

Single Asset Real Estate Under 11 U.S.C. § 362(d)(3): A Narrower Construction Than You Might Expect (Or, Why Every Hotel Should Have a Gift Shop and Troubled Golf Courses Should Keep Their Bars Open)

By George W. Kuney¹ and Jeffrey R. Patterson²

I. Introduction

The Bankruptcy Reform Act of 1994 introduced a formal definition of "single asset real estate" to the Bankruptcy Code and provided for seemingly mandatory relief from stay for lenders seeking to foreclose upon such assets, if debtors did not quickly propose reorganization plans or begin making payments to their secured creditors. Despite Congress's grant of this secured creditors wish, the amendments have not been the panacea that lenders expected. The statutory exceptions, coupled with a narrow judicial interpretation of the definition of "single asset real estate" have rendered these amendments all but nugatory.

Now, in 2001, the definition of single asset real estate is being amended to increase its scope by removing the \$4,000,000 secured debt cap. Lenders may applaud this result in the face of an expected continued economic slowdown and increase in default, foreclosure, and Chapter 11 activity. Despite this victory, however, Congress has not addressed the narrow judicial interpretation of single asset real estate that limits application of § 362(d)(3)'s mandatory relief from stay provisions. Therefore, despite the broadening amendments of the current bankruptcy reform bills, mandatory relief from stay under § 362(d)(3) is not likely to be the automatic remedy that lenders may expect. The lenders lobby, although successful in getting legislation passed, has not had the same level of success in proposing legislation that will actually address the lenders' concerns and constrain the traditional discretion of bankruptcy judges.

This article first examines the statutory amendment from 1994 and its legislative history, and then provides an overview of case law interpreting the statute. The article then examines the amendments currently awaiting reconciliation and presidential signature, and concludes that the case law interpreting the 1994 "single asset real estate" amendments provides a broad judicial exception to what would otherwise be mandatory relief from stay. Further, the failure to specify the form of relief that is required if

¹ Mr. Kuney is an Associate Professor at The University of Tennessee College of Law where he is the Director of the Clayton Center for Entrepreneurial Law. He provides legal and business consulting services nationwide. He was a partner in Allen Matkins Leck Gamble & Mallory LLP until 2000.

² Mr. Patterson is a partner in the San Diego office of Allen Matkins Leck Gamble & Mallory LLP where he concentrates his practice on commercial litigation and debtor-creditor matters.

§ 362(d)(3)'s conditions are met provides another method for bypassing the apparent intent of the statute, all while remaining well within its plain meaning. These judicial interpretations are the predictable reaction of bankruptcy courts to enactments drafted with something less than rigorous precision which are intended to curtail traditional judicial discretion in the administration of Chapter 11 cases. Although § 362(d)(3) may never be amended out of the statute by Congress, the courts have all but accomplished that end through their decisions.

II. The Bankruptcy Reform Act of 1994 And the Definition of Single Asset Real Estate.

In reaction to perceived abuses of Chapter 11 by entities formed to hold a single piece of real property, the 1994 Amendments added § 362(d)(3) to the Bankruptcy Code.³ The added section requires a bankruptcy court to grant relief from the automatic stay to enable a secured creditor to realize upon collateral that constitutes "single asset real estate" unless, within 90 days of the petition date, (a) the debtor files a Chapter 11 plan that has a reasonable possibility of being confirmed within a reasonable time or (b) the debtor makes interest payments to the secured creditor. Specifically, Bankruptcy Code § 362(d)(3) provides that:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay - -

.....
(3) with respect to a stay of an act against single asset real estate under subsection (a), by creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) -

³ The legislative history of the 1994 Amendments is devoid of specific comments or indications regarding legislative intent behind the enactment of §§ 101(51B) and 362(d)(3) beyond brief statements that the amendment will shift the burden to the debtor to preserve the automatic stay and prevent other, unnamed "problems" in single asset real estate cases. See Appendix E, COLLIER ON BANKRUPTCY 9-70 to 9-130 (15th ed. 1996) (reprinting 140 CONG. REC. H 10,764 (daily ed. Oct. 4, 1994), 140 Cong. Rec. S 14,461 (daily ed. Oct. 6, 1994), 140 Cong. Rec. E 2101 (daily ed. Oct. 6, 1994), 140 CONG. REC. S 14,597 (daily ed. Oct. 7, 1994), and 140 CONG. REC. S 14,948 (daily ed. Oct. 7, 1994)). It is, therefore, unclear what concepts underly the notions of, for example, "cause" for an extension of the 90 day period of § 362(d)(3) and "no substantial business . . . other than the business of operating real property and activities incidental thereto" as stated in § 101(51B).

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate.⁴

“Single asset real estate” is defined as:

real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, liquidated secured debts in an amount no more than \$4,000,000.⁵

A quick reading of these provisions leaves one with the initial impression, especially if one is a secured creditor, that Congress stepped up to the plate and acted decisively by requiring relief from stay in most under-four-million-dollar single asset bankruptcy cases. A survey of the case law, however, indicates otherwise. As the following discussion indicates, lenders that pinned their hopes to § 362(d)(3) have been disappointed at the gaps in its coverage that emerge upon close examination by the bankruptcy courts. By merely removing the \$4,000,000 cap, the current bankruptcy reform bill does nothing to plug those gaps.

⁴ 11 U.S.C. § 362(d)(3).

⁵ 11 U.S.C. § 101(51B).

III. Case Law Defining Single Asset Real Estate.

A. Kkemko

One of the earliest cases to test the scope of § 362(d)(3) was *In re Kkemko, Inc.*⁶ *Kkemko* held that a marina did not constitute “single-asset real estate” under the Bankruptcy Code. The court based its ruling on two grounds. First, after acknowledging that there is no guiding legislative history, the court divined that the drafters and promulgators of § 101(51B) were working in a “bankruptcy context” and not in the context of “real estate law” or “fixture law,” and therefore, they must have intended “single-asset real estate” to mean “a building or buildings which were intended to be income producing, or raw land.”⁷ The court reasoned that since the secured creditor’s motion was based on a position that the debtor’s docks were appurtenant to debtor’s land and therefore to be regarded as real estate, the marina may fall within a definition of “single-asset real estate” in a “real estate context,” but not in a “bankruptcy context.”⁸

Kkemko’s second basis reflects the more common approach to the issue: whether what is under consideration is a business as contrasted to a piece of real estate simply held for income. The court found significant the fact that the marina was involved in more than just the rental of moorings.⁹ The court noted that the marina stored, repaired and winterized boats; provided showers and a pool; sold gas and had other income producing concessions. The court contrasted this situation with what it viewed as the classic “single-asset real estate” case: “where the owner of an encumbered building is attempting to avert loss of his building to his major lender who is grossly undersecured, and where there is no real hope that the owner can come forth with a viable confirmable Chapter 11 plan.”¹⁰

Of course this begs the question. Does the real estate in question have to be a building? Can it be series of buildings? Can it be income producing at all? Will any degree of retail income exempt it from the “single-asset real estate” label? These questions all seem to emerge from the two inherently vague criteria of the four articulated in § 101(51B): (1) “single property or *project* and (2) “which generates *substantially* all

⁶ 181 B.R. 47 (Bankr. S.D. Ohio 1995).

⁷ *Id.* at 51.

⁸ *Id.*

⁹ Query whether the rental of moorings, in and of itself, would be business enough to take the property out of the “single-asset real estate” definition? Later cases suggest the answer may be “yes.” See *infra.* notes 21 to 25 and accompanying text.

¹⁰ 181 B.R. at 52.

of the gross income of a debtor and on which no *substantial* business is being conducted by a debtor other than the business of operating the real property *and activities incidental thereto*." What constitutes a project, what is the business of operating real property and exactly what are the activities incidental thereto?

B. Cases After Kkemko.

Kkemko confidently stated that "apartment buildings and residential projects are within the scope of the definition."¹¹ *In re Philmont Development Company*¹² followed and fairly easily concluded that a series of semi-detached houses constituted a single project.¹³ Further, in the *In re Oceanside Mission Associates* case¹⁴ the court held that undeveloped, non-income producing land qualifies, an approach followed by the court in *In re Pensignorkay, Inc.*,¹⁵ with regard to a debtor holding 275 acres of raw land for future development.

Contrast *In re McGreals*,¹⁶ however, which held that for two or more separate properties to constitute a "single project" within the meaning of the statute, they must be linked together in some fashion in a common plan or scheme involving their use. The mere fact of common ownership, or even common border, will not suffice. Thus, where the debtor owned two adjacent parcels, but only one was developed and rented while the other was raw land, and the developer "credibly testified" that he had no plans to combine the properties in any way, the court held the parcels did not constitute a single project.¹⁷

Once one determines that a property or properties constitute a single project, the question is whether it generates substantially all of the debtor's gross income and whether any substantial business is being conducted on the property other than operating the property and activities incidental thereto. As noted above, bankruptcy courts in California and Pennsylvania have held that even where the property has no gross income

¹¹ *Id.* at 50.

¹² 181 B.R. 220 (Bankr. E.D.Pa. 1995).

¹³ *Id.* at 225.

¹⁴ 192 B.R. 232, 238 (Bankr. S.D.Cal. 1996).

¹⁵ 204 B.R. 676 (Bankr. E.D.Pa. 1997).

¹⁶ 201 B.R. 736 (Bankr. E.D.Pa. 1996).

¹⁷ *Id.* at 743.

it will qualify.¹⁸ Arguments that non-profit entities such as housing cooperatives are beyond the scope of the statute have also failed.¹⁹

C. CBJ Development – The BAP Further Contracted the Scope of Single Asset Real Estate.

In *In re CBJ Development, Inc.*,²⁰ the Ninth Circuit Bankruptcy Appellate Panel for the “BAP” ventured in a different direction when it upheld a bankruptcy court’s ruling that a 63-room hotel did not constitute “single-asset real estate.” In fact, the BAP expanded the bankruptcy court’s ruling in this regard. The lower court had rejected the debtor’s argument that operation of a hotel is more than mere operation of property and would not except the hotel from the statutory definition on that basis alone. The BAP reasoned, however, that although merely calling a building a hotel, or operating a business more akin to apartment rental, is insufficient to remove it from the definition of “single asset real estate,” the operation of a full service hotel is more than the mere operation of property. The BAP noted that the hotel in question was a 63-room full service hotel that had to employ a substantial number of people; rooms had to be cleaned, sheets and towels laundered, phone and “other services” provided.²¹ It therefore found that the operation of the hotel was “sufficiently active” to constitute a business other than the mere operation of property and was not “single asset real estate.”

The BAP went on to agree with the ground relied on by the bankruptcy court in holding that the hotel was not single asset real estate -- that the ancillary services offered by the hotel constituted “substantial other business.” The court found that the hotel’s gift shop, restaurant, bar, and the bus tours launched from the parking lot amounted to substantial other business. The court was not troubled by the fact that as of the petition date, with the exception of the gift shop, all of the other businesses were closed. The BAP recognized that the use of the present tense in § 101(51B) suggested that only current activities should be considered, to protect against debtor’s starting up post-petition ancillary businesses to avoid relief from stay, but brushed this aside finding that the restaurant and bar had been operated previously, were closed only for renovations and the debtor’s investors had put a substantial amount of money into the renovations.²²

¹⁸ *Oceanside Mission Assoc.*, 192 B.R. at 232 (Bankr. S.D.Cal. 1996); *In re Pensignorkay, Inc.*, 204 B.R. .

¹⁹ *In re 83-84 116th Owners Corp.*, 214 B.R. 530, 534 (Bankr. E.D.N.Y. 1997).

²⁰ 202 B.R. 467 (9th B.A.P. Cir. 1996).

²¹ *Id.* at 472.

²² *Id.* at 473.

under § 362(d)(3) was mandatory, *the court went on to find it had discretion to determine what sort of relief was proper under the circumstances.*²⁸ Using § 362(d)(3) as a case management tool, the court set a drop-dead date for plan confirmation or total relief from stay, allowing itself as much freedom and discretion as if the motion for relief had been brought under § § 362(d)(1) or § 362(d)(2).

F. The 2001 Amendments Do Not Effectively Address § 362(d)(3).

Interestingly, despite being widely perceived as a grant of the credit industry's wish list, neither current bankruptcy reform bill effectively shores up the lender protections of 11 U.S.C. § 362(d)(3). The amendments do nothing to change the *Kkemko/CBJ Development* interpretation of single asset real estate or *Condor One*'s approach to granting relief. Apparently, lobbying efforts focused on eliminating the \$4,000,000 secured debt cap for single asset real estate,²⁹ but ignored the case law reviewed in this article. Thus, the fundamental weaknesses of the original 1994 single asset real estate amendments will remain.

Both pending bills amend § 101(51B) as shown here:

The term "single asset real estate" means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, liquidated secured debts in an amount no more than \$4,000,000.³⁰

By failing to address the judicial creation of exceptions, and focusing on removing the cap, the amendments may do little to increase the scope or importance of § 362(d)(3).³¹

²⁸ See also *Riggs Bank v. Planet 10, L.C. (In re Planet 10, L.C.)*, 213 B.R. 478, 481 (Bankr. E.D. Va. 1997) (following *Archway*).

²⁹ *In re 83-84 116th Owners Corp.*, 214 B.R. 530, 535 (Bankr. E.D.N.Y. 1997).

³⁰ This block quote is the current text of 11 U.S.C. § 101(51B), marked to show the effect of H.R. 333 as passed by the House March 1, 2001 and S.420 as passed by the Senate March, 15, 2001. Additions underlined; deletions struck out. Specifically, S.420, Title XII, entitled "Technical Amendments," at § 1201(5) provides: "in paragraph (51B) [of the Bankruptcy Code] -- (A) by inserting 'who is not a family farmer' after 'debtor' the first place it appears; and (B) by striking 'thereto having aggregate' and all that follows through the end of the paragraph." H.R. 333 is identical in this respect.

³¹ But see *In re 83-84 116th Owners Corp.*, 214 B.R. at 535 (declining to create non-profit exception to definition of single asset real estate; "But until Congress amends the definition of § 101(51B), this Court has no discretion or authority to carve out a judicial exception from the

IV. Conclusion

Under the decisions to date, it appears that unless the property in question is undeveloped or, at most, the debtor is simply collecting rent in exchange for only providing space and no additional services, it will not be subjected to mandatory relief from stay under § 362(d)(3). Based upon the demonstrated potential for judicial end-runs of the section, it would be imprudent to advise a lender client that it will be able to take advantage of the single asset real estate protections that Congress has enacted. Conversely, owners of troubled real property should consider operating businesses or providing services on their properties for separate consideration such as those described in this article to avoid being characterized as "single asset real estate" debtors subject to mandatory relief from stay. It is doubtful this is what Congress or the special interests behind the legislation had in mind in 1994 or today. However, it may be an indication of predictable judicial recoil from legislative attempts to deprive the bankruptcy courts of their traditional discretion in administering bankruptcy cases.

Clearly, if Congress hopes to create special "hard and fast" protections for lenders and to prevent perceived abuses in the Chapter 11 process, it will have to completely and explicitly remove vague adjectives such as "substantial" and "incidental" and judicial discretion from the working of the statute. Without passing on the merits of such a regime, the cases show that this has not yet come to pass, and the 2001 legislation shows that the lenders' lobby has not yet learned how to draft around the discretion of the courts.

unambiguous words of the statute, no matter how many of his friends, relatives and fellow judges live in co-op apartments.").