

## Court Denies Creditor's Motion to Dismiss Chapter 11 Case Despite Multiple Factors in Favor of Dismissal

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In a recent case<sup>1</sup> out of the bankruptcy court for the Southern District of Florida (the "Court"), a secured creditor moved to dismiss a debtor's bankruptcy case "for cause" based on the debtor's bad faith filing.<sup>2</sup> The debtor owned certain commercial real estate in south Florida (the "Commercial Property") and leased space to various tenants, one of which had recently applied for both state and federal licenses to sell medical marijuana.<sup>3</sup> The secured creditor had a first-position mortgage on the Commercial Property.<sup>4</sup> After a decade-long lending relationship soured, the debtor initiated a lender liability action against the secured creditor in state court.<sup>5</sup> The secured creditor subsequently filed three state court actions against the debtor including, *inter alia*, an action to foreclosure its mortgage on the Commercial Property (the "Foreclosure Action").<sup>6</sup>

A final judgment was entered in the Foreclosure Action and the state court scheduled a foreclosure sale for the Commercial Property.<sup>7</sup> On the eve of the foreclosure sale, the debtor removed the state court case to federal court, thereby cancelling the sale.<sup>8</sup> The Foreclosure Action was subsequently remanded and a second foreclosure sale was scheduled.<sup>9</sup> Once again, on the eve of the sale, the debtor sought to remove the Foreclosure Action to federal court.<sup>10</sup> Similarly, the federal court remanded the Foreclosure Action to state court, this time entering an Order enjoining the debtor from any further removals to federal court.<sup>11</sup>

The state court once again scheduled a foreclosure sale.<sup>12</sup> In a continued attempt to delay the foreclosure sale, the debtor filed multiple emergency motions, all of which were denied by the state court.<sup>13</sup> Finally, on the day prior to the sale, the debtor filed its chapter 11 bankruptcy petition thereby causing the foreclosure sale to be cancelled for a third time.<sup>14</sup>

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<sup>1</sup> In re Arm Ventures, LLC, 564 B.R. 77 (Bankr. S.D. Fla. 2017).

<sup>2</sup> Id.

<sup>3</sup> Id. at 79.

<sup>4</sup> Id.

<sup>5</sup> Id.

<sup>6</sup> 564 B.R. at 79.

<sup>7</sup> Id. at 80.

<sup>8</sup> Id.

<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> 564 B.R. at 80.

<sup>12</sup> Id.

<sup>13</sup> Id.

<sup>14</sup> Id.

The secured creditor immediately sought relief from the Court arguing that most of the factors set forth by the Eleventh Circuit in *Phoenix Piccadilly, Ltd. V. Life Insurance Co. of Virginia (In re Phoenix Piccadilly, Ltd.)*, 849 F.2d 1393 (11<sup>th</sup> Cir. 1988) were present, and that the Court should dismiss the debtor's case, or alternatively, grant relief so that the secured creditor could move forward with its Foreclosure Action.<sup>15</sup> In an effort to prove it was committed to reorganizing, the debtor strategically filed a plan of reorganization prior to the hearing on the secured creditor's motion.<sup>16</sup>

The Court first laid out the standard for determining whether to dismiss a debtor's case "for cause" based on a bad faith filing.<sup>17</sup> The Court stated that it must consider factors that show an intent to abuse the judicial process and the purposes of the reorganization provisions, and whether there is a realistic possibility of an effective reorganization or if the debtor is merely seeking to delay or frustrate the legitimate efforts of its secured creditors.<sup>18</sup> The Court went on to note that the following factors in favor of dismissal were present in the debtor's case: (i) debtor only had one true asset, the Commercial Property, (ii) debtor had no employees, (iii) debtor filed its case based on its frustration at the lack of success of its other litigation strategies to avoid a foreclosure of the Commercial Property and (iv) the case was merely a dispute between the secured creditor, the debtor, and several guarantors.<sup>19</sup> Notably, the Court suggested that the debtor had at least eight unsecured creditors whose claims were not insignificant in comparison to the secured creditor's claim.<sup>20</sup>

The secured creditor further argued that, notwithstanding the aforementioned factors, the debtor's plan relied on income generated from a tenant of the Commercial Property selling marijuana, and that courts had universally held that a plan funded by the sale of marijuana could not be confirmed.<sup>21</sup> In response, the Debtor asserted that the tenant was preparing to file the appropriate licenses under state and federal law necessary to sell marijuana, and thus, the proposed plan was confirmable.<sup>22</sup>

The Court pointed out that the law is clear in that a plan of reorganization funded through income generated through selling marijuana cannot be confirmed unless the entity selling the marijuana is legal under both state and federal law.<sup>23</sup> Furthermore, because the debtor's plan, as currently constructed, relied upon the uncertainty of its tenant obtaining both a state and federal license to sell marijuana, the Court found that the feasibility requirement for confirming a plan could not be met.<sup>24</sup>

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<sup>15</sup> *Id.* at 80, 82.

<sup>16</sup> 564 B.R. at 81.

<sup>17</sup> *Id.* at 82.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 82 - 83.

<sup>20</sup> *Id.* at 83.

<sup>21</sup> 564 B.R. at 81.

<sup>22</sup> *Id.* at 83.

<sup>23</sup> *Id.* at 84. The Court noted that it could not confirm the debtor's plan because the plan did not satisfy 11 U.S.C. 1129(a)(3), which requires that a plan be proposed in good faith and not by any means forbidden by law.

<sup>24</sup> *Id.* at 85. The Court pointed out that as of writing its opinion, only the University of Mississippi had ever received approval by the federal government to grow, harvest, and store marijuana for use by researchers.

Despite the foregoing factors weighing heavily in favor of dismissal, the Court denied the secured creditor's motion to dismiss the debtor's bankruptcy case.<sup>25</sup> Instead, the Court granted the secured creditor relief from stay, but gave the debtor fourteen (14) days to file an amended plan that did not depend on the sale of medical marijuana as a source of income.<sup>26</sup> In denying the dismissal request, the Court focused its attention on the significant unsecured debt held by the debtor's other creditors, and deemed that dismissal would not be in the best interest of those creditors.<sup>27</sup> However, the Court did order that if the debtor failed to amend the complaint as outlined, then the debtor's case would be converted to a Chapter 7 bankruptcy case.<sup>28</sup>

Creditors should thoroughly inspect a debtor's plan to ensure that the plan is funded from an activity that is legal under both state and federal law. Additionally, creditors should consider using a similar argument any time a debtor proposes a plan that is dependent on an uncertainty (i.e., obtaining a license, winning a contract, etc.). Furthermore, creditors should be aware that courts are reluctant to dismiss a debtor's case when there are other creditors present whose interests would be best served by the debtor moving forward with its reorganization efforts.

**If you would like more information, please contact:**

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or the Burr & Forman attorney with whom you regularly work.

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<sup>25</sup> *Id.* at 86.

<sup>26</sup> 564 B.R. at 86.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*