

ORDERED.

Dated: September 15, 2021



Karen S. Jennemann
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION
www.fmb.uscourts.gov

In re)	
)	
Universal Towers Construction, Inc.,)	Case No. 6:20-bk-03799-KSJ
)	Chapter 11
Debtor.)	
)	

**ORDER ALLOWING
CLAIMS OF CONSTRAZZA INTERNATIONAL
CONSTRUCTION, INC. AS A CLASS 3B UNSECURED CREDITOR**

Since the Debtor, Universal Towers Construction, Inc. (the “Debtor” or “UTC”), was formed in 1998, the two shareholders, Constrazza International Construction, Inc. (“Constrazza”) and Universal Towers Investimentos E Participacoes, LTDA (“UTI”), have feuded. In 2015, UTI, who controlled the Debtor, unjustifiably reduced Constrazza’s equity interests from 35% to 3% and then directed UTC to redeem Constrazza’s shares under section 607.146(1) of the Florida Statutes.

Constrazza then sued UTC and UTI in Florida State Court for a money judgment and attorneys' fees.¹

After five years of scorched earth litigation between the fighting shareholders, on March 13, 2020, the Florida State Court issued a Final Judgment finding that UTI improperly reduced Constrazza's shares from 35% to less than 3%, restored Constrazza's rightful shares, and enforced UTC's election to redeem or purchase Constrazza's 35% share of UTC's equity interests. The Florida State Court also listed numerous improper and inequitable acts of UTI assisted by the Debtor including "a myriad of violations of the shareholder agreement, By-laws and pre-existing loan agreements."²

The Florida State Court then liquidated the value of Constrazza's 35% interest in UTC, converting its equity interest to a fixed debt. The "fair value" of Constrazza's shares "as of the day before the date on which the petition for judicial dissolution was filed" (September 3, 2015) was \$135,857.54 per share.³ Doing the math, the "fair market value" of Constrazza's 70.70 shares of UTC common stock, therefore, was liquidated into a fixed amount of \$9,605,128.40, as of September 3, 2015.⁴

The Florida State Court later issued its Supplement to Final Judgment Awarding Prejudgment Interest.⁵ The state court added \$2,067,515.41 in statutory pre-

¹ Doc. No. 132 and 143. *Constrazza Int'l Constr., Inc. v. Universal Towers Constr., Inc., et. al.*, No. 2015-CA-008342-A001OX (Fla. 9th Cir. Ct. filed Sept. 4, 2015).

² Doc. No. 132-1.

³ Doc. No. 132-1.

⁴ Doc. No. 132-1.

⁵ Doc. No. 132-2.

judgment interest, for a total award of \$11,672,643.81. (The State Court reserved ruling on Constrazza’s attorneys’ fees claim, which remains pending and unliquidated in this bankruptcy case.⁶) But the bottom line is that UTC undisputedly owes Constrazza at least \$11,672,643.81⁷ and possibly as much as \$5.5 million more for Constrazza’s legal fees.⁸ The Florida State Court orders are final and non-appealable.

Rather than pay Constrazza, UTC voluntarily filed for Chapter 11 bankruptcy on July 3, 2020.⁹ Constrazza submitted two proofs of claim in this bankruptcy case: (i) Claim No. 5 for \$11,293,431.88,¹⁰ based on the State Court Final Judgment; and (ii) Claim No. 7 for \$5.5 million, based on Constrazza’s asserted but disputed attorneys’ fees. The disputes resolved in this Chapter 11 case all revolve around permutations of the continuing feud between the divorcing shareholders—Constrazza and UTI.

The Debtor previously operated a large hotel in the Orlando tourist corridor. With the market decline caused by the recent COVID pandemic and sudden lack of guests and revenue, UTC proposed to sell the hotel in a liquidating Chapter 11 Plan (the “Plan”).¹¹ The Debtor’s marketing and sale efforts were very successful. The hotel ultimately sold for \$35.7 million,¹² with the Liquidating Trustee holding sufficient

⁶ Doc. Nos. 249 and 351.

⁷ This amount does not factor in any payments made or any interest accumulated since March 14, 2020.

⁸ This is the amount of legal fees requested in Constrazza’s Claim No. 7. Constrazza’s entitlement to these fees and the liquidation of their amount remains unresolved.

⁹ Doc. No. 1.

¹⁰ This amount reflects a May 5, 2020 payment of \$500,000 and interest. Based on Constrazza’s exhibit to its Claim, Claim No. 5 appears to include interest calculated through May 9, 2020.

¹¹ Doc. Nos. 239 and 267.

¹² Doc. No. 316.

funds to pay *all* creditors, including Constrazza, and provide a recovery to UTI, the remaining shareholder.

The Plan, confirmed on March 25, 2021,¹³ pays unsecured creditors 100% of their claims in Class 3. With Constrazza's consent, two sub-classes exist—Class 3A consists of all allowed general unsecured claims *other than* any allowed unsecured claim of Constrazza; Class 3B consists of all allowed unsecured claims of Constrazza *that are not subordinated § 510(b) Claims*. Class 3B claims will receive distributions “remaining after payment in full of all Class 3A Claims.”¹⁴ So, Constrazza agrees it should be paid *after* general unsecured creditors but before UTI receive distributions as the sole remaining shareholder.¹⁵

The only remaining issue is whether Constrazza should be paid as an unsecured creditor in full before UTI, as the remaining shareholder of the Debtor, receives any distributions, or, instead, whether Constrazza should receive payments in the equity class *pari passu* with UTI as a shareholder.¹⁶ Constrazza assumedly will receive a substantially greater return as an unsecured creditor than to split the remaining sales proceed with UTI on a 35%/65% basis. Given all other creditors will receive payment in full, only UTI benefits by subordinating Constrazza's claims to Class 4.

¹³ Doc. No. 315.

¹⁴ Doc. No. 315.

¹⁵ The issue is framed in the Debtor's Memorandum in Support of Subordination of Certain Claims of Constrazza (Doc. No. 246) and various responses and replies. Doc. Nos. 262, 285, 288, 382, 403, and 405. A hearing was held on June 25, 2021, and this written order supplements a preliminary oral ruling made on July 14, 2021.

¹⁶ This Order only addresses the distribution and priority issues between Constrazza and UTI raised in this main bankruptcy case under § 510(b) of the Bankruptcy Code. A different subordination issue under § 510(c) alternatively is decided in a separate Memorandum Opinion and Final Judgment simultaneously entered in related Adversary Proceeding No. 6:20-ap-00115-KSJ.

Constrazza's Claims Are Not Subject to Subordination Under § 510(b)

UTC seeks to subordinate both of Constrazza's claims under § 510(b) of the Bankruptcy Code because the claims are damages "arising from" Constrazza's stock purchase.¹⁷ Constrazza counters that its claims should not be subordinated because UTC does not have standing to raise this issue.¹⁸ Constrazza also argues that its claims should not be subordinated because Constrazza held debt (not equity) when the Florida State Court liquidated the monetary value of Constrazza's equity. Constrazza then held only a fixed right to payment but no longer had any potential upside as a shareholder.

Section 510(b) of the Bankruptcy Code¹⁹ addresses mandatory subordination:

[A] claim arising from rescission of a purchase or sale of a security of the debtor . . . [or] for damages arising from the purchase or sale of such a security . . . shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security.²⁰

"The purpose of § 510(b) is to prevent shareholders, who assume the risk of a business' failure by investing in securities rather than debt instruments, from filing claims as creditors when the debtor does fail."²¹ "The statute was designed to prevent stockholders from reaping the benefit of unlimited profits without also fully accepting the inherent risks of ownership, namely loss of their investment."²² Section 510(b)

¹⁷ Doc. Nos. 246, 285, 382, and 403.

¹⁸ Doc. Nos. 262, 288, and 405.

¹⁹ All references to the Bankruptcy Code refer to 11 U.S.C. § 101 *et seq.*

²⁰ 11 U.S.C. § 510(b).

²¹ *Official Comm. of Unsecured Creditors v. Am. Cap. Fin. Servs. (In re Mobile Tool Int'l, Inc.)*, 306 B.R. 778, 782 (Bankr. D. Del. 2004) (citing *Baroda Hill Invs., Ltd. v. Telegroup, Inc.*, 281 F.3d 133, 141 (3d Cir. 2002)).

²² *Id.*

“does not operate to reduce or eliminate [the] claim, but only to ensure that [the claimants] receive compensation for their claim on the same basis as the claimants who are on the level to which their claim is subordinated.”²³ Bankruptcy courts have stated that a claim based on a promissory note is not subject to subordination under § 510(b) because they are based on a fixed debt obligation.²⁴

Here, I find § 510(b) does not require the subordination of Constrazza’s claims to Class 4. Constrazza was divested of its ownership interest in the Debtor as of September 2015, the date the Florida State Court valued its equity interest. And remember, this was done at the election of UTI and UTC to redeem Constrazza’s shares, albeit only after they impermissibly attempted to reduce the percentage of Constrazza’s interest from 35% to 3%. Based on UTI and UTC’s concerted actions, Constrazza lost the potential for any upside or profit in September 2015, years before this bankruptcy case was filed.²⁵ Constrazza “no longer enjoyed the primary benefit of

²³ *Kaiser Grp. Int’l, Inc. v. Pippin (In re Kaiser Grp. Int’l, Inc.)*, 326 B.R. 265, 268 (D. Del. 2005).

²⁴ *See Montgomery Ward Holding Corp. v. Schoeberl (In re Montgomery Ward Holding Corp.)*, 272 B.R. 836 (Bankr. D. Del. 2001); *In re Mobile Tool Int’l, Inc.*, 306 B.R. 778. *But see In re Caprock Oil Tools, Inc.*, 585 B.R. 823, 829 (Bankr. S.D. Tex. 2018) (rejecting the reasoning in *In re Mobile Tools* because court’s analysis “was limited to only one aspect of § 510(b)’s purpose—whether the former equity holder could experience greater profits after exchanging it for a note,” and stating that it “diverges from the Fifth Circuit’s analysis of § 510(b)’s purpose which held ‘the investors initially bargained for the risk and return expectations of investors’”); *SeaQuest Diving, LP v. S&J Diving, Inc. (In re SeaQuest Diving, LP)*, 579 F.3d 411, 423-24 (5th Cir. 2009) (affirming the bankruptcy court’s finding that a minority shareholder’s claim based on an Illinois judgment for the forced repurchase of his shares was “inextricably intertwined with [his] shareholder status” and, thus, fits within § 510(b) and must be subordinated; but also recognizing that the case could yield a different result if the transaction had been a redemption rather than a rescission).

²⁵ *See CIT Grp. v. Tyco Int’l Ltd. (In re CIT Grp. Inc.)*, 460 B.R. 633, 640 (Bankr. S.D.N.Y. 2011), *aff’d*, 479 F. App’x 393 (2d Cir. 2012) (alteration in original) (quoting *Am. Broad. Sys., Inc. v. Nugent (In re Betacom of Phoenix, Inc.)*, 240 F.3d 823, 830 (9th Cir. 2001)) (“The crucial difference between creditor and investor expectations is that [t]he creditor can only recoup her investment; the investor expects to participate in firm profits.”).

ownership: the potential for unlimited profits” and this claim is “not the type which section 510(b) mandates be subordinated.”²⁶

UTC elected to redeem Constrazza’s shares through the mechanics of a statutory scheme. Constrazza’s interest in UTC was liquidated “as of the day before the date on which the petition for judicial dissolution was filed.”²⁷ So, Constrazza has what amounts to a fixed debt obligation. Because Constrazza has a claim based on a redemption that is a fixed debt obligation, its claim is not subject to subordination under § 510(b).²⁸

UTC and UTI ask this Court to ignore the parties’ litigation for the last five years and their misconduct amply found by the Florida State Court effectively preventing Constrazza from any meaningful participation in the Debtor’s operations and unjustifiably reducing Constrazza’s equity ownership percentage. Now, after this litigation concluded, UTI and the Debtor’s shenanigans are exposed, and this bankruptcy case was filed, they brazenly ask this Court of equity to limit Constrazza recovery by forcing it back into a shareholder status under § 510(b).

UTI again assisted by the Debtor attempts to increase its recovery by diluting the value of Constrazza’s distribution. This is not fair, equitable, or required by the Bankruptcy Code. UTI is treating the subordination provisions of § 510(b) as a sword

²⁶ *In re Mobile Tool Int’l, Inc.*, 306 B.R. at 782.

²⁷ Doc. No. 132-1.

²⁸ See *In re Montgomery Ward Holding Corp.*, 272 B.R. 836; *In re Mobile Tool Int’l, Inc.*, 306 B.R. 778; cf. *Orange Cty. Nursery, Inc. v. Minority Voting Trust (In re Orange Cty. Nursery Inc.)*, 523 B.R. 692, 702 n.9 (C.D. Cal. 2014) (recognizing there is a distinction to be made when the “value is fixed or was capped or otherwise prevented from sharing in any upswing”).

to increase its recovery, not to do what the statute intends—to ensure unsecured creditors get paid before shareholders try to “sneak in” and get a higher priority distribution as an unsecured creditor. Here, all unsecured creditors will be paid in full before *either* Constrazza or UTI get paid. UTI improperly is using the subordination statute to increase its own recovery at the expense of Constrazza.

And, although I do not reject the Debtor’s standing to raise this subordination issue, I ask why they would. Even more I question the actions of the supposedly impartial and independent Liquidating Trustee continuing this argument solely to benefit UTI.

Constrazza’s Claims 5 and 7 (to the extent allowed) shall be paid in Class 3B under the Plan. Although Constrazza’s claims will be paid after other general unsecured creditors in Class 3A,²⁹ Constrazza’s claims *will not* be subordinated to Class 4 interests under § 510(b) of the Bankruptcy Code. UTI, the sole remaining shareholder, will receive any distribution in Class 4 only after *all* other superior claims are paid in full.

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The Clerk will serve a copy of this Order on all interested parties.

²⁹ *Cf. Matter of Envirodyne Indus., Inc.*, 79 F.3d 579, 584 (7th Cir. 1996) (holding that “Section 510(c) of the Bankruptcy Code authorizes courts to subordinate the unsecured claims of non-tendering, cashed-out shareholders of a short-form merger under Delaware law to those of other general unsecured creditors”).