

# Bankruptcy & Restructuring Law Monitor

PROVIDING COMMENTARY AND THE LATEST UPDATES ON BANKRUPTCY & RESTRUCTURING LAW

PUBLISHED BY



## Jason Realty's Restrictions on Use of Rents as Cash Collateral Do Not Apply to a Debtor's Use of Hotel Revenues

*Posted at 9:03 AM on May 11, 2011 by Jason R. Finkelstein*

The Bankruptcy Court for the District of New Jersey (Kaplan, J.) recently held that hotel revenues (including revenues generated from room occupancy, food and beverage sales, catering, gift shop purchases, spa, and related hotel services) do not constitute “rent” within the meaning of the Third Circuit decision of *In re Jason Realty, L.P.*, 59 F.3d 423 (3d Cir. 1995). Therefore, even if they are absolutely assigned to the secured lender, hotel revenues can be used by the debtor as cash collateral to pay its ordinary and necessary operating expenses and to reorganize. *In re Ocean Place Dev., LLC*, No. 11-14295 (Bankr. D.N.J. Mar. 31, 2011).

Ocean Place Development, LLC (“Debtor”) owned a 254-room beachfront resort in Long Branch, New Jersey, which included a large conference center, three restaurants, a bar/lounge, a full-service spa, and numerous other amenities. Ocean Place owed approximately \$58 million pursuant to the terms of its loan agreement with AFP 104 Corp., as successor to Barclays Capital Real Estate Inc. (“AFP”). Repayment of the loan was secured by, among other things, a Mortgage and an Assignment of Rents and Leases (the “Assignment of Rents”). Both the Mortgage and Assignment of Rents defined the term “rents” broadly, to include all “... revenues and credit card receipts collected from guest rooms,

restaurants, bars, meeting rooms, banquet rooms and recreation facilities, all receivables, customer obligations, installment payment obligations and other obligations now existing or hereafter arising or created out of the sale, lease, sublease, license, concession or other grant of the right of the use and occupancy of the property or rendering of services by Borrower [Debtor] or any operator or manager of the hotel . . . .”

Following the Debtor’s default under the loan, AFP obtained a foreclosure judgment. The Debtor filed a Chapter 11 petition before the scheduled foreclosure sale, and sought authority to use cash collateral consisting of hotel revenues. AFP objected, and cross-moved for an order dismissing the Debtor’s case as a bad faith filing or, alternatively, for relief from the automatic stay to proceed with the foreclosure sale. The Bankruptcy Court granted the Debtor’s request to use cash collateral, and denied AFP’s motion.

In a case of first impression, the Bankruptcy Court commenced its opinion with an analysis of whether hotel room revenues constitute property of the estate within the meaning of Section 541 of the Bankruptcy Code. The Court framed its task as two-fold: (i) first, it had to decide whether a security interest in hotel room revenues constitutes an interest in realty or an interest in personalty that must be perfected and enforced under Article 9 of New Jersey’s version of the Uniform Commercial Code (“UCC”); and (ii) second, even if such interest was deemed personalty, whether the Debtor’s use of hotel revenues was consistent with Jason Realty.

Article 9 governs transactions which create security interests in personal property or fixtures. The Court found that the loan transaction in this case clearly was a “secured” transaction, as the loan documents granted the lender a security interest in the rents and leases and further stated that “Borrower [Debtor] intends for the security instrument to be a ‘security agreement’ within the meaning of the UCC.” Additionally, the loan documents provided other indications of a secured transaction as they allowed: (i) the Debtor to collect rents as long as it was not in

default of the mortgage; (ii) AFP to use post-default rents only to reduce the Debtor's obligations to AFP; and (iii) for automatic termination of the Assignment of Rents after repayment of the loan.

The Court then noted that Article 9 does not extend to interests in or liens on *real* property, including a lease or rents thereunder. However, based on a case from the Bankruptcy Court for the Southern District of New York, *In re Kearney Hotel Partners v. Richardson*, 92 B.R. 95 (Bankr. S.D.N.Y. 1988), the Official Comments to the UCC and an examination of New Jersey statutes, the Bankruptcy Court concluded that hotel room revenues are "accounts" or "payment intangibles," and not "rents." In so ruling, the Court adopted the distinction from those authorities between guests in hotel rooms, who are simply licensees, and tenants under a lease. Thus, Judge Kaplan held that despite the definition of "rents" in the loan documents, hotel revenues are personal property included in the definition of property of the estate.

The Court then examined whether classifying hotel room revenue as personal property conflicts with the Third Circuit's precedent in *Jason Realty*. After discussing the background of *Jason Realty*, Judge Kaplan noted that case involved an absolute assignment of rents due from tenants of a two-story retail and office building, and not the assignment of receipts from a debtor's operation of a hotel, restaurant or spa. Additionally, the Court distinguished *Jason Realty* on the basis that the Third Circuit was tasked with assessing the "treatment of an assignment under New Jersey property law and the ensuing rights of an assignee arising under an absolute assignment of rents." Judge Kaplan, to the contrary, had to determine whether hotel room revenues should be treated as real property interests. Because he determined that interests in hotel revenues should be treated as personalty under Article 9, he was not required to address whether "the assignment of rents absolutely vested title in AFP." Indeed, Judge Kaplan did not even necessarily dispute that the loan transaction evidenced both a security agreement and an absolute assignment of rents. Based on his

distinction of Jason Realty from the case before it in Ocean Place, Judge Kaplan declined to extend Jason Realty to personal property security interests, and allowed the Debtor to use its hotel room revenues as cash collateral so long as AFP remained adequately protected.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North  
25 Main Street  
Hackensack, NJ 07601  
Phone: (201) 489-3000

900 Third Avenue  
16th Floor  
New York, NY 10022  
Phone: (212) 752-8000

500 Delaware Avenue  
Suite 1410  
Wilmington, DE 19801  
Phone: (302) 652-3131

300 East Lombard Street Suite 2000  
Baltimore, MD 21202  
Phone: (410) 230-0660

301 Commerce Street  
Suite 1700  
Fort Worth, TX 76102  
Phone: (817) 810-5250