

The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843 - 2011

PHILADELPHIA, WEDNESDAY, APRIL 6, 2011

VOL 243 • NO. 66 \$5.00 An **ALM** Publication

Receivership Versus Bankruptcy for a Single-Asset Real Estate Entity



Imagine your client, Condo Construction Inc. (Condo), is in the last stages of developing a 36-unit condominium project that it owns in Society Hill. Condo owns no other assets, and has no business other than the condominium project. The project is late and over budget, and the secured lender, BigBank, has not been paid on its mortgage and construction loan.

BigBank is threatening to foreclose and seek the appointment of a receiver in the Philadelphia Court of Common Pleas. No personal guarantees exist on the project. Jim Smith, Condo's president and project manager, has come to you convinced that Condo should file for bankruptcy to avoid the appointment of a receiver and maintain possession of the project. He also wants to understand how the appointment of a receiver would impact the project.

The goals of a receivership and of a Chapter 11 bankruptcy are the same: to preserve the value of the project for the benefit of all parties. In each proceeding, the secured lender can assert its right to protect its position, and the creditors have the right to the preservation of their claims. However, the methods of protection differ greatly between a receivership and a bankruptcy.

In Pennsylvania, receiverships are governed by Pennsylvania Rule of Civil Procedure 1533, which sets forth the rules for the appointment of receivers. Pursuant to Rule 1533, a temporary receiver may be appointed only if the plaintiff files a bond or other deposit with the prothonotary to protect against the improper appointment of a receiver. Once an appraisal is performed, the receiver reports the entity's assets, property and liabilities to the court, and makes recommendations for maximizing the value of the property. The plaintiff must have an interest in the property before a receiver can be appointed at its request.

Since a receivership is an equitable remedy, "a receiver will not be appointed unless it appears that the appointment is necessary to save the property from injury or threatened loss or dissipation ... [n]or will one be appointed where there is another safe, expedient, adequate and less drastic remedy at law." (See the Pennsylvania Supreme Court's 1977 opinion in *Northampton National Bank of Easton v. Pisciano* , quoting *Credit Alliance Corp. v. Philadelphia Minit-Man Car Wash Corp.* , a 1973 case.)

As the secured lender, BigBank clearly has a property interest in the project, and could argue that only the appointment of a receiver would save the project from disaster.

A voluntary petition in bankruptcy is filed pursuant to Title 11, Chapter 11 of the U.S. Code. To file, a corporate entity must have a resolution from its board authorizing the filing. The entity then files its petition, and subsequently files and verifies its schedules and statement of financial affairs. These disclosures mirror the information that a receiver gives to the court of common pleas, but the information is accessible to the public early in the case and is disclosed voluntarily by the debtor-in-possession.

Condo's Smith must hear the unpleasant news first: No matter what information he may believe is private regarding the finances of Condo, it will ultimately be disclosed to a court, whether in the receiver's report or in the statements and schedules in a bankruptcy setting. Condo's desire to maintain control of the project is the most important consideration in determining whether a bankruptcy or a receivership will be better for it. In a state court receivership, Condo will lose control over the project. The receiver assumes all decision-making roles and may have different ideas regarding the completion of the project and marketing efforts.

In a bankruptcy, Condo will control the project from the start as a debtor-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code. However, BigBank doubtlessly will file a motion for relief from stay pursuant to Section 362(d) of the Bankruptcy Code as soon as practicable. Since BigBank has already threatened receivership, it is likely that it could be ready to file the motion within days of the petition date. Permanent control of the project is still up in the air, and if Condo files a bankruptcy, BigBank will not go away.

So, what is more valuable to Condo: ongoing control of this project, or resolution of the dispute in contemplation of a larger scheme? Resolution of the dispute might be preferable if Condo or any related entity or group has ongoing or anticipated projects where BigBank is the secured lender. It may be worthwhile to Condo to cede control of this project to BigBank if it will benefit Condo on other projects into the future and maintain important business relationships.

Condo's relationship with its creditors is another element in determining whether a bankruptcy or receivership will be more advantageous. A receivership could benefit Condo by shifting the creditors' focus to the receiver. This may help to calm creditors' fears if they doubt the project's completion, and they will be reassured if they believe there to be self-dealing on the part of ownership.

In a bankruptcy, Condo will be able to take advantage of the automatic stay provided by Section 362 of the Bankruptcy Code by staving off any existing litigation and placing all creditors of the same type in the same class. If there are any current lawsuits pending against Condo, they will be stayed as of the date Condo files its petition. Creditors with unsecured claims at the petition date will have their claims reduced significantly, which could constitute a great cost savings to Condo. Condo could reject contracts that are disadvantageous or unnecessary without fearing litigation outside the Bankruptcy Court, and can continue doing business by assuring creditors that post-petition obligations are administrative claims against Condo's estate, which will receive priority over pre-petition claims.

In advising Condo, the creditors' stance is an essential piece of information. Have they expressed concerns that there is fraud or self-dealing in the project? Will they continue to work with Condo through a bankruptcy? What is the total amount due now to unsecured creditors? Are there any relationships with noteholders, bondholders, or ongoing contracting parties that are necessary for the project that must be assumed, whether in the normal course or in the capacity of a critical vendor?

Another essential consideration is the relative cost of a receivership and a bankruptcy. The costs of a receivership are likely to be much lower than the costs of a bankruptcy. In a receivership, Condo may retain counsel but there is a lower likelihood of litigation because the costs of litigating with BigBank will be minimal. Any costs involved in litigating with creditors would be incurred whether in a bankruptcy or a receivership.

In contrast, bankruptcy can be an extremely expensive proposition. Condo must pay its own counsel's fees and costs, as well as the fees and costs of counsel for any official committee of unsecured creditors that may be appointed, and possibly (pursuant to loan documents with BigBank) counsel fees and costs for BigBank's counsel in litigating the case. Condo must seek leave of the Bankruptcy Court to employ its counsel and professionals, pay them, pay pre-petition arrearages that would otherwise be unsecured, assume or reject contracts with suppliers and subcontractors, and perform other tasks necessary to maintain the project. Drafting and

litigating can eat up fees for a cash-strapped debtor, and there is the inherent uncertainty of filing any motion before any court. Finally, since Condo is a single-asset real estate entity as defined in Section 101(51B) of the Bankruptcy Code, it has only 90 days of exclusivity to file a plan and disclosure statement pursuant to Section 362(g) of the Bankruptcy Code. This forces Condo to quickly determine its best course of action and incur the costs of preparing and filing a plan.

An understanding of Condo's liquidity is therefore essential to this analysis. Does Condo have the capacity to pay debtor's counsel, counsel for the committee, and vendors going forward? If Condo has insufficient cash flow, then perhaps the appointment of a receiver will benefit Condo in the long run by minimizing debts that would, in a bankruptcy context, have priority over other claims, and placing the burdens of managing payments to continue the project on the receiver.

In advising Condo of its next steps, a bankruptcy may seem like a natural solution to BigBank's threats. However, before preparing a petition, a full analysis of the overall picture is necessary. The client must examine the overall goals of Condo both in terms of this project and other projects. It must analyze its relationships with creditors, understand the extent of Condo's liquidity, and determine whether control of the project is essential to its overall success. •

Nella M. Bloom is an associate with *Cohen Seglias Pallas Greenhall & Furman*. She focuses her practice on bankruptcy, commercial, real estate, administrative, and disadvantaged business entity certification matters. Bloom is admitted to practice in Pennsylvania, New Jersey and Delaware. She can be reached at nbloom@cohenseglia.com or 215-564-1700.