AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
Issues and Information for Today's Busy Insolvency Professional

Secured Creditors Note: SARE Analysis Remains the Same under BAPCPA

Contributing Editor:
Andrew P. Moratzka
Mackall, Crounse & Moore PLC; Minneapolis
apm@mcmlaw.com

About the Author

Drew Moratzka is an attorney in the banking and financial institutions and bankruptcy and creditors' rights groups at Mackall, Crounse & Moore PLC in Minneapolis.

Lien on Me

For some time, secured creditors have had the ability to expedite a debtor's bankruptcy proceeding under §362(d)(3) of the Bankruptcy Code. In order to use that section, however, the debtor must qualify as a single-asset real estate debtor (SARE) under §101(51B) of the Code. BAPCPA amended this definition to specifically exclude a family farmer and delete the reference to a $4 million cap. The effect of these edits was recently analyzed by the Fifth Circuit.


Andrew P. Moratzka

In *Ad Hoc Group of Timer Noteholders v. The Pacific Lumber Co.; Scotia Pacific Co.* (*In re Scotia Pacific Co., LLC*), 508 F.3d 214 (5th Cir. 2007), the court of appeals analyzed the definition of a single-asset real estate debtor under BAPCPA. The appellant noteholders (the noteholders) challenged the bankruptcy court's holding that Scotia Pacific Co. LLC (debtor) was not a SARE debtor under the Code and was therefore not subject to expedited reorganization procedures set forth in §362 of the Code. Refusing to agree that BAPCPA changed prior precedent, the appeals court affirmed the bankruptcy court.

After filing a chapter 11 bankruptcy petition with more than $850 million in senior secured obligations, the noteholders moved to expedite the bankruptcy proceedings under §362(d)(3) of the Code on the basis that debtor qualified as a SARE debtor. Focusing on the "substantial business" of the debtor, the bankruptcy court determined that the debtor was clearly engaged in an active economic enterprise. The noteholders disputed this holding on appeal.

Of particular concern to the court's analysis was the debtor's business and corporate structure. The debtor's business was to maximize revenue from timber grown on certain lands, while ensuring sustainable forest growth. A majority of the debtor's employees were scientists employed within the forestry program. The specialized work done by these employees included inventory analysis, conservation compliance, harvesting planning (including road maintenance, design and engineering), erosion and water quality management, and other scientific studies.

Before addressing these facts in light of the SARE definition under BAPCPA, the appeals court first reviewed case law as it developed from 1994 forward. Relying heavily on an opinion from the Eastern District of Texas (*In re Golf Club Partners LP*, No. 07-40096-BTR-11, 2007 WL 1176010 (E.D.Tex. Feb. 15, 2007)), the court agreed that most courts took a practical view of the concept of single-asset real estate. In short, the activities on the real estate must be minimal, and the revenues received by the owner must be passive in nature.

The noteholders' arguments focused on the fact that BAPCPA excluded family farmers and removed the $4 million cap. The appeals court disagreed, determining that including large enterprises did not mean Congress intended to overrule established precedent.

The court's analysis was therefore based on the established three requirements to qualify as a SARE debtor, which are (1) the real property must qualify as a single property, (2) that generates substantially all the debtor's gross income and (3) on which no substantial business is conducted. The court focused on the third requirement. It stated that the "[debtor's] timberland is clearly more than a passive investment. [The debtor] has over 60 employees and at times hires additional independent contractors to assist in conducting its business. Sophisticated operations take place on the timberland such as planning, growing, and maintaining the timber as well as building and maintenance of roads on the real estate which constitute substantial business other than the operation of the real property and activities incidental thereto." *In re Scotia Pacific*, 508 F.3d at 224-25.

The court's decision was recently cited by the Bankruptcy Court for the Eastern District of Tennessee. *In re Webb Mtn. LLC*, 2008 WL 656271 (Bankr. E.D. Tenn. March 6, 2008). *Webb* cited *Scotia Pacific* for the proposition that prior case law concerning SARE is still applicable. *Webb* then went on to analyze the case before it under the three factors described in *Scotia Pacific*. Of particular concern to the *Webb* court was whether the property constituted a "single property" because there were five parcels and the property's lack of development. Citing *In re Pensignorkay*, 204 B.R. 676, 681-82 (Bankr. E.D. Pa. 1997), the *Webb* court found the fact that a debtor may hold title to more than one property does not necessarily exclude it from qualifying as a SARE debtor. In fact, the five tracts in that case were contiguous and were at all times contemplated as comprising one large parcel to be developed as a resort project. Because the debtor had not yet developed this property and was not conducting any active business, the *Webb* court entered an order determining the debtor's assets to be SARE.

These opinions are a fresh reminder of the requirements for a debtor to qualify as a SARE debtor. Creditors' counsel are well advised to review the opinions prior to bringing a motion under §362(d)(3) of the Code. ■

Reprinted with permission from the ABI Journal, Vol. XXVII, No. 4 May 2008.