EFiled: Jan 25 2013 11:43AM EST
Transaction ID 49122196
Case No. 4817-VCN

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OF THE
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January 25, 2013

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Re: *Wells Fargo Bank, N.A., successor-by-merger to Wachovia Bank, National Association v. Peninsula at Longneck, L.L.C.*
C.A. No. 4817-VCN
Date Submitted: October 10, 2012

Dear Counsel:

Defendant Peninsula at Longneck, L.L.C. ("Peninsula") owns approximately 750 acres on Indian River Bay, in Sussex County, Delaware. It obtained approval for the development of 1,401 lots. Mixed use development was supported by a wide range of amenities, including a private, guarded entrance, swimming pools, tennis courts, a golf course, fitness facilities, walking trails, a golf pro shop, and a

grill room. Approximately 673 lots have been sold and approximately 728 lots remain for sale.[1] Perhaps because of the times, Peninsula was not successful. The mortgage holder, Plaintiff Wells Fargo Bank, N.A. ("Wells Fargo"), foreclosed on the project.[2] The project is so far "under water" that neither Wells Fargo, as the first lienholder, nor any other creditor of Peninsula has any chance of being paid in full.

On October 9, 2009, the Court appointed Land Tech Receiver Services, LLC (the "Receiver") as the receiver for the project.[3] At that time, approximately 615 lots had been sold. Because there was no reason to expect any funds to be available to any creditor other than the first lienholder and because all known creditors either consented or did not object after notice, the Receiver was permitted to continue the development effort, including having the ability to sell lots free and clear of any liens and encumbrances. Appointing a receiver avoided the concern

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[1] There are approximately 560 homeowners.
[2] Wells Fargo is the successor to Wachovia Bank, N.A. It acts in its own behalf and in behalf of National City Bank.
[3] The authority for that act may be found in § 10.8 of the mortgage given by Peninsula on the project. Peninsula is organized under the laws of Virginia.

that a more typical foreclosure might interrupt project development which would impair the chances that the project might eventually flourish.

On April 5, 2012, a consent judgment was entered in favor of Wells Fargo, and it authorized foreclosure of the project.

The Receiver has managed, and attempted to continue the development of the project, since its appointment. It pursued extensive sales efforts but, ultimately, came to the conclusion—supported by the absence of serious inquiries from potential buyers—that it would not be able to generate enough proceeds to pay the creditors because the project has a value substantially less than Wells Fargo's first mortgage.

The Receiver has moved for authorization to transfer the property to Wells Fargo, or its designee, free and clear of all liens and encumbrances, and to make a payment of $200,000 (with funds to be provided by Wells Fargo) to identified creditors on a pro rata basis.[4] The alternative would be a foreclosure sale. The

[4] Receiver's Mot. to (a) Transfer Receivership Property Free and Clear of Liens, Claims and Encumbrances, and (b) Make Pro-Rata Distribution to Certain Creditors. Four creditors would benefit. *Id.* Ex. A. They would receive less than fifteen percent of what they are owed.

Receiver contends that the owners of the more than 600 lots that have been sold would be better off if a foreclosure sale could be avoided. The uncertainties and the stigma of a foreclosure sale of such a major project would have lasting consequences for the residents who have made substantial investments in the homes built on the project's lands. Thus, the lot purchasers "get something" from the Receiver's proposal. Also, the creditors "get to share" in the $200,000 payment, which is $200,000 more than they would receive if foreclosure occurred. Because the Wells Fargo mortgage exceeds any anticipated sale proceeds by a significant margin, the creditors are better off under the Receiver's proposal than they would be under a foreclosure sale.

There is, however, one objection to this approach. Intervenor Dennis E. Silicato (the "Intervenor") presents several arguments against the Receiver's requests. The Intervenor is not a busybody intermeddler. He owns two lots within the project's lands, and he is assessed "homeowner association dues" to support the project's amenities. The costs are allocated among the owners of lots sold by either Peninsula or the Receiver. The arrangement proposed by the Receiver in

lieu of foreclosure would result in the transfer of the lots to Wells Fargo, or its designee, but Wells Fargo, or its designee, would be in the position of Peninsula, as developer, initially—without any obligation to pay such assessments. If Wells Fargo bought at the foreclosure sale, an almost certain outcome if foreclosure occurs, it would likely be faced with assessments for the hundreds of lots that it would acquire. Thus, if Wells Fargo purchased the remaining assets at a foreclosure sale, the Intervenor's assessments for the homeowner association fees presumably would be significantly less because the same costs would be apportioned over a greater number of lots. Interestingly, no other lot owner has joined with the Intervenor.

The notion that the project's failure will be little known if the artifice of a transfer in lieu of foreclosure is ordered seems far-fetched. How the hundreds of homeowners would benefit otherwise is not clear. Neither Wells Fargo nor its unidentified designee has made any commitments that might be viewed as benefitting the lot owners' interests. Perhaps there would be advantages to the residents, but the record, at least at this stage, does not demonstrate what they

might be. Simply avoiding an unquantified stigma of project failure is too uncertain or speculative to serve as a foundation for extraordinary equitable relief.

The Court granted the Receiver the authority to sell lots on a free-and-clear-of-liens basis in order to "keep the project going." The advantages of a successful project to the residents were obvious. Unfortunately, it did not turn out as was hoped. Nevertheless, the potential of real benefit supported the use of equity's broad powers.

Now, the Receiver emphasizes the two sets of rights that are at issue: those of real property ownership and those of a "declarant" under a set of restrictive covenants. It argues that the two sets of rights must be maintained together to avoid "significant harm to all parties."[5] The Receiver develops this theme as follows:

> [N]o third party would be interested in purchasing the balance of the development if it could not also acquire an assignment of the Declarant's rights and therefore be guaranteed to benefit from them. If that were to happen, the purchaser of the real property would be

[5] Receiver's Suppl. Submission in Supp. of Mot. to (a) Transfer Receivership Property Free and Clear of Liens, Claims and Encumbrances, and (b) Make Pro-Rata Distribution to Certain Creditors at ¶ 4.

> saddled with an obligation for "homeowner association dues" with absolutely no corresponding benefit from assuming that obligation, thereby further reducing the value of the property by potentially millions of dollars. A purchaser at foreclosure would not live in the house, use the amenities, swim in the pool, nor enjoy time at the golf course. . . .[6]

Perhaps the Receiver is correct, but the effort to sell the project with the real estate interests and the development rights bundled together has been ongoing for more than three years, and the Receiver has offered no reason to believe that market interest is likely to improve. In short, the Receiver asks the Court to employ rarely used equitable powers because maybe, just maybe, something good might come of it. The absence of a reasonably predictable and beneficial outcome persuades the Court that it has no basis to deviate from the established means by which transfers associated with defaulted-upon mortgages are accomplished—foreclosure.

Although no particular advantages to the resident owners have been established, the proposed payment of $200,000 to certain creditors would indeed be beneficial because, otherwise, these creditors will receive nothing. For a project

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[6] *Id.*

of this size, the amount is relatively small, although to the creditors, it would be, of course, far better than nothing.

The difficulty for which the Court has no answer is the relative allocation of cost burdens. Under the Intervenor's analysis, Wells Fargo (or its designee), if relieved of the potential obligation of a purchaser at a foreclosure sale to pay assessments, would soon save more than will be paid to the creditors. Thus, one may surmise, the payment to the creditors—a desirable goal—comes eventually at the expense of the homeowners—an undesirable goal—whose larger pro rata share of the expenses associated with the amenities will continue.[7] This allocation of costs among various disappointed stakeholders in the project carries no clearly right or wrong answer. Ultimately, it does not constitute the type of clear benefit that would justify invoking the extraordinary powers of equity and deviating from the normal procedures for matters of this nature.[8]

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[7] The future of the amenities may be uncertain. Wells Fargo has supported the project during the Receiver's tenure. If Wells Fargo had made concrete commitments for the good of the development, the Court's analysis might be different.

[8] *See* 10 *Del. C.* §§ 4734, 4973, 4985.

For the foregoing reasons, the Court declines to exercise its equitable powers to authorize the transfers recommended and requested by the Receiver, and the Receiver's motion is denied.[9]

An implementing order will be entered.[10]

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Peter B. Ladig, Esquire
Veronica O. Faust, Esquire
Richard E. Berl, Jr., Esquire
Daniel F. Wolcott, Jr., Esquire
Register in Chancery-K

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[9] The Intervenor advanced a number of other arguments, ranging from the Court's lack of authority under 10 *Del. C.* § 371 to the impropriety of precluding an opportunity for a Sheriff's Sale to establish an accurate amount for a deficiency judgment. With the conclusion set forth above, the Court need not address the Intervenor's other contentions.

[10] The Court has addressed this matter with some concern that the Receiver did not take advantage of the opportunity to develop a better factual record for the relief which it has sought. There may have been some confusion—and the Court may have been responsible for some of it—about the Receiver's perceived need to develop a more comprehensive record. In light of that concern, the Court is willing, on prompt application, to vacate the order to be entered to allow for the development of that record.