United States Bankruptcy Court
Northern District of Illinois
Eastern Division

Transmittal Sheet for Opinions for Posting

Will this opinion be Published? No

Bankruptcy Caption: In re Lancelot Investors Fund, L.P., et al.

Bankruptcy No. **Case No. 08-28225**

Adversary Caption: Ronald L. Peterson, as Chapter 7 Trustee for Lancelot Investors Fund L.P., et al v. Brightwater Club Property Owners Association

Adversary No. : 11-00646

Date of Issuance: April 15, 2011

Judge: Judge Jacqueline P. Cox

Appearance of Counsel:

Attorney for Plaintiff: Oliver J. Larson

Attorneys for Defendant: Eliot G. Schencker, Hal Kyles

Trustee: Ronald L. Peterson

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	
	)	
LANCELOT INVESTORS FUND, L.P., *et al.*,	)	Chapter 7
	)	
Debtors.	)	Case No. 08-28225
	)	
	)	
RONALD L. PETERSON, as Chapter 7 Trustee for Lancelot Investors Fund, L.P., *et al.*,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adv. No. 11-00646
	)	
BRIGHTWATER CLUB PROPERTY OWNERS ASSOCIATION,	)	Honorable Jacqueline P. Cox
	)	
Defendant.	)	

ORDER ON MOTION OF TRUSTEE FOR A PRELIMINARY INJUNCTION
(Dkt. No. 4)

Trustee Ronald L. Peterson seeks a Preliminary Injunction herein pursuant to 11 U.S.C. §§ 362 and 105 of the Bankruptcy Code. He asks the court to enjoin the Brightwater Club Property Owners Association ("Brightwater") from pursuing its foreclosure rights under Colorado law as to property owned by Clearwater Development, Inc. ("CDI"). For the reasons set forth herein, the court finds that the imposition of a preliminary injunction is not warranted.

Debtor, KD 8, LLC ("KD 8"), is a co-lender on a $46,000,000 loan (the "Loan") made to CDI to develop a golf resort/community in Eagle County, Colorado. KD 8's economic percentage of the Loan is approximately forty-three percent. The agent for the lending group is

Kennedy Funding, Inc. ("KFI").

The Trustee argues that certain Colorado lawsuits ("Colorado Actions") which seek foreclosure of Brightwater's statutory liens are barred pursuant to the section 362(a) automatic stay of the Bankruptcy Code because, if successful, the Colorado Actions would terminate the Debtors' interest in the property. He also argues that section 105(a) of the Bankruptcy Code gives bankruptcy courts authority to stay actions in other courts beyond claims by and against the debtor, to include suits to which the debtor need not be a party but which may affect the amount of property of the bankrupt estate, or the allocation of property among creditors. *In re IFC Credit Corp.*, 422 B.R. 659, 662 (Bankr. N.D. Ill. 2010) (citing *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir. 1998)).

Brightwater is a homeowners association representing the purchasers of houses and other interests in an unfinished golf/resort community (the "Property"). The developer is delinquent in its payment of association fees to Brightwater for unsold or uncompleted portions of the Property. Brightwater claims that under Colorado law it is entitled to an enforceable lien for up to six months of such unpaid association fees, and that it is entitled to priority over all other liens and encumbrances, including the deed of trust securing the Loan. Brightwater has filed two actions, covering successive periods, seeking to foreclose its liens for unpaid association fees of approximately $232,000.

I. Jurisdiction

The court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157 and 1334(a). Under 28 U.S.C. § 1334(a), the federal district courts have "original and exclusive jurisdiction" of all cases under the Bankruptcy Code. However, the district courts may refer

bankruptcy cases to the bankruptcy judges for their districts under 28 U.S.C. § 157(a). The District Court for the Northern District of Illinois has made such a reference through its Internal Operating Procedure 15(a). When presiding over a referred case, the bankruptcy judge has jurisdiction under 28 U.S.C. § 157(b)(1) to enter appropriate orders and judgments as to core proceedings in the case. Actions seeking to enjoin state court actions are core proceedings. *In re Johns-Manville Corp.*, 801 F.2d 60, 64 (2nd Cir. 1986); *In re Lion Capital Group*, 46 B.R. 850, 854-55 (Bankr. S.D.N.Y. 1985).

II. Authority to Enjoin Lawsuits Against Nondebtors

Under section 362(a) of the Bankruptcy Code, the filing of a petition operates as a stay of the commencement or continuation of proceedings against the debtor to recover on prepetition claims. 11 U.S.C. § 362(a). This provision protects assets of the debtor's estate but it does not stay actions against nondebtors. Section 105(a) of the Bankruptcy Code provides that the bankruptcy court "may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a).

Courts have applied general preliminary injunction standards to determine whether to stay actions against nondebtors. They have concluded that such equitable relief is appropriate only in "unusual circumstances." *McCartney v. Integra Nat'l. Bank North*, 106 F.3d 506, 510 (3d Cir. 1997).

A section 105(a) injunction restraining creditors from proceeding against nondebtors is justified only if the creditors' actions would interfere with, deplete or adversely affect property of a debtor's estate or which would frustrate the statutory scheme embodied in Chapter 11 or

diminish a debtor's ability to formulate a plan of reorganization. *In re Lazurus Burman Assocs*., 161 B.R. 891, 898 (Bankr. E.D.N.Y. 1993).

Courts generally recognize the following circumstances in which the entry of a section 105(a) injunction restraining creditors from proceeding against nondebtors is appropriate:

> (1) there be the danger of imminent, irreparable harm to the estate or the debtor's ability to reorganize[1];
>
> (2) there must be a reasonable likelihood of a successful reorganization;
>
> (3) the court must balance the relative harm as between the debtor and the creditor who would be restrained;
>
> (4) the court must consider the public interest; this requires a balancing of the public interest in successful bankruptcy reorganizations with other competing societal interests.

In re Monroe Well Service, Inc., 67 B.R. 746, 751-52 (Bankr. E.D. Pa. 1986).

In *Fisher,* the Seventh Circuit held that a bankruptcy court may enjoin proceedings in other courts under the following circumstances:

> (1) such proceedings defeat or impair its jurisdiction over the case before it;
>
> (2) the moving party has established a likelihood of success on the merits; and
>
> (3) the court must consider whether the injunction will harm the public interest.

*Fishe*r, 155 F.3d at 882.

The Trustee has not satisfied these requirements by clear and convincing evidence. The court is not satisfied that the imposition of a preliminary injunction is warranted.

---

[1]The Seventh Circuit does not require the showing of irreparable injury since its 1998 ruling in *Fisher*. *Fisher*, *infra,* at 882.

III. Do the Colorado State Court Proceedings Impair or Defeat this Court's Jurisdiction?

There was considerable discussion at the March 30, 2011 hearing of the Trustee's Motion for a Preliminary Injunction of whether a foreclosure sale under Colorado law would eliminate the Debtors' interest. Neither the movant nor the opponent discussed statutes or case law on the issue.

The priority of six months of delinquent association fees does not eliminate the Debtors' interest. Their security interest could be subordinated to a limited extent, pursuant to Colorado law, to Brightwater's interest. Pursuant to Colorado law:

> (1) If, at a sale, the property is sold for an amount in excess of the written or amended bid amount executed by the holder of the evidence of debt secured by the deed of trust or other lien being foreclosed, such excess proceeds shall be first applied to any deficiency as indicated in the holder's bid, and then paid to the officer to be held in escrow until the end of all redemption periods as provided in section 38-38-302.
>
> (2) Upon the expiration of all redemption periods provided in section 38-38-302, any remaining excess proceeds shall be paid in order of recording priority to junior lienors, determined as of the recording date of the notice of election and demand or lis pendens according to the records, who have duly filed a notice of intent to redeem and whose liens have not been redeemed pursuant to section 38-38-302, in each case up to the unpaid amount of each such lienor's lien plus fees and costs. A lienor holding a lien that is not entitled to redeem by virtue of being recorded after the notice of election and demand, a lienor that has not timely filed a notice of intent to redeem pursuant to section 38-38-302, or a lienor who accepts less than a full redemption pursuant to section 38-38-302(4)(c) shall not have any claim to any portion of the excess proceeds. *After payment to all lienors and the holder entitled to receive excess proceeds pursuant to this section, any remaining excess proceeds shall be paid to the owner of the property as of the date and time of the recording of the notice of election and demand or lis pendens*. (Emphasis added).

Colorado Revised Statutes Annotated Section 38-38-111.

The limited detriment to the bankruptcy estate due to the priority of Brightwater's interest cannot be ameliorated by the imposition of a preliminary injunction. Bankruptcy courts apply federal bankruptcy law to property interests defined by state law. *Butner v. United States*, 440 U.S. 48, 55 (1979). The court cannot rule as a matter of law that Colorado law does not apply herein, as *in rem* liens generally survive bankruptcy. *See Johnson v. Home State Bank*, 501 U.S. 78 (1991).

The bankruptcy court can stay secured lenders from pursuing their state law remedies, as often happens when a secured lender sues a debtor's principals on the principals' guarantee of a debtor's obligations. *See Gander v. Harris*, 432 B.R. 781, 785 (Bankr. N.D. Ill. 2010), *aff'd,* 442 B.R. 883 (N.D. Ill. 2011).

The Debtors have not suggested a substitute remedy for Brightwater's interest. This court's jurisdiction and authority to implement bankruptcy objectives will not be impaired if Brightwater pursues its remedies under Colorado law. The Debtors' interest in foreclosure sale proceeds will not improve if the court enters a preliminary injunction. Delay for delay's sake does not have any appeal under the circumstances herein. There is no reason to stay the Colorado Actions.

VI. Rejection Issues

Brightwater suggests that the Debtors' rejection of the KFI contract means that they have no further interests to protect, that they have no need for a preliminary injunction and that the adversary proceeding should be dismissed. The Debtors' contract rights survive rejection. They may be liable for damages for breach, however, rejection does not amount to a renunciation of all of their rights under the agreement with KFI. *In re Schnabel*, 612 F.2d 315, 317 (7th Cir.

1980).

VII. Reasonable Likelihood of Successful Reorganization

There is no reasonable likelihood of a successful reorganization. This is not a reorganization case. The Debtors seek only to liquidate their assets and to ratably distribute the proceeds of their assets to their creditors.

VIII. Will the Imposition of a Preliminary Injunction Impair the Public Interest?

The public interest will not be served by restraining Brightwater. The public interest lies in promoting a successful reorganization. *In re Integrated Health Services, Inc.*, 281 B.R. 231, 239 (Bankr. D. Del. 2002).

Again, the Debtors have sought bankruptcy relief under Chapter 7, a liquidation proceeding, not under Chapter 11, the reorganization alternative. Colorado has to be allowed to complete the foreclosure effort and hopefully restore the property to economic viability by having a solvent entity take possession of it and complete the project.

While the Seventh Circuit does not require a finding of irreparable injury to justify the imposition of a stay of other actions, it is appropriate to note that the balance of relative harm as between the Debtors and Brightwater weighs in favor of Brightwater. The Debtors have rejected its executory contract with Kennedy Funding, Inc., the entity which holds the security interest. It would be unfair to Brightwater to harm it by restraining its enforcement efforts for an indeterminate period of time while the Debtors liquidate their assets. The court notes that the Trustee has not asked to restrain Brightwater for a limited period of time.

The Trustee's Motion for a Preliminary Injunction is DENIED.

Dated: April 15, 2011 **ENTERED:**

____

Jacqueline P. Cox
United States Bankruptcy Judge