

Bankruptcy

Fed-up creditors forcing developers into bankruptcy

October 08, 2009

By: Polyana da Costa

Andrew Scott, the owner of a security consulting company in Boca Raton, knew it was a long shot when he decided to go after \$8,400 he says he was owed by the developer of a West Palm Beach office building.

The project, Courthouse Commons, was facing a \$30 million foreclosure suit filed by Great Florida Bank, and Scott would also have to compete with more than 20 other creditors of the developer.

Scott joined forces with two other unsecured creditors and forced developer Courthouse Commons LLC into involuntary Chapter 11 bankruptcy. The three creditors were owed about \$27,000.

As the real estate market struggles and more foreclosures loom, owners of distressed properties are increasingly being threatened by secured and unsecured creditors with involuntary bankruptcy.

While it can be a good strategy for creditors desperate to recover some money, it also poses risks and can backfire on creditors, said Craig Kelley, the attorney for three creditors that pursued Courthouse Commons.

"There is more talk over involuntary bankruptcies than ever before," said Kelley with Kelley & Fulton in West Palm Beach. "Creditors who are getting fed up are certainly considering it as an option before they are further depleted by a debtor, but when it comes to pulling the trigger, they are being cautious." Attorneys and creditors can be sanctioned and hit with costly punitive damages if the court determines the bankruptcy petition was filed without merit or in bad faith, Kelley said.

And "you can do real damage to a debtor by forcing them into bankruptcy," he said. "So creditors have to be very sure their claims are bona fide and undisputed before filing; otherwise, they can end up shooting their own foot."

Of more than 18,000 petitions filed in the U.S. Bankruptcy Court for the Southern District of Florida during the fiscal year that ended Sept. 30, only 829 were involuntary petitions. Data for the recently completed fiscal year are not yet available.

Attorneys say filings could increase as more creditors considering involuntary bankruptcy move forward in court.

In addition to the Courthouse Commons case, Kelley said he has a client who is weighing filing an involuntary bankruptcy action against a development project in Palm Beach County. He would not identify the developer or client before the petition is filed but said unsecured creditors on the case are owed about \$15 million.

To Robert Furr of Furr and Cohen in Boca Raton, who represented Great Florida Bank in the Courthouse Commons bankruptcy, involuntary bankruptcy is a good strategy for creditors and lenders. "it's something very effective," he said.

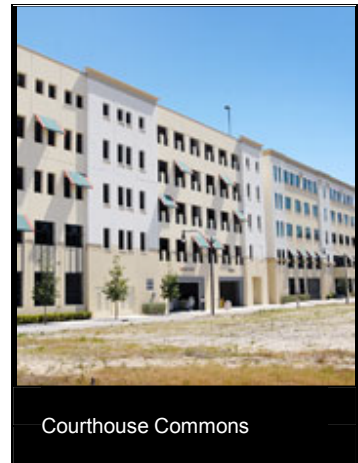
Attorney **Shari Olefson**, of Fowler White Boggs in Fort Lauderdale, agreed that lenders and creditors are increasingly considering using involuntary bankruptcy as leverage against developers.

"We discuss it with all of our lender clients as an option," she said. "Both creditors and lenders are looking at this option as an act of desperation in some cases."

The incentive for a primary lender to force a developer into bankruptcy is to quickly get a receiver in charge of the project if the lender suspects wrongdoing on the part of the developer, Olefson said. It can take months to have a receiver appointed to a project through a foreclosure process in state court.

"It forces borrowers to come clean with everything," she said. "It gets all the money on the table."

In the Courthouse Commons case, developer PBM Development, which is managed by Peter McAlister and held a



40 percent interest in the project, agreed to convert the filing into a voluntary Chapter 11 bankruptcy and cooperated with the bank, Furr said.

The 100,000-square-foot, 2-year-old building, which is across the street from the Palm Beach County Courthouse, was finished in 2007 and recently sold for \$15 million at a bankruptcy auction. The buyer was a subsidiary of Great Florida Bank.

The auction's highest bid was \$11.25 million, and Great Florida, which provided a \$30 million loan to build the project, was not willing to give up the property at such a loss. "It cost \$30 million to build it," Furr said.

Great Florida plans to hold onto the property for about five years until it can recover what it was owed, Furr said.

Scott and other unsecured creditors are expected to receive a small percentage of what they are owed.

In order to get the approval of the other creditors to sell the property and have the [bankruptcy plan](#) confirmed by the court, Great Florida agreed to pay a "carve-out" of \$100,000 to the unsecured creditors.

Lenders often negotiate carve-outs with unsecured creditors in order to move the process along.

"Let's say the bank is owed \$150 million on a condo project," said bankruptcy attorney Philip Hudson, of Arnstein & Lehr in Miami, "A Chapter 11 is filed, and a buyer comes to the auction and buys it for \$100 million. The bank is entitled to all of that money, but it might agree to a \$10 million carve-out for the unsecured creditors."

Court documents say at least \$1 million is claimed by unsecured creditors against the Courthouse Commons. Great Florida has 30 days to dispute claims by individual creditors, but assuming all are valid, the creditors would not get more than 10 percent of what they are owed.

After paying legal fees, Scott will be lucky to receive any money from the payout, he said, but he doesn't regret trying.

"It was a learning experience," he said.

Hudson has represented several developers who had been threatened with involuntary bankruptcy, but they settled with lenders and creditors before a filing.

Paul Singerman, a bankruptcy attorney with Berger Singerman in Miami, said most involuntary bankruptcies he has seen result from a lack of transparency on the part of the project's management. "It's often creditors reacting to information, anecdotal or factual, that the company obligated to them is engaged in allegedly improper business practices, such as asset transfers, and the company is not being responsive and transparent," he said.

Whether an involuntary petition is initiated by a lender or a creditor, they should be certain the claims are justified, said Hudson. He said clients recently asked him to consider involuntary actions against developers, but he decided not to file.

Involuntary bankruptcy petitions require the participation of at least three creditors with undisputed claims totaling \$13,475 or more when the debtor has more than 12 creditors. Their claims should be not be subject to any disputes — the creditor needs a judgment or the debt needs to be admitted by the debtor. A creditor who is owed \$13,475 or more may file individually when the debtor has fewer than 12 creditors, but lawyers normally feel safer seeking a joint filing with other creditors.

"We always use three, just to be sure," Kelley said. "Bankruptcy is a good strategy and may create a remedy [for creditors] that is not otherwise available in foreclosure court, but you need to be extremely cautious about it."

Polyana da Costa can be reached at polyana.dacosta@incisivemedia.com or at (561) 820-2065.

Courthouse Commons photo by Melanie Bell