

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA**

In re:

Foxwood Hills Property Owners Association, Inc.

Debtor

Case No. 20-02092-hb
Chapter 11

RESPONSE OF UNITED STATES TRUSTEE TO ORDER REGARDING § 1102

The Acting United States Trustee for Region Four (the “UST”) files this response to address the Court’s inquiry set forth in the Order Regarding 11 U.S.C. §1102 entered on April 8, 2021 (the “Order”). *See* ECF Doc. No. 244. In the Order, the Court solicited views from parties in interest as to whether it should enter an order pursuant to 11 U.S.C. § 1102(a)(2) directing the UST to appoint one or more committees of parties deemed “Equity Interests: Membership Interests” to assure adequate representation of such parties in this bankruptcy proceeding. This response is filed pursuant to 28 U.S.C. § 586 and 11 U.S.C. § 307¹. In support of his response, the UST states as follows:

BACKGROUND

1. Foxwood Hills Property Owners Association, Inc. (the “Debtor”) filed for relief under chapter 11 of the Bankruptcy Code on May 8, 2020. *See* ECF Doc. No. 1.

2. The Debtor is a nonprofit corporation that filed as a small business debtor. *Id.*

As such, no committee of unsecured creditors was appointed.

¹ All further references to the United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*, will be by section number only.

3. The Debtor is a property owners association (“POA”) for a community comprised of approximately 4,100 lots owned by approximately 3,300 owners of record. *See* Disclosure Statement, ECF Doc. No. 189, at Art. II.B. The community has more than 20 different sections of property comprising the Foxhill community. *Id.*, Art. II.A.

4. In developing different sections of the community, the developer filed different covenants and restrictions as part of the real property records. *Id.*, Art. II.B. The developer also conveyed deeds that had differing amounts in assessments payable to the Debtor. *Id.* Accordingly, for many years the Debtor was inconsistent in enforcing restrictions and assessing dues. *Id.*

5. In October of 2017, one of the homeowners filed a civil action against the Debtor seeking a declaratory action to determine what she owed in annual assessments and that she was not a member of the Debtor (the “Civil Action”). *Id.*, Art. II.B.4.

6. After incurring over \$300,000.00 in legal fees in the Civil Action and after a second action in a non-bankruptcy forum by a second homeowner, the Debtor elected to file for relief under chapter 11 for the main purpose of commencing a single adversary proceeding in which it sued all the homeowners (Adv. Pro. No. 20-80049, the “Adversary Proceeding”). *See, id.*, Art. III.A. The Adversary Proceeding seeks a declaratory judgment that (a) all homeowners are members of the Debtor with equal voting rights, and (b) all homeowners pay budget-based dues and assessments to POA under the 2011 Bylaws. *Id.*

7. The Bankruptcy Court has entered default judgments against approximately 97% of the total number of homeowners, and judgment has been entered that they are members of the Debtor and will pay budget-based dues and assessments to the Debtor. *Id.*

8. On March 4, 2021, the Debtor filed a plan of reorganization (the “Plan”) and accompanying disclosure statement (the “Disclosure Statement”). *See* ECF Doc. Nos. 188 and 189. The Debtor proposes to pay all of its creditors 100% of their claims. The Plan classifies the homeowners in separate “impaired” classes depending on the sections of the neighborhood to which they belong. *See* Plan at Art. 3.12 – 3.17. The Debtor, however, does not propose to pay the homeowners any monies; rather, it seeks to make some changes to the by-laws and clarify the Board’s interpretations and enforcement of the restrictions. *Id.*

9. Upon information and belief and based on statements that Debtor’s counsel made at the hearing on the approval of the Disclosure Statement, the Debtor intends to amend the Plan to delete the bylaw provisions, thus making the classification of the homeowners into different classes in the Plan obsolete.

10. The Court continued the Disclosure Statement hearing until May 4, 2021, and subsequently issued the Order, to which the UST responds as set forth herein.

11. To date, some homeowners have filed responses to the Order supporting the appointment of a committee. *See* ECF Doc. Nos. 254 and 255. On April 15, 2021, the Debtor also filed a response to the Order opposing the appointment of any such committee. *See* ECF Doc Nos. 256.

ARGUMENT

This case presents unique facts in that the Debtor is able to pay its creditors in full, and the main intent for the bankruptcy filing was not to reorganize the POA’s balance sheet *per se*. The Plan currently on file proposes to pay creditors 100% of their claims, and, as the Debtor itself acknowledged, the POA filed this Chapter 11 case “for the primary purpose of addressing issues relating to restrictions in certain deeds and recorded real property filings, some of which

have not been followed or enforced for decades.” *See* Disclosure Statement, Art. II.A., p. 2. Against this backdrop, the Court’s determination of whether to appoint additional committees pursuant to section 1102(a)(2) is based on a high standard for which no proof has been advanced by the homeowners or any other party in interest. Moreover, the Bankruptcy Code only provides for the appointment of additional committees of creditors or equity holders. Because it is currently unclear as to whether the homeowners are creditors or equity holders, they bear the burden of establishing this threshold issue prior to the Court’s consideration of any request for an additional committee in this case.

Section 1102(a) of the Bankruptcy Code governs the formation, appointment, and modification of official committees and equity security holders. It provides under what circumstances the Court and the UST may act and under what standards. More specifically, section 1102(a)(2) states that “[o]n request of a party in interest, the court may order the appointment of *additional* committees of creditors or of equity security holders if necessary to assure adequate representation of creditor or of equity security holders.” § 1102(a)(2) (emphasis added). Courts have unanimously agreed that the appointment of additional committees of creditors or equity holders is an “extraordinary remedy” that courts are generally reluctant to grant. *See In re Residential Capital, LLC*, 480 B.R. 550, 557 (Bankr. S.D.N.Y. 2012); *In re Spansion, Inc.*, 421 B.R. 151, 156 (Bankr. D. Del. 2009) (“The court’s appointment of an additional committee is considered ‘extraordinary relief’ and should be ‘the rare exception’”); *In re Winn-Dixie Stores, Inc.*, 326 B.R. 853, 857 (Bankr. M.D. Fla. 2005) (*citing In re Enron Corp.*, 279 B.R. 671, 685 (Bankr. S.D.N.Y. 2002)) (same).

Section 1102(a)(2), under which the Court is considering the appointment of a committee, applies to “additional committees” only. Here, given that the Debtor filed as a small

business debtor, a committee of unsecured creditors was not appointed. Given the pool of unsecured creditors and their payment in full within a reasonable time period under the proposed Plan, it is arguable as to whether “cause” exist for the appointment of a committee of unsecured creditors here.² Moreover, because there is no committee of creditors, it is not clear whether it is appropriate for the Court to appoint an “additional” committee of equity holders in this case.³

Section 1102(a)(2) expressly provides that “upon request of a party in interest” the court may order the appointment of additional committees if such appointment is necessary to assure adequate representation of creditors or equity security holders. At present, although certain homeowners have filed statements indicating that they would support such a request, no party in interest has formally made such a request or provided evidence or information as to why such an appointment would be necessary to assure adequate representation of a class or group of creditors or equity security holders. Courts have found that the party seeking appointment of an additional committee has a high burden to meet. *Enron*, 279 B.R. at 685; *In re SunEdison, Inc.*,

² The UST acknowledges and respects the Court’s authority to appoint a committee of “creditors” in small business cases “for cause”. See § 1102(a)(3). As set forth herein, however, it is not clear whether the homeowners have a “claim” against the estate. Also, for the same reasons set forth in this response, the UST is concerned that the appointment of a committee or multiple committees of homeowners in this case may not be warranted and may not ultimately accomplish the desired result.

³ For purposes of full disclosure, the UST acknowledges the holding in *In re Yahweh Center, Inc.*, 2016 WL 5417363 (Bankr. E.D. N.C. 2016), where a group of former employees sought the appointment of a special committee to represent their collective interests. In that case, due to the lack of interest, no general committee of unsecured trade creditors existed that could otherwise adequately represent the wage claimants’ interest. Ultimately the Court ordered the appointment of a special committee with limited powers to represent the non-insider wage claimants. The *Yahmew Center* case, however, is distinguishable on multiple factors. First, the case is out of North Carolina, where the UST has no role. Second, the movants were clearly creditors of the estate with prepetition claims. Third, the Court expressly found that the movants had successfully demonstrated a common interest and a willingness to work together; accordingly, the Court concluded that a committee would function “effectively” and “in an efficient manner.”

556 B.R. 94, 103 (Bankr. S.D.N.Y. 2016) (“The proponents must demonstrate that appointment of an official committee is ‘necessary’ to adequately represent equity’s interest, ‘a high standard that is far more onerous than if the statute merely provided that a committee be useful or appropriate.’”); *In re Residential Capital*, 480 B.R. at 558 (“Despite having discretion to direct the appointment of additional official committees, courts are hesitant to grant such relief, and the requirements that the moving party show that such a committee is ‘necessary to assure adequate representation’ has been described as ranging from a ‘high standard’ to requiring a showing that an additional committee is ‘absolutely necessary’, ‘essential,’ or ‘indispensable.’”).

Because section 1102 deals with committees of “creditors” or “equity security holders”, any such members/homeowners requesting or to be considered for such committee would have to prove that they fit within such definitions, as there is no authority in the Bankruptcy Code for the appointment of a committee of entities or individuals who do not fit those categories. *See* §§ 101(10) and (17). Here, despite being listed in Schedule F as having “property owner rights in the Foxwood Hills Community” in an “unknown amount” (see ECF Doc. No. 17, Schedule F), it is not clear whether the homeowners have a “claim” as such term is defined in section 101(5) or whether they fit the definition of “equity security holder”. The POA is a nonprofit corporation with members, but it is unclear as to whether the homeowners as members of the POA are “equity security holders” as such term is defined in section 101(16).

Even if the homeowners were deemed to be creditors or shareholders, in determining whether to appoint an additional committee, courts usually consider whether the appointment is necessary to assure the movants are adequately represented and, if so, then the Court must decide whether it should use its discretion and order such appointment. *See In re Residential Capital*, 480 B.R. at 557; *In re Spansion, Inc.*, 421 B.R. at 156. Although there are no enumerated factors

set forth in the Bankruptcy Code to consider “adequate representation”, courts often apply the following factors: (1) the ability of the exiting committee to function; (2) the nature of the case; (3) the standing and desires of the various constituencies; (4) the ability of creditors to participate in a case without an additional committee; (5) the delay and additional cost that would result if the court grants the motion; (6) the tasks which a separate committee is to perform; and (7) other factors relevant to the adequate representation issue. *See In re Residential Capital*, 480 B.R. at 558; *see also In re Winn-Dixie Stores, Inc.*, 326 B.R. at 857 (setting forth similar factors to consider); *In re Spansion, Inc.*, 421 B.R. at 156 (“if equity holders have no reasonable prospect of receiving a meaningful distribution, an equity committee could serve no legitimate role in negotiating a plan.”); *In re Sunedison, Inc.*, 556 B.R. at 102 (considering various factors as well as the timing of the motion relative to the status of the chapter 11 cases).

When taking the factors set forth above into consideration, it is arguable whether the homeowners could satisfy their burden that bankruptcy courts have established for the appointment of additional committees. Even if the homeowners were claimants or equity holders as such terms are defined in section 101, there is no guarantee that any appointed committee would provide a benefit which would outweigh the costs associated with the formation of such committee. *See In re Sunedison*, 556 B.R. at 102 (“The cost concerns center on the fact that the appointment of an Equity Committee is ‘closely followed by applications to retain attorneys and accountants.’”).

The UST acknowledges that while the case is a small business debtor case, the issues that have been presented are complicated. But the complexity for the most part appears to be due to (a) the homeowners’ inability to agree on the restrictions that apply to their specific property section and the community as well as the applicability of the bylaws and the assessment of fees

and dues, and (b) ongoing disputes between the Board and some of the homeowners regarding the enforcement and implementation of the restrictions and assessments and collection of fees and dues. This is not the typical case for an equity committee where the dispute is over the likelihood that equity will receive a meaningful distribution in this case. The homeowners in this case are not receiving – nor do they expect to receive – any funds. Their disagreement seems to relate to corporate governance issues and state law concerns regarding the implementation and enforcement of restrictions and any amendments to the bylaws.

If the plan were amended to only address payments to creditors, as the Debtor has indicated, there would appear to be no need for a committee as the plan currently provides for distributions of 100% of the claims. Any committee would only be for the purpose of representing the interests of the homeowners and facilitating communications or resolution of governance disputes outside of the plan. Furthermore, it does not appear that the homeowners have been deprived of their voice in this case. They have been given ample opportunity to be heard and to participate in the bankruptcy case and have done so as reflected by several objections that were filed to the disclosure statement as well as some of their involvement in the Adversary Proceeding.

The UST shares the Court's sentiments and wishes in finding a path toward an amicable resolution in this case. While the UST is ready to fulfill his duties as the Court may determine, for the reasons set forth above, the UST believes that the homeowners bear the burden to prove the standards of section 1102(a)(2) as set forth above; which, to date, they have not. To the extent that they cannot bear the burden to meet the standards, nothing would prevent the

homeowners to form an informal committee⁴ or for the Debtor and/or homeowners to agree to voluntary mediation.

WHEREFORE, the UST requests that the Court decline from entering an order directing the UST to form one or more committees of parties deemed “equity interests: membership interests” unless and until the homeowners meet their burden under section 1102(a)(2).

Respectfully submitted,

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April 16, 2021

⁴ It is not clear, however, whether any of their professional fees could be reimbursed pursuant to § 503(b) unless they are deemed to be creditors or equity security holders.

CERTIFICATE OF SERVICE

I, Linda Barr, do hereby certify that on April 16, 2021, I served the below-named documents upon the parties listed below by First-Class United States Mail, postage prepaid, with return address clearly shown, as designated below.

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The Debtor has agreed to post the UST's response on the American Legal Claims Services, LLC's website.

by electronic transmission through the Court's Electronic Case Filing system to the following participants:

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