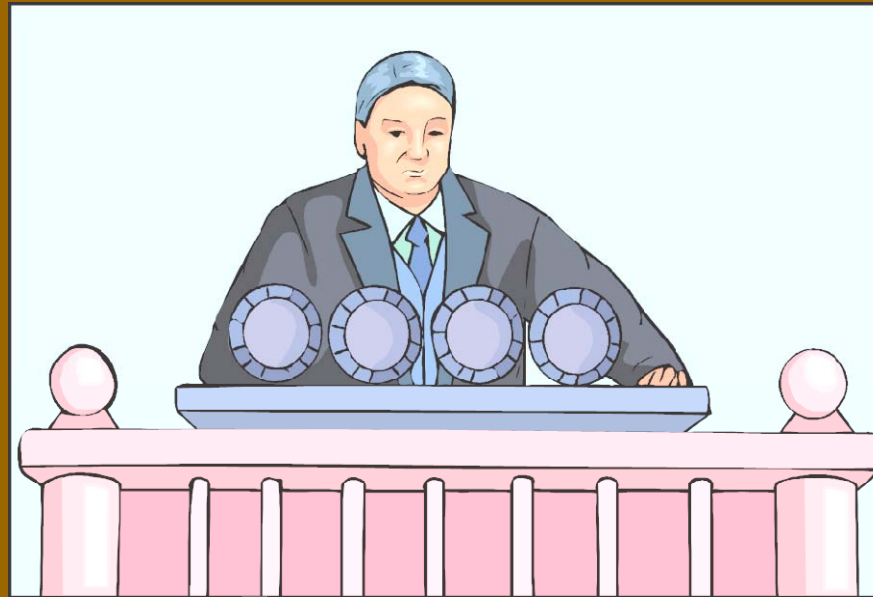


# Advantages of seeking a Receiver

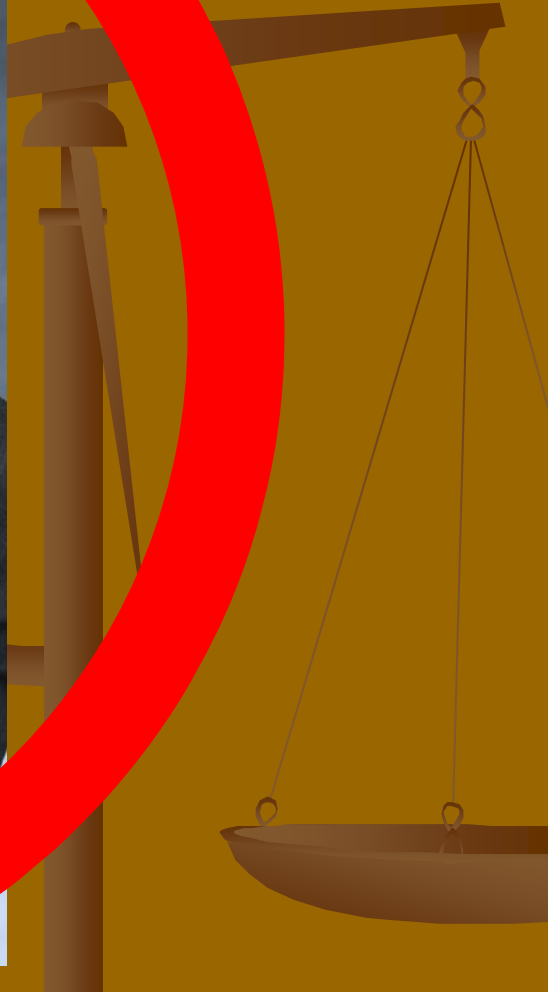
- ❖ Not a debtor in possession as is the case with most Chapter 11 debtors
  - Broad discretion of the plaintiff in proposing a receiver
  - Independent qualified receiver candidates
  - Expertise: Specialized knowledge of the business or assets
  - Experience



# Advantages of seeking a Receiver



- ❖ Court makes ultimate decision regarding the appointment of a receiver who serves as an officer of the Court



# Advantages of seeking a Receiver

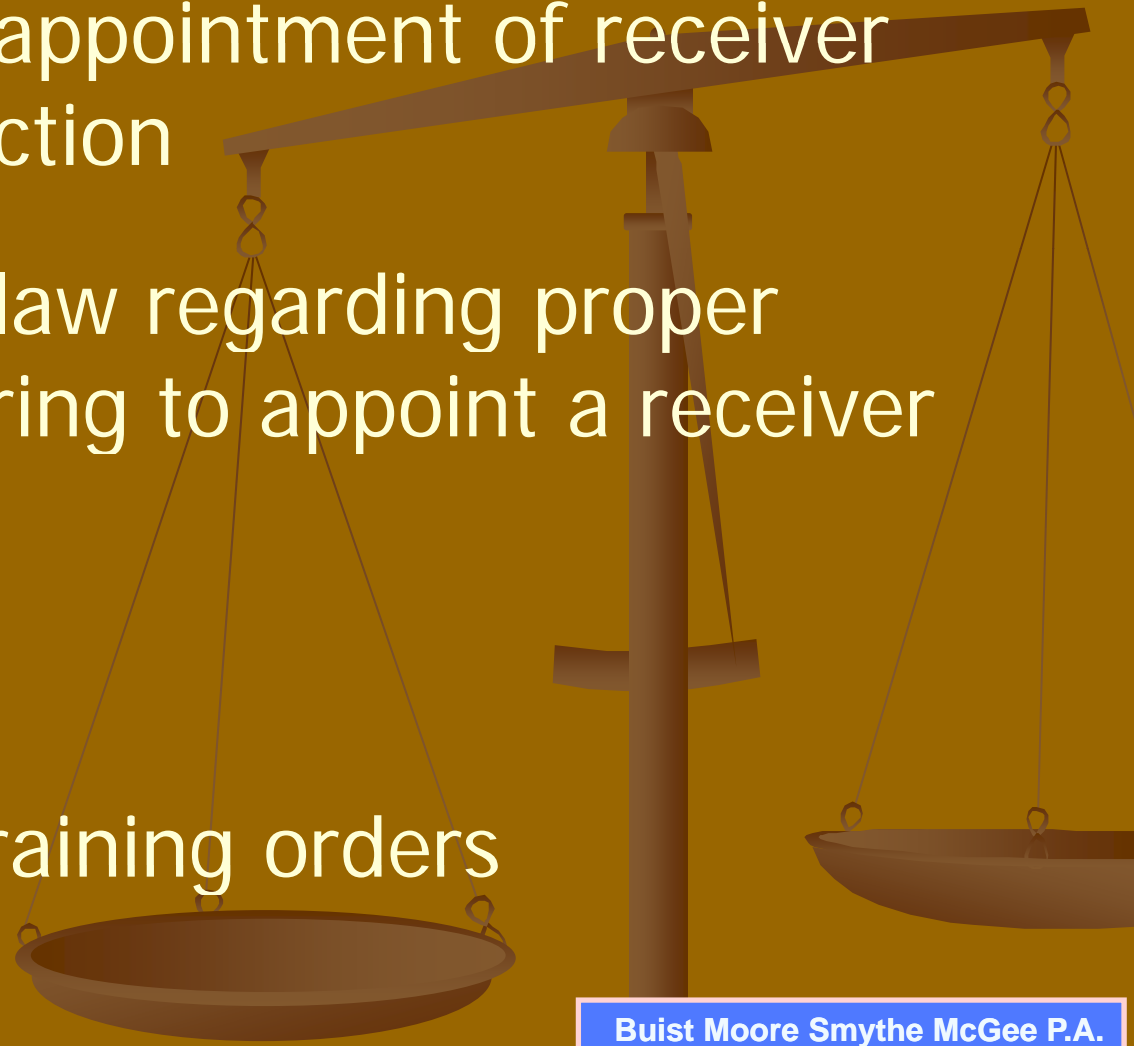
- ❖ Individual v. Corporate Appointment
- ❖ Receiver serves as officer of Court, not as a representative of the lender





# Notice of Hearing

- ❖ Time frame for appointment of receiver varies by jurisdiction
- ❖ Rules and case law regarding proper notice on a hearing to appoint a receiver often conflict
- ❖ Ex parte Orders
- ❖ Temporary restraining orders



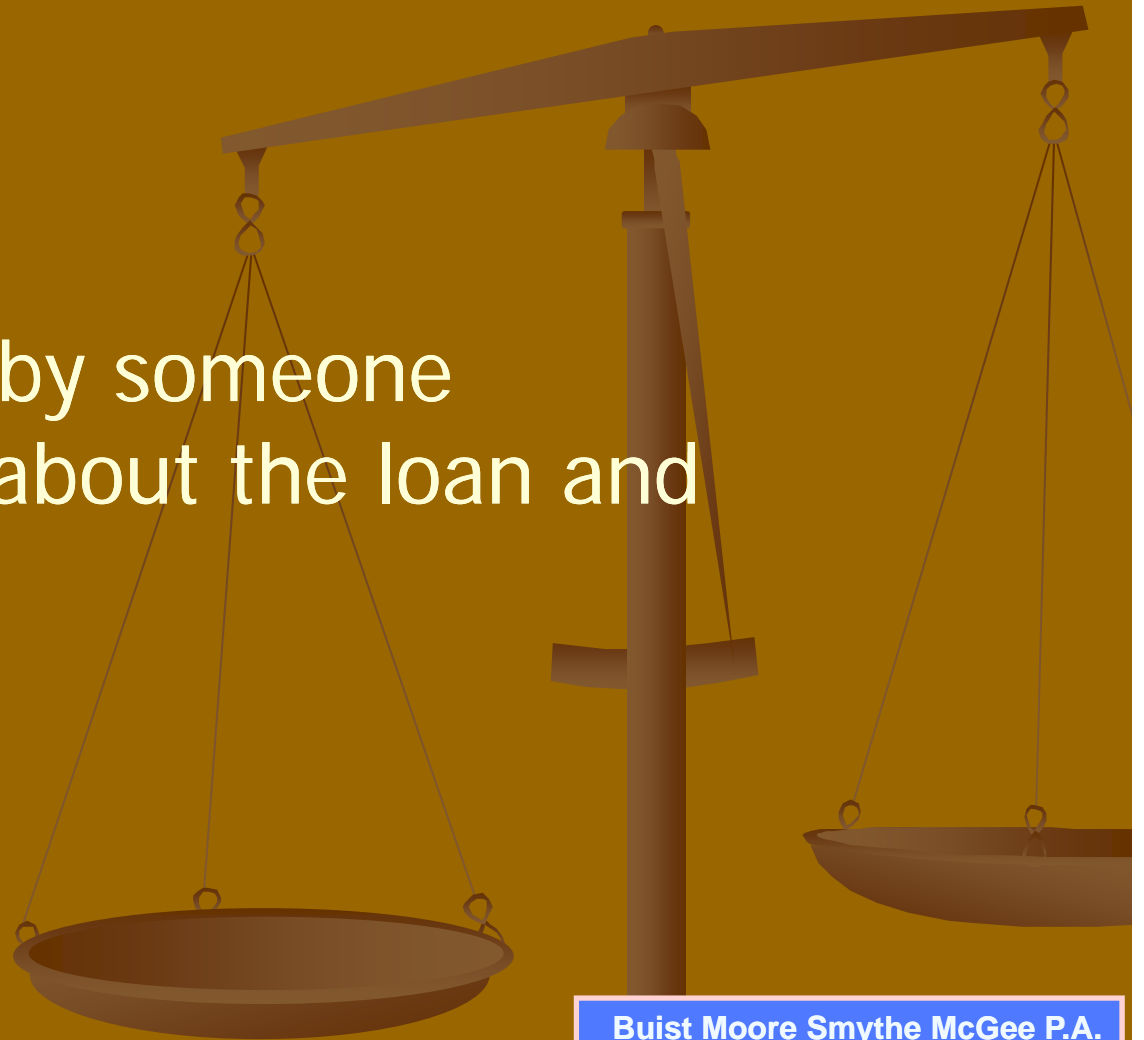
# Appealability of orders appointing a receiver

- ❖ Stays
- ❖ Bond requirements



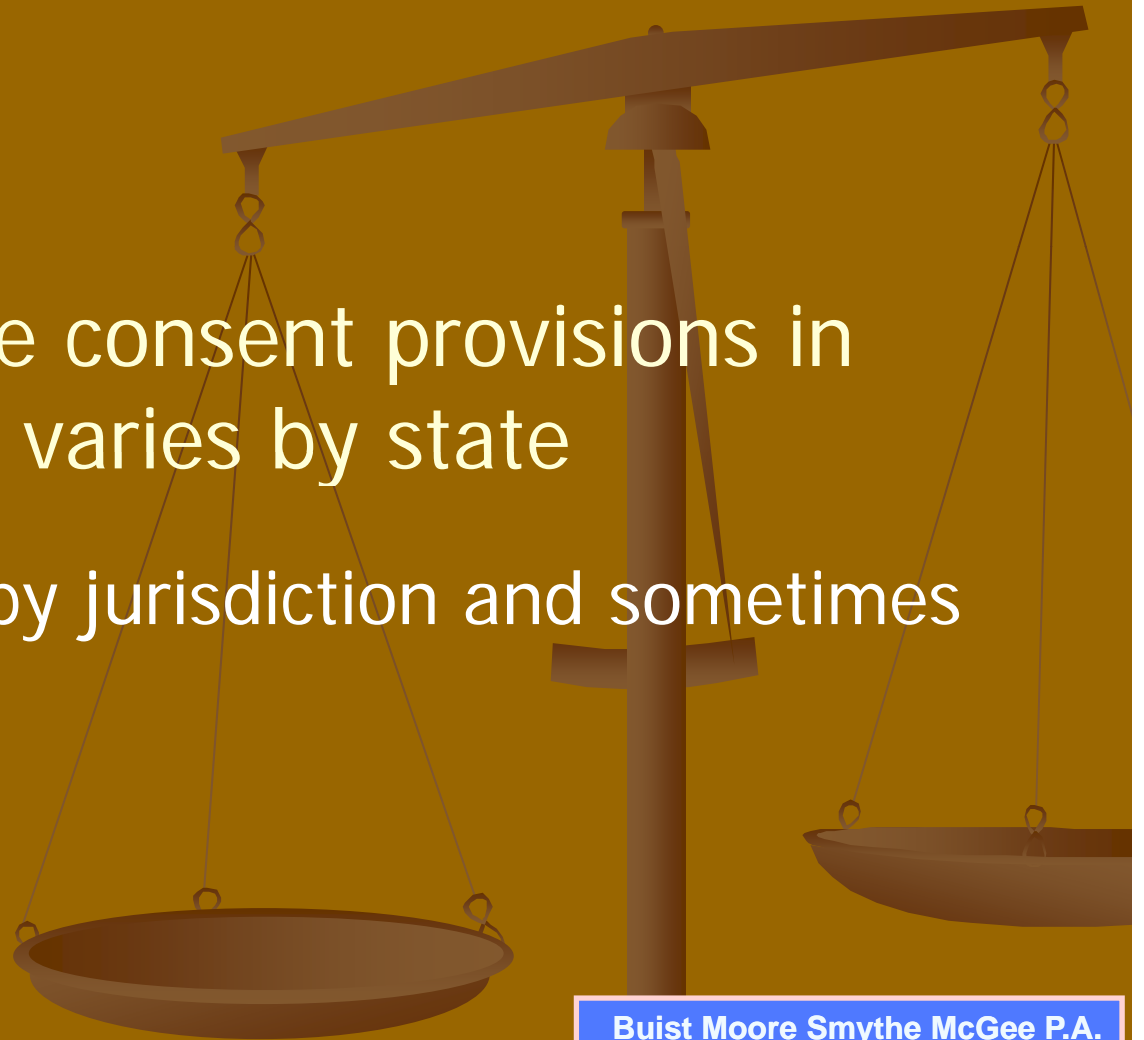
# Contents of Motion Seeking Appointment

- ❖ Affidavit
- ❖ Must be signed by someone knowledgeable about the loan and property



# Legal Standard Required to Obtain a Receiver

- ❖ Varies by State
- ❖ Ability to enforce consent provisions in loan documents varies by state
  - Practice varies by jurisdiction and sometimes by Judge



# Judicial discretion

- ❖ “Appointment of a receiver is a drastic remedy, to be exercised with great circumspection.”



# Legal standard

## ❖ State statutes

- Waste
- Material injury to debtor's property
- Fraud
- Mismanagement of assets



# Legal standard

- ❖ Moving party establishes an apparent right to the property which is the subject of the action;
- ❖ Subject property is in the possession of an adverse party; and
- ❖ Property or its rents and profits are in danger of being lost, materially injured or impaired.

# Purpose of Receivership



- ❖ “The purpose of a receivership is to preserve the status quo of the assets in dispute pending resolution of the litigation.”
- ❖ Borrowing
- ❖ Ability of Receiver in some jurisdictions to sell assets free and clear of liens, claims and encumbrances



# Composition of Receivership Estate


- ❖ Description of assets
- ❖ Lender's collateral package



# Order must specify the property being placed into receivership



- ❖ Income stream
  - Loan Documentation Issues
- ❖ Software and collateral issues
  - Proprietary software



**Powers of receiver  
generally governed  
by the provisions of  
the order**

# Borrowing

- ❖ Ability to borrow
  - Maintaining operations
  - Improving the property
  - Priority of borrowings
- ❖ Well-developed bankruptcy law



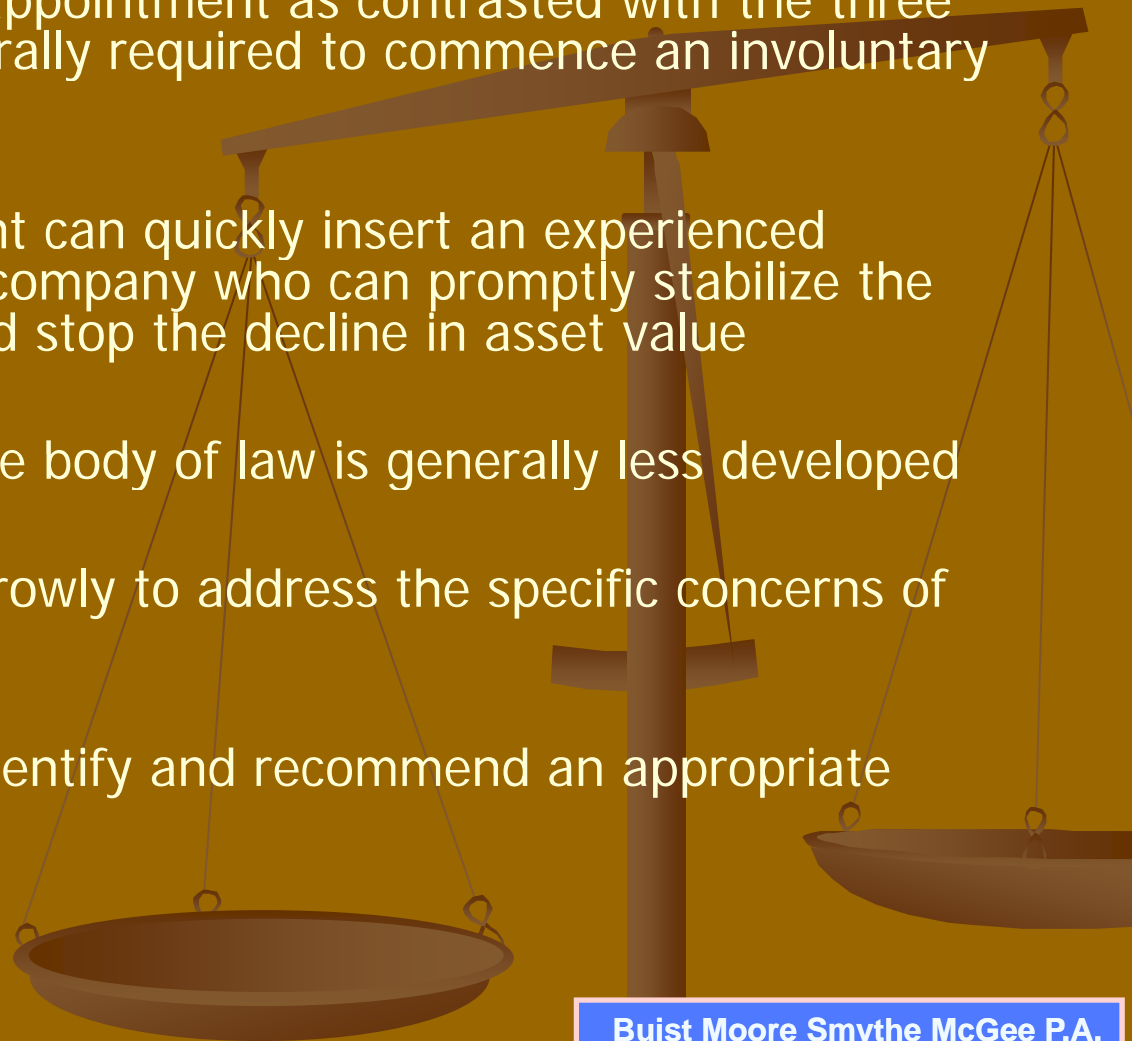
# Ability to Sell Property

- ❖ Law varies among jurisdictions
- ❖ UCC considerations



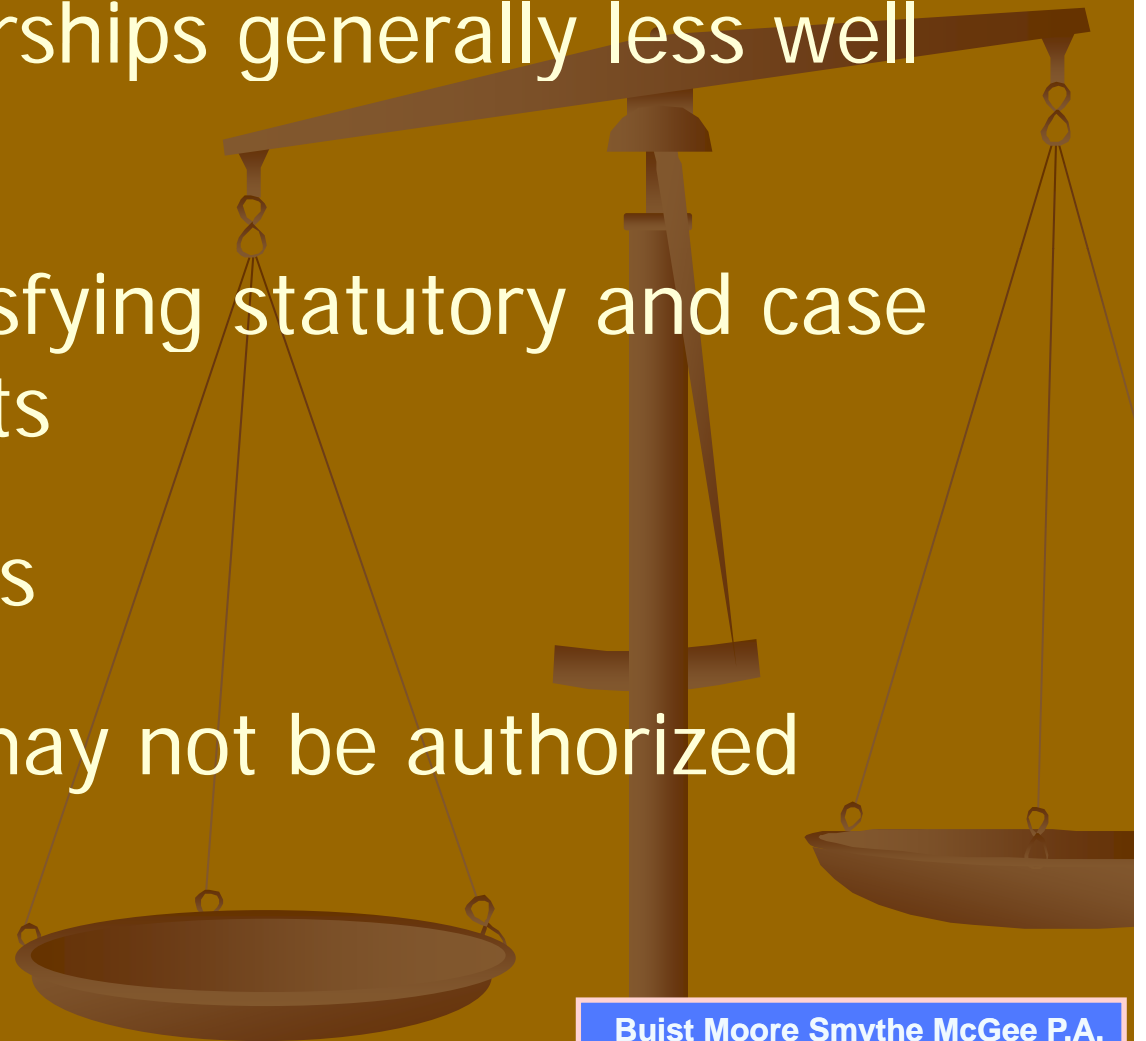
# Pros of Receivership

- ❖ Single creditor can seek appointment as contrasted with the three unsecured creditors generally required to commence an involuntary bankruptcy proceeding
- ❖ Party seeking appointment can quickly insert an experienced manager into a troubled company who can promptly stabilize the company, stem losses and stop the decline in asset value
- ❖ Greater flexibility since the body of law is generally less developed
- ❖ Relief can be tailored narrowly to address the specific concerns of the petitioning creditor
- ❖ Petitioning creditor can identify and recommend an appropriate candidate



# Cons of Receivership

- ❖ Law on Receiverships generally less well developed
- ❖ Difficulty in satisfying statutory and case law requirements
- ❖ Borrowing issues
- ❖ Sale of Assets may not be authorized



# Legal Issues For Receiverships



by

**Morris A. Ellison**

**Buist, Moore, Smythe & McGee PA**

**5 Exchange Street**

**Charleston, South Carolina 29402**

E-mail: [mellison@buistmoore.com](mailto:mellison@buistmoore.com)