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DISTRESSED COMMERCIAL REAL ESTATE

ABA Business Law Section
2024 Spring meeting
April 5, 2024

DISTRESSED COMMERCIAL REAL ESTATE

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What We Are Going To Cover?

- Receiverships
 - General
 - California
 - Cannabis
 - UCRERA
 - Termination of Receiverships
- Bad Boy Guarantees
- Bankruptcy
 - Types
 - Automatic Stay
 - Commercial Leases
 - Sales
- Workouts
- Foreclosures on Real Property

RECEIVERSHIPS

- GENERAL

- Receiverships can be filed either in State court under State law or in Federal Court under Federal Law.
 - Useful in situations where there are only a few, or only one, secured creditors.
 - Frequently arise when the Debtor has multiple commercial real estate properties
 - requires a professional property manager Assets can then be sold off .
 - possible for creditor to get a receivership in place as a type of injunctive relief.
 - propose and hire professionals who are known in the community and/or to the judge.
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CALIFORNIA RECEIVERSHIPS

- California Receivership law:
 - Code of Civil Procedure §§ 564, 566; Cal. Rules of Ct. 3.1179(a).
 - CCP § 564 confers the superior court with jurisdiction to appoint a receiver. However, the court doesn't have jurisdiction over property.
 - Receiver is a court-appointed neutral, disinterested agent appointed to take over control and management of property.
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 - Receiver acts for the benefit of all.
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 - Holds assets specifically for the court.
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CANNABIS COMPANIES

Receiverships v. Bankruptcy Cases

- A receivership under state law may be the only remedy for insolvent cannabis companies, as cannabis remains a Schedule I controlled substance under the Controlled Substance Act (CSA).

UNIFORM COMMERCIAL REAL ESTATE RECEIVERSHIP ACT (UCRERA)

- Receiver does not take title but holds as custodian.
 - Receiver is lien creditor under UCC Section 9-301.
 - Sales are free and clear of liens with court order.
 - Reversal or modification on appeal does not affect validity of sale.
 - Automatic stay applies to all persons.
 - Can reject executory contract .
 - Rejection damages attainable.
 - Ipso facto clause not enforceable.
 - Cannot reject unexpired lease if owner is the landlord.
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TERMINATION OF RECEIVERSHIPS

- New 9th Circuit case, agreeing with 1st Circuit .
 - *WB MusicCorp. v. Royce Int'l Broadcasting*, No. 21-55264 (9th Cir. Aug. 31, 2022).
 - 9th Circuit court affirmed district court denying dismissal of receivership after sale of three radio stations and satisfaction of judgment.
 - Held district court had broad discretion to prolong receivership to accomplish certain things, such as, protecting creditors, professionals, filing reports, etc.
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BAD BOY GUARANTIES

a/k/a Non-Recourse Carve-Out Guaranties

- At this point, they have become standard on many commercial real estate loans—if the terms of the carve-out are violated, the loan automatically becomes full- or partial-recourse against the Guarantor.
 - “Bad Boy Acts,” or “Prohibited Acts” may include the following:
 - Misapplication of funds;
 - Unauthorized movement or disposal of any collateral;
 - Failure to timely pay taxes, assessments or other charges;
 - Failure to maintain appropriate insurance;
 - The filing of any mechanic’s liens, materialmen’s liens or other like liens;
 - Intentional damage, intentional destruction or permitting waste;
 - Borrower contests, delays or otherwise hinders any action taken by Lender;
 - Appointment of a receiver.
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BAD BOY GUARANTIES

a/k/a Non-Recourse Carve-Out Guaranties

- Examples of non-recourse carve-outs that often swallow the rule:
 - Any material negligent or willful misrepresentation made by Borrower;
 - The falsity of any warranty or representation;
 - Additional consensual liens on the collateral;
 - Any failure to maintain, repair or restore the collateral;
 - Any default under the Loan Documents.

BANKRUPTCY

- Important BK concepts for lenders to understand
- Property of the estate – 11 U.S.C. §541
- Automatic stay – 11 U.S.C. §362(a)
 - Relief from stay – 11 U.S.C. §362(d).
 - Termination.
 - Annulment.
 - Modification.
 - Conditioning.

BANKRUPTCY

- Grounds for relief from stay
 - no equity in the real property.
 - “cause,” including lack of “adequate protection.”
 - “single asset real estate cases”
 - i. debtor has failed to, (1) file a plan of, or (2) start paying monthly interest payments.

- Is there even a stay in successive filings? 11 U.S.C. §362(c)
 - 11 U.S.C. §362(c)(3)(C)(i), the second case is presumptively filed “not in good faith” as to all creditors.
 - 11 U.S.C. §362(c)(3)(C)(ii), the second case is presumptively filed “not in good faith” as to a specific creditor.
 - 11 U.S.C. §362(c)(4)(A)(i), if an individual debtor files a third bankruptcy case and the first and second cases were pending within same year.
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COMMERCIAL LEASES

- 11 U.S.C. §365(b) - Assumption / Assumption & Assignment / Rejection
- Debtor bears the burden of proof.
- 11 U.S.C. §365(b)(1)(A) – “prompt” cure?
- 11 U.S.C. §365(b)(1)(B) – compensate, or provide “adequate assurance” of ability to promptly compensate.
- 11 U.S.C. § 365(b)(1)(C) – “adequate assurance” of future .
- See also additional shopping center standards under 11 U.S.C. §365(b)(3)(A)-(D).
- Effect of rejection of commercial lease.
- Does rejection of a commercial lease terminate a sublease
- Can a debtor-landlord sell free and clear of a tenant’s lease under section 363(f) of the Code?

SECTION 363 SALES

- 11 U.S.C. §363(b) permits sales of property free and clear of liens or interests (see §363(f) discussed below).
 - attractive to a potential purchaser.
 - accompanied by Order.
 - Requirements for sales free and clear of liens—
 - applicable non-bankruptcy law permits sale of such property free and clear;
 - such entity consents;
 - such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
 - such interest is in bona fide dispute; or
 - such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.
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- Pursuant to 11 U.S.C. § 363(m), a sale to a good-faith purchaser of estate property cannot be set aside on appeal, unless the sale order is stayed upon appeal. But see *MOAC Mall Holdings LLC v. Transform Holdco LLC*, 598 U.S. 288, 143 S.Ct. 927, 215 L.Ed.2d 262 (Apr. 19, 2023) (resolving a Circuit split, the U.S. Supreme Court unanimously held that section 363(m) is not jurisdictional).
 - *Moac Mall Holdings* raises the question of what effectual relief might a court fashion on appeal of an unstayed order authorizing sale of estate assets to a good-faith purchaser, without affecting the validity of the sale?
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WORKOUTS

Workouts & Non-Foreclosure Remedies

- Negotiated resolution to avoid BK and/or foreclosure
 - Forbearance Agreements.
 - Loan restructuring
 - Utilize pre-negotiation agreements.
 - Note sales.
 - Imposition of default interest.
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Strategies for negotiating and documenting workouts or restructuring agreements

- Recitals should include the principal and interest due.
 - Always specify the existing defaults and reserve rights.
 - Include express reaffirmations.
 - Obtain releases from borrower for all claims against the bank.
 - Include all accommodation parties' consent.
 - include express termination events and outside termination date.
 - Make bankruptcy filing an automatic event of default.
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FORECLOSURES ON REAL PROPERTY

- Real Property Lien Types
 - Judicial v. Power of Sale
 - Foreclosures
 - Foreclosure of Real Property Lien
 - Deeds in Lieu
 - Foreclosure v. Deed in Lieu
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- Potential Title Issues
 - Additional Title Issues
 - Priority Rules
 - Redemption Rights
 - Fixtures
 - Equitable Subrogation
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Foreclosures on Real Property (California Authorities).

- Beware of California's one-action (or single action) rule, see § 726(a); see also *Sec. Pac. Nat'l Bank v. Wozab*, 51 Cal.3d 991 (1990)
- As the second element of the one-action rule, the lender must exhaust its security before suing the borrower directly on the debt. CCP § 726.
- A *creditor's* ability to pursue a deficiency on the debt is limited by California's anti-deficiency laws under CCP §§ 580b and 580d.
 - California anti-deficiency laws do not apply to guaranties of loans secured by real property, see CCP §§ 580a to 580e and 726

QUESTIONS?
