

**United States Bankruptcy Court
Northern District of Illinois
Eastern Division**

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Bankruptcy Caption: In re J.S. II, L.L.C., et al

Bankruptcy No. 07 B 3856

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Judge: Hon. Jacqueline P. Cox

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**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:)	Chapter 11
)	
J.S. II, L.L.C., et al)	Case No. 07 B 3856
)	
Debtor.)	Judge Jacqueline P. Cox

**ORDER ON MOTION TO APPROVE RECONSIDERATION OF
INTERLOCUTORY ORAL RULING REGARDING THE NEED
FOR CONSENT OF THOMAS A. SNITZER TO SALE, ETC.**

Debtors J.S. II, L.L.C. (“J.S. II”), River Village I, L.L.C. (“River Village”), River Village West, L.L.C. (“River Village West”) and KND Investments (“KND”) filed for protection under Chapter 11 of the Bankruptcy Code (“Code”) on March 1, 2007. On March 8, 2007 an order was entered allowing the Debtors’ estates to be jointly administered pursuant to Federal Rule of Bankruptcy Procedure 1015(b), which allows joint administration of the estates of 2 or more related Debtors.

The Debtors were organized to acquire, develop, finance and sell industrial and residential real estate located on the near south side of Chicago, Illinois (“Chicago”). Their main venture is Bridgeport Village, a development of 115 homes along the south branch of the Chicago River. The Debtors own 3 industrial properties in the area which they lease to various lessees. They also have an option to purchase additional real estate on the near south side of Chicago.

Debtor J.S. II was formed in 1997; it owns the Bridgeport Village real estate. It is a manager-managed Illinois limited liability company; its members are John J. Kinsella, Sid Diamond and Thomas Snitzer.

Debtor River Village I was formed in 1998; it serves as the project’s development agent. It is a manager-managed Illinois limited liability company; its members are Kinsella Investments, L.P. (Kinsella L.P.”), Diamond Family Partnership, L.L.C. (“Diamond L.L.C.”), Thomas Snitzer and the

Snitzer Family L.L.C. (“S.F.L.L.C.”) (collectively “the Snitzer Parties”). In exchange for Thomas Snitzer’s agreement to serve as manager of River Village I and the Bridgeport Village Project, Kinsella L.P. and Diamond L.L.C. agreed to give the Snitzer Parties a membership interest in River Village I. Thomas Snitzer acted as River Village I’s manager until he was enjoined from interfering with the management and control of the Project in a June, 2005 state court order.

Debtor River Village West was formed in 2001; its purpose includes acting as the rental agent for the Bridgeport Village Project. It is a manager-managed Illinois limited liability company. Its members are Kinsella L.P., Diamond L.L.C., Thomas Snitzer and S.F.L.L.C. Thomas Snitzer managed this entity until he was enjoined by the June, 2005 court order from interfering with the management and control of the Project.

Debtor KND was formed in 2005; it is a manager-managed Illinois limited liability company. It serves as lessor for space at the Debtors’ three industrial properties. J.S. II is the sole member of KND.

Debtors’ principals John Kinsella and Sid Diamond claim to have provided 100% of the Debtors’ capital in the amount of \$7.5 million. They claim that they loaned the Debtors \$920,000 and personally guaranteed up to \$14.6 million of the Debtors’ bank debt. They also claim that they have pledged \$4.7 million in personal assets as security for the Debtors’ bank debt. As provided by the Project’s agreements, Thomas Snitzer and S.F.L.L.C. have contributed no capital to any of the Debtors, have not signed any personal guaranties and have not pledged any personal assets as security for the Debtors’ obligations.

In 2003 a subcontractor complained about safety issues. Thomas Snitzer assured Kinsella and Diamond that he had investigated the concerns and found that there were no problems. Between May 2002 and November 2004 the City of Chicago (the “City”) issued 78 Stop Work Orders, most for work performed contrary to what was allowed by permits issued by the City. The City discovered numerous building code violations, including the following: many homes were missing a required

means of egress from the third floor; garage rooftop decks had been constructed without permits or verification that they were structurally adequate and neither Thomas Snitzer nor the Project's construction manager had obtained a general contractor's license or bond.

The City shut down the Project in November 2004 for the various permit and building code violations. Allegedly, City officials lifted the Stop Work Orders after Thomas Snitzer promised to address the City's concerns. Allegedly, Snitzer later refused to meet with City officials and never told Kinsella and Diamond about the shutdown. In January 2005, the City shut down construction at the site a second time. As a result the Project's initial lender, Bank of America, declared the Project's loan in default. It is alleged that Thomas Snitzer did not inform Kinsella and Diamond of this situation and that they learned of it from press reports.

Kinsella and Diamond discovered that many homes had safety violations; that unpaid subcontractors filed mechanics liens on portions of the Project; that obligations totaling \$2 million were not reflected on the books; that various lawsuits were filed against the Debtors; that rental revenues were transferred out of certain accounts and that premiums had not been paid on the Project's liability insurance policy. In addition, many homeowners complained that Thomas Snitzer failed to complete construction "punch list items", an industry term for defects discovered after a homeowner takes possession.

Diamond and Kinsella succeeded in having the City forego suing any of the Debtors in Housing Court. Thomas Snitzer responded to their intervention by suing them in a state court Chancery action seeking to enjoin their interference with his management of the Project. Kinsella and Diamond filed a multi-count counterclaim against the Snitzer Parties:

- Counts I, III and IV: Counts I, III and IV of the Counterclaim seek the statutory expulsions of the Snitzer Parties from the Debtors pursuant to Section 35-45 of the Illinois Limited Liability Company Act on the basis of their wrongful conduct, breach of the operating agreement and material breach of duty.
- Count II: Count II of the Counterclaim seeks declaratory relief with respect to the

2004 Memorandum of Understanding that granted Snitzer a membership interest in J.S. II.

- Count V: Count V of the Counterclaim alleges that Snitzer breached the Project entities' operating agreements by failing to provide access to financial documents, by making major decisions without seeking approval of the other members, by failing to exercise ordinary prudence in discharging his duties as manager and by failing to discharge his duties as manager in good-faith.
- Count VI: Count VI of the Counterclaim alleges that Snitzer breached the 2004 Memorandum of Understanding by failing to provide required financial documents, by failing to act in good faith with respect thereto and by failing to make distributions for tax years 2003 and 2004 to allow the members to pay their taxes.
- County VII: Count VII of the Counterclaim alleges that Snitzer breached his fiduciary duties to the Project entities by engaging in grossly negligent, reckless, or intentional conduct, failing to exercise ordinary prudence in discharging his duties as manager of the Project entities, failing to discharge his duties as manager in good faith, failing to manage the Project entities in accordance with applicable laws and refusing to meet with the other members of the Project entities to allow the business of the Project to be conducted as required by the operating agreement.

The above facts are from the Verified Statement of John J. Kinsella in Support of the Debtors' Chapter 11 Petitions and Initial Motions and Applications, page 10 (07 B 03856: Doc. 67, Exhibit 1).

The state court enjoined the Snitzer Parties from interfering with the management and control of the Project and from acting as the manager of River Village I, River Village West and J.S. II. Diamond and Kinsella were given authority by that court to act on behalf of the Debtors to obtain financing, to act to resolve the Project's safety, building code and punch list issues and to complete construction and sale of the homes then underway.

In River Village West, L.L.C. v. Peoples Gas Light & Coke Co. (04 cv 3392) filed on May 13, 2004 in the District Court for the Northern District of Illinois, Thomas Snitzer attempted to block settlement of environmental litigation between the Debtors and Peoples Gas. Thomas Snitzer wanted to place the Pitney Option (obtained as part of the settlement) into an entity controlled solely

by him. An emergency motion was filed in state court seeking authority to settle the matter, and to place the option in J.S. II, the entity that commenced the litigation. The state court ruled in Kinsella and Diamond's favor.

Later litigation with Peoples Gas resulted in the state court finding:

“Mr. Snitzer had an equal vote with Kinsella and Diamond in terms of litigation matters concerning Peoples and Dial, which has gone by the wayside. He chose not to do so. He chose to take his own action by filing lawsuits without the knowledge of Kinsella and Diamond, without the knowledge of the lawyer hired to negotiate with Peoples. And these lawsuits, in my opinion, had a bearing on the ability of the venture to negotiate and finalize a settlement with Peoples. As such, it is my opinion that Mr. Snitzer violated his fiduciary duties.”

See Transcript of Proceedings, January 10, 2007, Snitzer vs. Kinsella Investments LP, at 8:2 - 8:13 (Doc. 67, Exhibit 1 Page 13).

Thomas Snitzer then filed Snitzer v. Degnan (07 cv 339), a civil rights case, in the District Court for the Northern District of Illinois against Eleventh Ward leaders Timothy Degnan and Thomas Dipiazza, as well as the Commissioner of the Department of Buildings Stan-Lee Kaderbek and the City of Chicago. It alleges that 11th Ward leaders demanded special favors, a share of the profits, and illegal kickbacks from the Bridgeport Village project. Snitzer further alleges that after he rejected demands of the Eleventh Ward leaders, the City shut the project down for building code violations and engaged in a campaign to keep the project frozen despite the minor nature of the alleged violations. That case remains pending.

The Sale Motion

The Debtors have sought leave of court to sell certain of its real estate, the properties located at 3333 South Iron Street, Chicago, Illinois and 1500 West 33rd Street, Chicago, Illinois. (Docket Entry 313). Interested Parties Thomas A. Snitzer and Snitzer Family, L.L.C. object to the sale on several grounds. The main objection is that since the inception of the bankruptcy the Debtors intended to sell their commercial properties subject to residential zoning which would

maximize their value to the estate. The motion to sell, however, seeks to conduct an as-is, as-zoned sale of the property at \$12.24 per square foot for a total of \$10.5 million. Since residential prices in Bridgeport have risen dramatically since the Debtors built residential properties there, the Objectors assert that if sold subject to residential re-zoning, the property could sell for \$30.00 per square foot for a total of \$24 million. The Debtors indicated in their advertisement of the auction and sale, however, that they would consider offers contingent on changes in zoning. Auction Mart, CHI. TRIB., Nov. 28, 2007, § 3, at 4.

In Chicago there is a practice of aldermanic privilege in which the alderman has the sole prerogative of allowing a zoning change. The City Council votes on these matters, but the City Council defers to the position of the alderman of the ward in which the real estate is located. (Docket Entry 319, Ex. 1, Balcer Tr. P. 24-25).

It is alleged that Eleventh Ward Alderman James A. Balcer has in the past refused to allow the real estate involved herein to be re-zoned for residential use. (Docket Entry 319, Ex. 1, Balcer Tr. At 17-21, 104-11). However, when deposed, the alderman indicated that he was open to having the property re-zoned. (Docket Entry 319, Ex. 1, Balcer Tr. Pp. 105). He explained that he wanted other parcels in the area to be developed first. (Docket Entry 319, Ex. 1, Balcer Tr. P. 103). According to the Objectors his willingness to approve a re-zoning to residential means that the proposed as-is sale would not maximize the value of the real estate for all creditors.

At one point the court was informed that the Debtors were told that the lawsuit pending in the district court imperiled their re-zoning effort. This was denied; the court was told that the alderman was not unresponsive and would be happy to look at their development plan. At his deposition, the alderman denied that the lawsuit played any role in his willingness to consider a zoning change for the property. (Docket Entry 319, Ex. 1, Balcer Tr. Pp. 30 & 109). He also said that he has not tried to hold the debtors' properties for another developer. (Docket Entry 319, Ex. 1, Balcer Tr.P. 112). He did say that he felt wronged by the lawsuit's allegations that he

was to get three homes at reduced prices. (Docket Entry 319, Ex. 1, Balcer Tr. P. 43). Alderman Balcer's attorney interjected that no plans were ever presented to him. (Docket Entry 319, Ex. 1, Balcer Tr. P. 136).

The Objectors also question whether the Debtors possess sufficient authority to propose a sale without the consent of either Thomas A. Snitzer or the Snitzer Family, L.L.C. The Court asked the parties to brief the issue of Snitzer's consent.

On November 13, 2007 the Court ruled that Thomas A. Snitzer's consent was required for the sale, based on the June 23, 2005 order in the state court Chancery matter and paragraph 1.053 of the Operating Agreement. Reconsideration is requested based on the provisions of the Memorandum of Understanding (MOU). The Debtors assert that under it, Snitzer lacks voting rights under the Operating Agreement.

Memorandum of Understanding

The MOU admits Snitzer as a 50% member of J.S. II, L.L.C. but reserved to the future memorializing in writing their respective rights and responsibilities as members of J.S. II, L.L.C. (MOU at ¶ 6 on page 2).

Regarding the state court Chancery litigation, Judge Nowicki found as a matter of law based on the MOU, that Thomas Snitzer was a member of the J.S. II, L.L.C. State law determines the extent of a party's interest in property. Federal bankruptcy law determines how that interest will be treated. Fisher v. Apostolou, 155 F.3d 876, 880 (7th Cir. 1998). The Debtors point out that the MOU reserved to the future a precise delineation of the rights and responsibilities of the Diamond, Kinsella and Snitzer Parties. Debtors argue that this court can not unilaterally give Snitzer rights that to date have not been delineated. This court did not give Snitzer the right to consent to the sale, but ruled that Illinois law at 805 ILCS 180/15-1(c)(11) gave him that right.

Illinois Limited Liability Company Act

It provides: 805 ILCS 180/15-1(c)(11)

(c) The only matters of a member or manager-managed company's business requiring the consent of all of the members are the following:

(11) the sale, lease, exchange, or other disposal of all, or substantially all, of the company's property with or without goodwill.

Operating Agreement

The Operating Agreement at paragraph 1.053 provides for the affirmative vote of all of the members to sell, lease or otherwise dispose of all or substantially all of the assets of the Company as part of a single transaction or plan. The Debtors' position is that the sale motion does not dispose of all or substantially all of the assets of the Company and that the motion is separate and apart from a Chapter 11 plan, noting that the plan proposes that all of the Debtors' assets be liquidated, although the plan is not yet effective. The Debtors also assert that only Kinsella and Diamond are parties to the Operating Agreement because Snitzer's rights and responsibilities have yet to be delineated and because Snitzer has not undertaken a share of the project's financial responsibility.

Section 1.077 of the Operating Agreement provides that in the event of a deadlock of the vote which requires a majority interest, the majority of the individual members approving said act as opposed to the respective percentage interest of said members shall prevail. This provision allows Diamond and Kinsella as a 2-vote majority to prevail if Snitzer as a 50% member opposes an act. This provision governs matters requiring a majority vote.

According to the objecting Snitzer entities, the sale of the 2 properties herein amount to 71% of the Debtors' assets. According to the Debtors, the 2 properties herein amount to 38% of the Debtors' assets. In either instance this sale involves less than substantially all of the Debtors' assets. Therefore, the Operating Agreement and the Illinois Limited Liability Company Act do

not require Snitzer's consent to the sale herein. The other assets are the Holsum property, the remaining lots and houses of Phase I, and the Gray Option.

Request for Appointment of Trustee or Examiner

The Debtors request that the court appoint a trustee with limited power or an examiner with expanded power to conduct the sale if the prior ruling that Snitzer has to consent stands.

These requests are denied. The court does not have authority to appoint a trustee with limited authority. "There is no such entity as a limited purpose trustee under the Code." Official Comm. of Asbestos Pers. Injury Claimants v. Sealed Air Corp. 285 B.R. 148, 157 (Bankr. D. Del. 2002).

Section 1106(b) of the Code authorizes the appointment of an examiner with expanded authority, i.e., authority to do more than examine. However, there are no grounds for such. There is no evidence of mismanagement or fraud in this situation. The Snitzer objection focuses on the price differential which is outweighed by the deteriorating condition of the real estate market and the Debtors' need to pay down its DIP lending by \$5 million in January, 2008. The Debtors incurred their DIP lending obligation on June 28, 2007, long before the present dispute with Snitzer. (Docket Entry 206). A rezoning effort would take approximately 9 months; the Debtors need funds now.

The Debtors' real estate broker, Vernon Schultz, was deposed herein on November 9, 2007. He explained that the lower price per square foot resulted from the alderman's initial refusal to rezone the property, his preference for a lower density development and other factors. The alderman wanted the property on the east side developed first and said that the property herein on the west side could be considered for rezoning in the future, years later. He also indicated that the industrial nature of the surrounding parcels limited the price of the property involved in the sale motion. The Pepsi distribution facility and a metal refinishing operation are

problems. (Schultz Transcript Page 83).

The objectors say that asking the market to offer to purchase the property subject to rezoning in 20 days is unreasonable. Mr. Schultz testified that he has been marketing the property for residential use for several months, since March of 2007. (Schultz Transcript Page 73).

The Motion to Reconsider is **GRANTED**. The sale may proceed without the consent of Thomas A. Snitzer and S.F.L.L.C. The request for appointment of a Trustee is **DENIED**. The request for appointment of an examiner is **DENIED**.

Dated: November 29, 2007

ENTERED:

Jacqueline P. Cox
United States Bankruptcy Judge