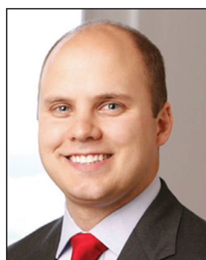
Benchnotes

By Aaron M. Kaufman, Paul R. Hage and Patrick A. Clisham

Coordinating Editor
Aaron M. Kaufman
Dykema Gossett PLLC
Dallas



Coordinating Editor
Paul R. Hage
Jaffe Raitt Heuer & Weiss, PC
Southfield, Mich.

Coordinating Editor
Patrick A. Clisham
Engelman Berger, PC
Phoenix

Aaron Kaufman is a member of Dykema Gossett PLLC in Dallas. Paul Hage is a partner with Jaffe Raitt Heuer & Weiss, PC in Southfield, Mich. Patrick Clisham is the managing shareholder of Engelman Berger, PC in Phoenix.

Comparing and Contrasting the PROMESA Stay with 11 U.S.C. § 362

Last summer, in response to Puerto Rico's looming debt crisis, Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA).[1] Among other provisions included in PROMESA is a temporary bankruptcy-like stay of debt-related litigation. In *Peaje Investments LLC v. Garcia-Padilla*,[2] the First Circuit considered two separate actions for relief for the PROMESA stay. The night before the scheduled hearings on their motions, the district court denied both motions and cancelled the hearings. While not expressly stated in the denial, the district court implicitly held that both movants were adequately protected by the continuous replacement of their respective collateral (*i.e.*, future toll revenues and employer contributions).

Of particular interest in *Peaje* is the First Circuit's comparisons between the PROMESA stay provisions and the relevant stay provision of § 362 of the Bankruptcy Code. First, the court noted that under the Bankruptcy Code, "cause" is expressly defined to include lack of adequate protection; no similar provisions exist under PROMESA. This distinction ultimately made no difference, however, because the First Circuit recognized that even before the Bankruptcy Code's enactment, the U.S. Supreme Court held that creditors were constitutionally entitled to protection of their interests "to the extent of the value of the[ir] property."[3]

The First Circuit also noted that PROMESA requires relief to be considered "after notice and a hearing." Here, the district court denied relief and cancelled the hearings. Recognizing that § 362 of the Bankruptcy Code also requires stay-relief motions to be acted upon "after notice and a hearing," the First Circuit concluded that "[a] hearing may not be necessary where, for example, the material facts are not disputed."[4]

To determine whether material facts were in dispute, the court next considered who had the burden of proof. On this point, the distinction between PROMESA and the Bankruptcy Code made a difference. Under the Bankruptcy Code, § 362(g) places the burden on the movant for all issues related to a debtor's equity, while the debtor carries the burden on all other issues. PROMESA has no similar burden-shifting provisions. The court explained that before the enactment of § 362 and its burden-shifting provisions, creditors were required to show that they would be harmed by the continuation of the automatic stay.[5]

Relying on this precedent, the First Circuit concluded that Congress's decision "not to transplant the Bankruptcy Code's express alteration of the pre-Code burden regime into PROMESA" means that creditors have the burden on all issues when seeking relief from the PROMESA stay.[6] The court explained that such a conclusion was consistent with the overall purpose of PROMESA and its temporary 10-month stay. Similarly, the Bankruptcy Code's burden-shifting provisions were consistent with the bankruptcy system where the automatic stay could last the entirety of the bankruptcy case.

Against this backdrop, the court considered the pleadings filed by the movants. With respect to the first movant, the court held that the movant failed to allege that it would have been harmed by the continuation of the stay. In fact, the first movant admitted that it had liens on future toll revenues and failed to allege or dispute that such future revenues were adequate to protect its interests. Thus, the court of appeals affirmed the decision to deny the first movant's motion for relief, concluding that the denial without a hearing was appropriate. As for the second movant, the court of appeals noted that the pleadings alleged uncertainty about future employer contributions and the potential insufficiency of such contributions to repay the applicable bonds. Based on these allegations, the court reversed the denial of the motion and remanded for a hearing before the district court.

Secured Creditor Rescued from Own Sub-Optimal Loan Document Drafting

The main issue before the court of appeals in *WBCMT 2007 C33 Office 9720 LLC v. NNN Realty Advisors Inc.*[7] was whether the definition of "a borrower" in the recitals of a guaranty — where the definition itself contains a hanging parenthesis — referred exclusively to the collective group of 17 borrowers, or whether it also referred to the borrower entities individually where context is required. The recital itself read as follows:

> Whereas, NNN Cypresswood Drive, LLC, NNN Cypresswood Drive 1, LLC, NNN Cypresswood Drive 3, LLC, Cypresswood Drive 4, LLC, Cypresswood Drive 5, LLC, Cypresswood Drive 6, LLC, Cypresswood

1 *See* 48 U.S.C. §§ 2101-2241. For more information and the latest news, visit ABI's "Puerto Rico in Distress" website at abi.org/PR-crisis.

2 2017 U.S. App. LEXIS 529 (1st Cir. Jan. 11, 2017).

3 *Id.* at *8 (quoting *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278, 61 S. Ct. 407, 74 L. Ed. 2d 235 (1982)).

4 *Id.* at *10 (citing *In re Marron*, 485 B.R. 485, 492 (D. Mass. 2012)).

5 *Id.* at *12 (citing *In re Planned Sys. Inc.*, 78 B.R. 852, 858 (Bankr. S.D. Ohio 1987); *In re Anchorage Boat Sales Inc.*, 4 B.R. 635, 641 at n.6 (Bankr. E.D.N.Y. 1980)).

6 *Id.* at *12.

7 844 F.3d 473 (5th Cir. 2016).

Drive 7, LLC, Cypresswood Drive 9, LLC, Cypresswood Drive 10, LLC, Cypresswood Drive 11, LLC, Cypresswood Drive 12, LLC, Cypresswood Drive 13, LLC, Cypresswood Drive 14, LLC, Cypresswood Drive 17, LLC, Cypresswood Drive 18, LLC, Cypresswood Drive 19, LLC, and Cypresswood Drive 20, LLC, each a Delaware limited liability company (as defined in the Security Instrument), the "*Borrower*" [has] obtained a loan ... in the principal amount of ... $17,500,000 ... from [Wachovia Bank].

The borrowing entities in this case held the underlying property as tenants-in-common, and the related guaranty agreement rendered an affiliate entity (NNN Realty) liable for the entire debt if "the Property or any part thereof becom[es] an asset in (x) a voluntary bankruptcy or insolvency proceeding of Borrower." After one of the borrower entities filed a voluntary bankruptcy case, its 3.305 percent tenants-in-common interest became an asset of its bankruptcy estate. Seizing on the language in the guaranty, the secured creditor sued NNN Realty for the full indebtedness.

NNN Realty defended itself on grounds that the loan documents were ambiguous because the definition of "borrower" suggested that NNN Realty's liability would only be triggered when all 17 of the borrowers filed bankruptcy cases. After a bench trial, the district court found no ambiguity in the definition of "borrower" and concluded that the presence of an "and" — rather than an "and/or" in the recital — was dispositive and indicated that "the term 'Borrower' refers to the full complement of entities." Thus, the district court agreed with NNN Realty that a single entity's bankruptcy filing did not trigger its unlimited liability.

On appeal, the Fifth Circuit reversed and rendered judgment in favor of the secured creditor. Specifically, the court of appeals held that the use of the term "and" was not dispositive; the recital merely indicated the 17 parties who were parties to the loan. The court also reasoned that the phrase "as defined in the Security Instruments" modifies "borrower," meaning that the definition of "borrower" was not fully contained within the guaranty. Incorporating the definition of "borrower" from the security instrument allowed the court to recognize that the term referred to the collective group and individual entities as the context required.

Turning back to the guaranty, the court provided several examples of provisions rendered meaningless if the "borrower" only referred to the 17 entities collectively. For that reason, the court concluded that the only reasonable interpretation of the definition, notwithstanding the hanging parenthetical and less-than-optimal drafting, was to refer to the 17 entities individually or collectively, as the context may require. Accordingly, the court reversed and rendered judgment for the secured creditor.

Miscellaneous

• *Tracht Gut v. Los Angeles County Treasurer & Tax Collector (In re Tracht Gut)*, 836 F.3d 1146 (9th Cir. 2016) (Ninth Circuit held that pre-petition tax sales conducted in accordance with California state law, upon appropriate notice and with opportunity for competitive bidding, conclusively established that price received was "reasonably equivalent value," and thus, sale could not be set aside as fraudulent transfer; court held that "the conclusive rule regarding mortgage foreclosures established by [the U.S. Supreme Court in *BFP v. Resolution Trust Corp.*] should also apply to tax sales in California"); and

• *Ozenne v. Chase Manhattan Bank (In re Ozenne)*, 841 F.3d 810 (9th Cir. 2016) (after Ninth Circuit Court of Appeals panel held that BAPs were not courts "established by an Act of Congress" and therefore lacked jurisdiction to issue a *writ of mandamus* under the All Writs Act, Ninth Circuit *sua sponte* called for rehearing *en banc*; on rehearing, and after receiving multiple *amicus* briefs, *en banc* court unanimously vacated its prior opinion and instead held that BAP lacked jurisdiction due to debtor's failure to timely appeal denial of his motion for sanctions for alleged stay violations; thus, court avoided deciding issue of whether BAPs are courts "established" by Congress). abi

Copyright 2017
American Bankruptcy Institute.
Please contact ABI at (703) 739-0800 for reprint permission.