

The Ninth Circuit Rejects "Whole Enterprise" Exception to Secured Lenders' Rights in Single Asset Real Estate Bankruptcy Cases

In what appears to be a case of first impression, the United States Court of Appeals for the Ninth Circuit rejected the notion that a single asset real estate debtor that is part of a larger real estate enterprise can avoid the special protections for secured creditors under the Bankruptcy Code. The decision is an important victory for creditors holding claims secured by real property of single asset debtors.

In the case, *In re Meruelo Maddox Properties, Inc.*¹, the debtor, Meruelo Maddox Properties-760 S. Hill Street LLC ("MMP Hill") was one of more than 50 subsidiaries of Meruelo Maddox Properties, Inc. ("MMPI") that filed voluntary petitions for bankruptcy in March 2009. The Court described MMPI's business enterprise as follows:

MMPI owns and develops real property in the Los Angeles area through a network of subsidiaries. MMPI has a centralized management team that operates MMPI and its subsidiaries, including MMP Hill. The business is operated on a consolidated basis: revenues from operation of MMPI's subsidiaries' properties each day are swept into a single general operating account that is used to pay expenses for MMPI and its subsidiaries. MMPI and its subsidiaries file consolidated financial reports with the SEC and consolidated tax returns with the IRS.

Early in the bankruptcy case, MMPI filed a motion seeking a determination that the single asset real estate provisions of the Bankruptcy Code, which provide special protections to secured creditors, did not apply to it or its subsidiaries. Bank of America, which held a

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¹ Case No. 10-56128 (9th Cir. January 27, 2012).

secured claim against MMP Hill, cross-moved for a determination that the single asset real estate provisions did apply.

Single Asset Real Estate Provisions of the Bankruptcy Code

The single asset real estate provisions of the Bankruptcy Code are intended to streamline cases in which (a) the debtor's only asset is a single property, (b) substantially all the debtor's gross income is generated by the property and (c) no substantial business is conducted by the debtor other than operating the property and activities incidental thereto.² In such cases, a creditor whose claim is secured by the property is entitled to relief from the automatic stay in order to exercise default remedies against the debtor and the property unless, by the later of 90 days after the bankruptcy filing or 30 days after a determination that the single asset real estate provisions apply, the debtor either (a) files a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time or (b) begins making monthly interest payments to the creditor at the non-default rate.

Court Rulings

The bankruptcy court held that although MMP Hill "appears to have the characteristics" of a single asset real estate debtor, the single asset real estate provisions of the Bankruptcy Code did not apply "because of the consolidated, interrelated nature of the business operations of MMPI and its subsidiaries" and because MMP Hill is "part of a whole business enterprise to which it would not be appropriate to apply the [single asset real estate] provisions." On appeal by Bank of America, the district court reversed, holding that there is no "whole enterprise" exception to the Bankruptcy Code's single asset real estate provisions. On further appeal by MMPI, the Ninth Circuit affirmed the district court's decision.

The decision is an important victory for lenders and other creditors holding claims secured by real property of single asset debtors. Many real estate businesses are organized and managed similar to MMPI and its subsidiaries operating as an integrated business with centralized cash management, centralized operational management and consolidated financial and tax reporting. Nevertheless, lenders to subsidiaries assess risk and price loans in reliance that the single asset real estate provisions of the Bankruptcy Code will apply in the event their borrower becomes a debtor in a bankruptcy case. If courts were to recognize a "whole enterprise" exception to the single asset real estate provisions, secured lenders would not have the benefit of mandatory relief from the automatic stay if the debtor does not promptly propose a viable plan or pay monthly interest. Instead, lenders could be stuck in a protracted bankruptcy case in which their loans are modified over their objection in a "cram-down" restructuring.³

It will be interesting to see if real estate debtors outside the Ninth Circuit raise the "whole enterprise" exception and whether courts will recognize or reject it.

² The single asset real estate provisions do not apply if the property is residential real estate with fewer than four residential units or if the debtor is a family farmer.

³ Significantly, both the district court and the circuit court noted that the single asset real estate provisions might not be applicable in a case where the various debtors' bankruptcy cases are substantively consolidated such that the separate assets and liabilities of each of the debtors are combined into a single pool and treated as though they belong to a single entity. In the case at issue, MMPI and its subsidiary debtor companies were not substantively consolidated.

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