



AMERICAN
BANKRUPTCY
INSTITUTE

Southwest Bankruptcy Conference

Distressed Commercial Real Estate and UCRERA

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DISTRESSED COMMERCIAL REAL ESTATE

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1

WORKOUTS Business Problems and Plan

- Identify the cause or problem to be solved from a business perspective
- Is the problem operational
- Is there sufficient cash—what is source of new funding
- Is this the right management team
- Does the project need to be sold
- Does it need to be refinanced or need new equity
- Is it time to close the facility or rezone or entitle the project or change its purpose
- Can a negotiated resolution of loan be obtained—
 - new collateral or guarantor,
 - change terms such as interest rate,
 - extend maturity or reduce monthly payment
 - can lender fund new TIs or advance taxes or advance certain operating expenses until a sale is obtained

2

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

3

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

4

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
- Potential Title Issues
- Additional Title Issues
- Priority Rules
- Redemption Rights
- Fixtures
- Equitable Subrogation

5

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
 - 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
 - Assets can then be sold off

6

UNIFORM COMMERCIAL REAL ESTATE RECEIVERSHIP ACT (UCRERA)

- Adopted in less than 15 states
- 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

7

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.

8

BANKRUPTCY

- Property of the estate – Section 541
- Automatic stay – Section 362(a)
 - Relief from stay – Section 362(d).
 - Termination
 - Annulment.
 - Modification
 - Conditioning
- Grounds for relief from stay
 - no equity in the real property
 - “cause,” including lack of “adequate protection”
 - “single asset real estate cases” debtor has failed to, (1) file a plan of, or (2) start paying monthly interest payments

9

- Is there a stay in successive filings? Section 362(c)
 - Section 362(c)(3)(C)(i), the second case is presumptively filed “not in good faith” as to all creditors
 - Section 362(c)(3)(C)(ii), the second case is presumptively filed “not in good faith” as to a specific creditor
 - Section 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

10

- Commercial Leases:
 - Assumption / Assumption & Assignment / Rejection – Section 365
 - Debtor bears the burden of proof
 - Section 365(b)(1)(A) – “prompt” cure?
 - Section 365(b)(1)(B) – compensate, or provide “adequate assurance” of ability to promptly compensate
 - Section 365(b)(1)(C) – “adequate assurance” of future performance
 - See also additional shopping center standards under Section 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?

11

- Section 363 Sales -
 - Section 363(b) permits sales of property free and clear of liens or interests (see Section 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
 - such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest

12

- Pursuant to Section 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?

13

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

14

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

15



Faculty

Theodore A. Cohen is a partner in the Finance and Bankruptcy Practice Group of Sheppard Mullin in the firm's Los Angeles office. He specializes in creditors' rights and focuses on lender, special servicer, indenture trustee and lessor representation in bankruptcies, loan and lease workouts, defaulted bond financings and secured transactions. He also represents distressed asset and stock buyers, sellers and assignees in bankruptcy § 363 sales, UCC foreclosure sales, real estate foreclosure sales, receiverships and assignments for the benefit of creditors. Mr. Cohen's experience includes workouts, CMBS loan enforcement, asset sales, stock sales, loan sales, cash-collateral issues, debtor-in-possession financing, relief-from-stay proceedings, plans of reorganization, preference and fraudulent transfer litigation, pre-bankruptcy counseling for debtors and creditors, reorganization issues, trust indenture enforcement, lease and contract assumption issues, and prejudgment remedies in state court, including writs of attachment, writs of possession, injunctions and receivers. He received his B.A. in 1987 from the University of California, Los Angeles and his J.D. from the University of California, Davis School of Law in 1990, where he served as executive editor of its law review.

Bradley D. Pack is a shareholder with Engelman Berger, PC in Phoenix, where he represents both creditors and debtors in different bankruptcy proceedings, negotiates and drafts complex loan and forbearance agreements, and practices in commercial litigation and civil appeals. Previously, he clerked for Hon. Susan Ehrlich at the Court of Appeals Division One. Mr. Pack currently serves on the board of the Arizona Bar Foundation. He previously served as a board member of the Anti-Defamation League Arizona Region and as the chair of its Government Relations, Advocacy, and Community Engagement committee. Mr. Pack is a Coordinating Editor for the *ABI Journal's* Benchnotes column, and he co-chairs the ABA's Business Bankruptcy Committee's Individual Chapter 11, Subchapter V, and Small Business subcommittee. He is an Arizona State Bar certified bankruptcy specialist. As an undergraduate, he worked on international child labor issues while interning for the AFL-CIO American Center for International Labor Solidarity. Prior to joining the firm, Mr. Pack clerked for Hon. Susan A. Ehrlich of the Arizona Court of Appeals. Mr. Pack has been recognized in *The Best Lawyers in America* in the fields of Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law since 2020, Appellate Practice since 2021 and Commercial Litigation since 2021. He also has been selected to *Southwest Super Lawyers* "Rising Stars" for Bankruptcy, Appellate and General Litigation since 2012, he is certified as a Bankruptcy Specialist by the State Bar of Arizona Board of Legal Specialization, and he was designated Volunteer Lawyer of the Month for representing the victims of a mortgage fraud scheme. Mr. Pack received his B.A. in labor studies and industrial relations from Pennsylvania State University and his J.D. *summa cum laude* from the University of Arizona James E. Rogers College of Law in 2005, where he was on the national moot court competition team and served as research editor for the *Arizona Law Review*.

Cathy L. Reece is a director at Fennemore Craig, P.C. in Phoenix and chairs its Financial Restructuring, Bankruptcy and Creditors' Rights Practice Group. She has experience in every aspect of complex corporate workouts and bankruptcies, and works with clients structuring complex transactions and purchasing distressed debt or assets. Ms. Reece has represented lenders in several commercial real estate receiverships, including receiverships involving an operating copper mine and three high-rise commercial office buildings, and she has represented committees and liquidating trusts in the liqui-

dation of assets and distributions to creditors involving allegations of Ponzi schemes and securities fraud. Some of her cases include representing the investors' committee in the bankruptcy of hard money real estate lender Mortgages Ltd., the joint creditors' committee in the Baptist Foundation of Arizona bankruptcies, the secured lender in a publicly traded bankruptcy case involving time shares and resort properties, the municipality that owned the arena where the NHL team played in the Arizona Coyotes hockey bankruptcy cases, a major petroleum-producer and former owner of the El Paso Refinery in litigation over complex environmental claims and restrictive covenants, the debtor-in-possession lender and purchaser of gold mines in cross-border chapter 15 proceedings, and a chapter 11 trustee in several cases involving the sales and operations of health care facilities. Ms. Reece is the president-elect of and serves on the Board of Regents for the American College of Commercial Finance Lawyers. She also is the chair of the American Bar Association Business Law Section's Subcommittee on Loan Workouts. Ms. Reece received her Bachelor's degree in music with high distinction from the University of Arizona and her J.D. from Arizona State University Sandra Day O'Connor College of Law, where she served as managing editor of the *Arizona State University Law Journal*. Following law school, she clerked for Hon. Sandra Day O'Connor at the Arizona Court of Appeals.

Zachary H. Smith is a partner and co-head of Moore & Van Allen PLLC's Bankruptcy & Restructuring practice, based in Charlotte, N.C. He has more than 20 years of experience in complex restructurings, representing a broad spectrum of stakeholders in special situations and bankruptcy proceedings. Mr. Smith's practice covers transactional and litigation matters, including the representation of private-equity sponsors, portfolio companies, independent directors and special committees in distressed M&A transactions; purchasers of distressed businesses and their assets; corporate debtors in all aspects of complex chapter 11 proceedings, including chapter 11 litigation; court-appointed receivers; financial institutions, special situation funds, and direct lenders in the restructuring and exit of troubled credits; stakeholders in cross-border insolvency situations; and special situations involving Puerto Rico. He has been recognized by *Chambers USA*, *The Best Lawyers in America*, *Law360* and *Turnarounds & Workouts*, and in 2017 he was named to ABI's inaugural class of "40 Under 40." He also is an adjunct professor at Duke University Law School, where he teaches courses in corporate restructuring, chapter 11, distress investing and structuring of financial transactions. Mr. Smith is a graduate of the Juilliard School and has given solo piano performances at Carnegie Hall and Lincoln Center. Mr. Smith received his A.B. *cum laude* from Harvard University and his J.D. *cum laude* from Boston University School of Law.