

TROUBLED SUBDIVISIONS

By

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Current economic conditions have led to a number of subdivisions that have not been completed by the developer for various reasons. Trying to find a way to complete a subdivision when the developer defaults or is in bankruptcy can be a tricky proposition. To add to the woes, if the bank that is acting as surety is taken over, or the bond company becomes insolvent, the task of finding a way to enforce the subdivision guarantee becomes even more difficult. Having in place proper subdivision security is the first step in trying to protect the municipality and the residents of the subdivision. Steps that the planning board can take to provide the best possible surety are outlined in another portion of this module. This paper will review the steps that a planning board should take when faced with a developer default, and the various enforcement avenues that are available.

I. SUBDIVISION DEFAULTS

A. General Default Procedures

A subdivision default is essentially a failure of the developer to complete the required work in a subdivision within the time limit established by the planning board either in the certificate of approval of the subdivision or in the subdivision covenant. When the developer does not comply with the time limit for completion of the subdivision, the board may seek to use the bond or monies provided as security in order to complete the construction of the subdivision ways and installation of utilities. General Laws chapter 41 section 81U provides:

Any such bond may be enforced and any such deposit may be applied by the planning board for the benefit of such city or town, as provided in section eighty-one Y, upon failure of the performance for which any such bond or deposit was given to the extent of the reasonable cost to such city or town of completing such construction or way.

It should first be emphasized that it is generally to the municipality's advantage to have the developer complete the subdivision than to enter the morass of subdivision default. To that end, working with the developer and granting reasonable extensions of time for completion of work is preferable to proceeding to default. Only when it is clear that the developer cannot or will not complete its obligations should the board begin the default process. The following steps are recommended:

1. First, the planning board should send the developer, by certified mail, a request that the developer attend a meeting of the planning board to provide a report concerning the expected completion date of the subdivision, and whether the developer will seek an extension of time. It should be determined if the surety's assent to an extension is required, and, if so, the developer should be advised, and should be responsible for obtaining the surety's written assent to an extended date. The board's letter should advise the developer that, if the developer fails to obtain an extension and the work is not fully completed, the board will consider exercising its options to enforce the performance guarantee, or take other legal action to require the developer to perform its obligations.

2. If step one is not successful, and it is clear that the developer will not complete the subdivision, the board should have its engineer provide a detailed list of all of the items of work that have not been completed, together with a detailed cost estimate for the completion of that work by the city or town. The cost estimate should take into account public bidding requirements, as well as contingencies, and the provisions of the planning board's applicable rules and regulations governing subdivisions.

3. The board should then send notice to the developer of the incomplete items of work, and of the time, date and place of the meeting at which the planning board will review the list and determine whether or not the developer is in default of its obligations under the subdivision approval and/or surety. The notice should also state that the developer will be entitled to be heard on the matter. A copy of the notice should be sent to the surety.

4. If, after affording the developer the opportunity to be heard on the subject of the unfinished subdivision, the board determines that the work has not been completed in a timely manner, it may vote to find the developer in default. The board should also vote to adopt the engineer's report on the unfinished items and cost estimate. The board should also vote to enforce the performance guarantee and/or seek other enforcement action.

5. If the board votes to enforce the performance guarantee, it should send a certified letter to the surety, notifying it that the developer has failed to complete the work secured by the surety by the deadline specified in the surety agreement (with any extensions), and demanding that the surety pay to the city or town the penal sum of the bond, or the monies held by the bank, (or a lesser amount if the cost estimate is substantially less than the surety amount) in accordance with the surety agreement. A

copy of the surety agreement should be appended to the letter, as well as the engineer's report of incomplete items and cost estimate therefore.

B. When the Surety Pays Over the Monies

In a perfect world, the surety will promptly pay over to the planning board the amount of the bond, or the monies deposited with the bank or held by the bank under a tripartite agreement. If that happens, there are still a number of hurdles to clear before the city or town can begin completing the subdivision.

Municipal funds cannot generally be expended without appropriation by the legislative body, be it town meeting, city or town council, or board of aldermen. The penultimate paragraph of General Laws chapter 41 section 81U provides, however, that upon local acceptance of that paragraph by a town that has a town meeting, any subdivision security funds taken by the town may be expended, up to a limit of \$100,000.00 per subdivision, with the approval of the board of selectmen.

In addition, a municipality generally cannot expend funds to improve a street unless the street is either a public way, or, in the case of minor repairs, the municipality has enacted a by-law allowing temporary repairs to private ways. In this respect, General Laws chapter 41 section 81DD provides:

The subdivision control law...shall not authorize a city or town to ... construct any way which may be indicated on any plan of a subdivision until such way has been laid out as a public way in the manner prescribed by law....

Finally, the work is subject to the public bidding statutes, prevailing wage laws, etc. applicable to public works projects.

C. When the Surety Refuses to Pay Over the Funds

There are, of course, instances where the surety is not so eager to pay over funds to the city or town to complete the subdivision. These are the cases where, hopefully, the planning board has a well-crafted agreement that governs the surety funds, and that has been signed by the surety. If a surety refuses to comply with its obligations after receiving the notice from the planning board described above, the next step should be a demand letter drafted by your municipal counsel. If that fails, an action for enforcement under G. L. c. 41 section 81Y, for breach of contract, and for other causes of action may be necessary. In addition to bringing suit against the surety, the town may also seek redress against the developer under G.L. c. 41 §81Y, or bring an action for injunctive relief or for breach of contract.

II. BANKRUPTCY

Although a complete review of bankruptcy provisions is beyond the scope of this paper, a few salient points need to be made. When a developer is in default, but is also the subject of a bankruptcy petition, the planning board must be careful not to take any action that would violate the bankruptcy laws.

A. The Automatic Stay

Upon filing of a bankruptcy petition, the Bankruptcy Court has exclusive jurisdiction over all of the debtor's property. 28 U.S.C. §1471(e). A petition for bankruptcy invokes the automatic stay provision of the Bankruptcy Code codified at 11 U.S.C. §362. This automatic stay applies to all entities, including government entities. In re Transcon Lines, 147 B.R. 770 (C.D. Cal. 1992). The Code provides that, upon filing of a bankruptcy petition, the petition acts to stay, among other things:

- (1) the commencement or continuation...of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the [bankruptcy] case...

- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate.

Whenever taking action which affects a party or its property which is subject to a bankruptcy petition, the city or town should be careful to observe the requirements of the automatic stay provisions, because a violation of the automatic stay provisions can result in the award of damages and punitive damages for the violation.

Significantly, the automatic stay does not apply to “the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit’s police or regulatory power...” 11 USC §362(b)(4). It is not clear that an action to obtain surety funds qualifies for this exemption, however. Generally, the courts apply a “pecuniary purpose” test. That is, whether the actions the city or town intends to take with respect to a party in bankruptcy seek a pecuniary benefit for the city or town, in which case the actions are stayed, or if the actions are taken with a view toward the municipality’s police or regulatory power, which come under the exemption. See In re Aegean Fare, Inc., 35 B.R. 923,927 (D. Mass. 1983). You should, of course, check with your counsel prior to taking any action with regard to an entity in bankruptcy.

B. Motion for Relief from the Automatic Stay

Another situation that can arise is where the developer is subject to bankruptcy proceedings, but the Town is holding cash security for the completion of the subdivision. Whether the funds are held solely in the Town’s name, or under both the Town and the developer (which is not recommended), may effect whether the funds are considered part of the bankruptcy estate. Funds that are not part of the bankruptcy estate are not subject

to the Bankruptcy Court. If the funds are part of the bankrupt estate, the Town may not take any action to seize the funds without first obtaining relief from the bankruptcy court in the form of relief from the automatic stay. Your municipal counsel can bring a motion for relief from the automatic stay in the bankruptcy court. Even if the funds are held in the name of the city or town only, it would usually be prudent to seek relief from the Bankruptcy Court prior to seizing the cash under a default of the subdivision.

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