

Construction Defect Defendants Using ABCs to Minimize Payments

Jeffrey S. Berlowitz and Jordan G. Weinkle, Daily Business Review

Community associations that pursue construction defect lawsuits against developers, contractors and design professionals have had to contend with bankruptcy filings by the defendants in these cases for decades.

However, in recent years, we have begun to see some of the defendants in these actions avoid liability by choosing to file an assignment for the benefit of creditors, or ABCs, rather than bankruptcy.

Today, corporate Chapter 7 bankruptcies have fallen out of favor with bankruptcy attorneys. For many Florida companies, the ABC presents a significantly more attractive option when they can no longer meet their obligations to lenders and other creditors.

Unlike federal bankruptcy proceedings, with ABCs, the assignor, or debtor, company that elects to liquidate its assets in order to repay its creditors is able to do so in a more debtor-friendly state court proceeding in which they are able to select and appoint the assignee, who then serves in the role in which trustees serve in bankruptcy cases to oversee the liquidation of the assignor's assets in order to pay secured creditors and unsecured creditors.

The ABC liquidation process typically takes the form of a private sale or auction in which creditors and parties of interest are notified of the sale and have the opportunity to present higher and better offers for the assets. Ultimately, the sale of the assignor's assets must be approved by the state court.

While there is no "automatic stay" on pending litigation imposed upon the filing of an ABC, unlike a bankruptcy stay which is immediately in effect upon the filing of a bankruptcy petition, creditors of the assignor are essentially stayed from continuing their pursuit of claims because

the comprehensive liquidation of the debtor's assets makes it virtually impossible to collect on a judgment.

Fresh Start

The most notable benefit of an ABC to the assignor company is the opportunity that the assignor's principals have to buy back their assets under a newly formed entity, should that newly formed entity offer the highest and best bid for the assets.

With ABCs, the assignors can and often do negotiate the buy-back of their business assets via the liquidation or auction process through a separate entity, enabling them to stay in business with little interruption or disruptions whatsoever while diminishing their debts to pennies on the dollar.

While this appears far-fetched at first glance, the ABC process is governed by Florida Statute Chapter 727 and under the watchful eye of the presiding state court judge. The proceeding is entirely legal despite the fact that disgruntled creditors may find it offensive to allow an assignor's principals to purchase their own assets back via a new entity formed for that very purpose.

With real estate development in South Florida now in full swing once again after years of tough times following the collapse of the housing market, some companies in the construction industry are looking for a fresh start, and the filing of an ABC can often provide that fresh start.

Counsel Required

As a result, we are now starting to see cases in which condominium associations and homeowner associations that either have pending construction defect litigation or have filed a notice of claim against developers, general contractors, subcontractors or other firms are being notified that their payouts will be determined via ABC actions in state court.

The ability to assess the strength of an association's construction defect claim against a debtor company filing an ABC requires a unique blend of bankruptcy law and community association law knowledge.

The analysis of the association's construction defect claim against the debtor would not only take into account the merit and magnitude of the underlying claim itself but also the strength of the claim as it relates to the ABC.

The association counsel, together with experienced bankruptcy counsel, should review the number of secured and unsecured creditors of the debtor, its assets and liabilities, the priority that the association's claim would take compared to the other claims, the amount that the association might recover through the post-liquidation payouts to creditors, and the practical nuances of an ABC in general.

Depending on how far along in the defect litigation the association may be when the ABC is filed, it is also important to consider whether the assignee will have adequate documentation regarding the association's claim in order to effectively determine how much of the claim, if any, will be allowed.

They will typically consider all of the engineering reports and evidence of the defects, but they will also take into account the practical considerations of the total sum that the sale of the assets will generate and the sums that are due to other creditors.

An association may seek to resolve its claim with the assignee who has been engaged to liquidate the assets and make distributions on allowed creditor claims by reaching a settlement with them for an allowed unsecured claim in the ABC, staving off unnecessary attorney fees to prove the construction defect claim.

It is likely that community association attorneys will find themselves out of their depth in pursuing construction defect claims against entities that have filed ABCs and in any ensuing negotiations with the assignees to maximize the award for the association. Experienced bankruptcy counsel will help to maximize the gains from claims.

Jeffrey S. Berlowitz is a partner with Siegfried, Rivera, Hyman, Lerner, De La Torre, Mars & Sobel in Coral Gables. He has focused on bankruptcy law since 1992 and regularly represents community associations dealing with unit owners who file for bankruptcy. Jordan G. Weinkle is an associate with the firm who focuses on community association law and construction defect litigation. They may be reached at jberlowitz@srhl-law.com and jweinkle@srhl-law.com.

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