

# **BANKRUPTCY TALES – Ninth Circuit Rejects (Part 1 of 2)**

by Joel R. Glucksman on February 10, 2012

## **NINTH CIRCUIT REJECTS “WHOLE BUSINESS ENTERPRISE” EXCEPTION to Single Outfit Real Estate Case Designation**

### **Part 1 – Single Asset Real Estate Cases**

A late January ruling by the Ninth Circuit Court of Appeals has gladdened real estate lenders and struck terror into the hearts of developers. Essentially, the court prevented a major real estate developer from using the “whole business enterprise” designation in order to avoid the requirements of the Bankruptcy Code’s “single asset real estate” designation.

To understand the significance of this decision, today’s posting will take a quick trip through the pushing and shoving that has occurred in bankruptcy between developers and lenders. My next posting will then address the recent Ninth Circuit ruling.

To begin with, one must first understand that bankruptcy has long presented an enormous headache to real estate lenders. In making real estate loans, they generally go to the enormous trouble of protecting their loan positions by taking back mortgages, rent assignments, and other security interests which are designed to protect their position as strongly as possible. [We’ll pass on the chance to make a snarky comment about the recent mortgage bubble.]

Then, having gone to all of this trouble, their borrowers file bankruptcy on them and make the lender’s lives difficult by hiding behind the Bankruptcy Code’s protective injunction, known as the “automatic stay.” The “stay” essentially prevents creditors, during the pendency of the bankruptcy, from chasing the debtor and liquidating their collateral. They have to stand by, twiddling their metaphoric thumbs, while the debtor gets to enjoy the fun of bankruptcy.

In an attempt to remedy what the lenders considered this horrible social wrong, Congress in 1994 added a provision to the Bankruptcy Code which provides “special” [that is to say harsher] treatment for “single asset real estate” debtors. The provisions are contained in §§101(51B) and 362(b)(3) of the Bankruptcy Code.

The Code first defines “single asset real estate” to be real property, constituting a single project, which generates “substantially all of the gross income of a debtor” and on which “no substantial business is being conducted” other than the business of operating the real property. Then, the Code states that a “single asset real estate” debtor must, no later than

ninety days after filing bankruptcy, have either filed a reasonably confirmable plan of reorganization or commenced monthly payments, on account of its mortgage, in an amount equal to the non-default contract rate of interest.

Quite obviously, the “single asset real estate” provisions were designed to make bankruptcy a far swifter process, and to lessen the time that a lender had to stand there twiddling. In my next post, we’ll discuss how this worked in practice.