

**UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NORTH DAKOTA
NORTHWESTERN DIVISION**

United States Securities and Exchange
Commission,

Court File No. 4:15-cv-053

Plaintiff,

vs.

North Dakota Developments, LLC,
Robert L. Gavin, and Daniel Hogan,

Defendants,

and

North Dakota Developments Property
Management LLC, Great American Lodge
LLC, NDD Holdings 1 LLC, NDD Holdings 2
LLC, NDD Modular LLC, Augusta
Exploration, LLC, and Ames Engineering &
Development Services LLC,

Relief Defendants.

**MEMORANDUM IN SUPPORT OF RECEIVER’S MOTION TO AUTHORIZE AND
CONFIRM SALE OF PROPERTY LOCATED AT GAL WATFORD WEST**

Receiver Gary Hansen (the “Receiver”) respectfully requests the Court approve a sale to Scotty D. Fain, Sr. (the “Purchaser”) of all improvements, fixtures, and personal property of Defendant North Dakota Developments, LLC (“NDD”) located at the man-camp facility known as Great American Lodge – Watford West (the “Sale Assets”).¹ Specifically, the Receiver seeks

¹ The Sale Assets are specifically identified in Exhibits A – D of the Bill of Sale, included as part of the Purchase Agreement, which is attached as Exhibit A to the Affidavit of Ranelle Leier (“Leier Aff.” or “Leier Affidavit”), filed herewith.

the entry of an Order approving the sale, in the form attached as Exhibit 1 to the Receiver's Motion to Authorize and Confirm Sale of Property Located at GAL Watford West ("Motion") and the Court's authorization of the Receiver to close the transaction with the Purchaser on substantively the same terms as set forth in the Purchase Agreement dated April 12, 2016, as amended and attached as Exhibit A to the Leier Affidavit (the "Purchase Agreement").

BACKGROUND

On May 18, 2015, the Court appointed Mr. Hansen as the Receiver for Defendant NDD and the Relief Defendants (collectively, the "Receivership Defendants"). (Dkt. No. 20.) At the time the U.S. Securities and Exchange Commission filed its Complaint, NDD was operating a man-camp called Great American Lodge – Watford West, located at 13025 Highway 85 N, Arnegard, North Dakota ("GAL Watford West" or the "Site"). Neither NDD nor the Relief Defendants own the real property on which the man-camp operated (the "Real Property"). Instead, NDD had a long-term lease allowing it to operate the man-camp on the Real Property.

In May 2015, over 430 individual housing units located in "Phase I" and "Phase II" at the Site were being rented or were available to be rented. Additional units located in "Phase III" were still under construction. Electricity to the Site was shut off in early May 2015 due to non-payment of bills. In addition, water service was not available because of an issue with the water lines. Instead, water was being trucked onto the Site every few days at a considerable cost. The man-camp has not been in operation since approximately May 7, 2015.

A. Marketing the Property and the Purchase Agreement

The Receiver has attempted to generate interest in the Site and the Sale Assets. The decline in the oil and gas industry and the desire of county officials to limit man-camps has hampered these efforts. The Receiver has received inquiries from interested persons and

provided information to those persons regarding the Site and the Sale Assets. Two interested persons submitted written offers – one by the Purchaser and one by an entity (the “Second Potential Purchaser”) that initially offered a significantly lower price. After additional discussions, the Receiver provided the Second Potential Purchaser with the primary deal terms of the Purchase Agreement and asked the Second Potential Purchaser to submit a revised offer. The Second Potential Purchaser then submitted a proposed term sheet with terms more comparable to the Purchase Agreement. The Receiver, however, determined that the Purchase Agreement set forth the better offer. After further discussions, the Receiver provided the Second Potential Purchaser with a redacted version of the Purchase Agreement and asked the Second Potential Purchaser to submit a “final and best offer.” The Second Potential Purchaser did not submit a revised term sheet.

The Receiver has entered into a Purchase Agreement with the Purchaser, who in the Receiver’s judgment submitted the highest and best offer. The Receiver believes that the consideration to be paid by the Purchaser constitutes reasonable equivalent value, and is fair and reasonable under the circumstances. The Purchase Agreement is contingent on Court-approval and was negotiated in a diligent, non-collusive, and good-faith manner.

The main deal points of the Purchase Agreement are: The Purchaser will pay a net purchase price for the Sale Assets of \$1,385,325.00 over a period of 18 months. The Receiver will retain a security interest in certain modular units until the purchase price is paid in full. The Receiver has agreed to pay Stoneart OFS, LLC (“Stoneart”) the sum of \$214,675.00 in exchange for Stoneart releasing its security lien on the Sale Assets. Stoneart is a North Dakota limited liability company wholly-owned by the Purchaser. On March 25, 2015, Stoneart filed a construction lien for unpaid work it performed for NDD at the Site in the amount of

\$388,620.88. Stoneart has informed the Receiver and provided documentation that the current principal balance of the Stoneart lien is \$214,675.00. The Receiver and the Purchaser have agreed that Stoneart will release its lien at the time of closing and the Purchaser will receive a setoff from the stated purchase price of \$1,600,000 for the current balance of the lien. This will result in a net purchase price of \$1,385,325.00.

The Purchaser intends to remove the modular units and other Sale Assets from the Real Property and has entered into a lease agreement with the Real Property owners allowing him to do so. The Purchaser is responsible for all costs of severing and removing the modular units from the Real Property. The full terms of the Purchase Agreement are set forth in Exhibit A to the Leier Affidavit.

B. The Appraisal Value of the Sale Assets

Shortly after being appointed, the Receiver engaged an appraiser familiar with man-camps and related assets in the Bakken Region of North Dakota and Montana to appraise GAL Watford West. The appraiser determined that the Site had an “as is” value as a going concern leasehold premise of \$2,120,000, with a date of value of September 3, 2015. Included in that “as is” valuation was \$1,160,000 of personal property. The personal property that is the subject of the appraisal is not co-extensive with the Sale Assets. Most notably, the appraiser did not include the modular housing units located in Phase III of the Site in his valuation because those units were inhabitable as they were under construction in order to comply with the Americans with Disabilities Act.

The Receiver recently asked the appraiser to update his opinion of value based upon any changes that have occurred both at the Site and in the market in the last 12 months. The appraiser concluded that the market value of the subject property would reasonably be at least

10% - 15% below the September 2015 valuation. This conclusion is based upon a number of factors, including:

- The continued decrease in oil and gas production in the region, as evidenced by North Dakota's Oil & Gas Economy report. This is further supported by the fact that Whiting Petroleum Corporation, the largest producer of oil in North Dakota, reportedly stopped fracking and completing wells as of April 1, 2016.
- A review of data from CoStar, a third party database tracking commercial real estate trends, which showed that multi-family operators and leasing agents throughout the Bakken Region indicated they have struggled to retain occupancy at historical levels without substantially lowering rents.
- The appraiser interviewed several brokers who indicated that financing is difficult to obtain and sales transactions are limited, if not completely absent. One broker noted a situation where a man-camp operator offered to convey all units at no charge if the prospective buyer would remove them from the grounds at its own expense. The brokers also cited limited consensus for valuations throughout the Bakken Region given ongoing conflicts with zoning/approvals and challenges in maintaining man-camp operations.
- The subject property has suffered some vandalism, resulting in damage to windows and doors and the loss of property.
- The weather and elements have impacted the modular units, causing additional depreciation of value.
- The Conditional Use Permit issued by McKenzie County to operate the man-camp on the Real Property has expired. In addition, McKenzie County officials have expressed

skepticism regarding whether the County would allow a new man-camp operation on the Real Property.

C. Existing Liens and Encumbrances

As part of the Purchase Agreement, the Receiver has agreed to convey the Sale Assets to the Purchaser free and clear of liens and encumbrances. The Receiver requested a lien search for Defendant NDD and the Relief Defendants that were involved or potentially involved with the operation of GAL Watford West. He also obtained additional information from the attorney for the owners of the Real Property. Through his due diligence, the Receiver has identified the following purported liens or other secured interests that may impact the Sale Assets.

1. Harper Ready Mix

On January 31, 2014, Harper Ready Mix (“Harper”) filed a construction lien with the County Recorder for McKenzie County. (Leier Aff., Ex. B.) The amount allegedly due is \$4,400.11 plus collection fees. The Lien states that Harper “has provided the following labor, skill or materials: Concrete Ready Mix for the Great American Lodging in connection with [the Real Property]. The name of the person(s) in possession of the Ready Mix is John C Evanson & Timothy Evanson & for which he has not been paid.” (*Id.* (underlining in original).)

2. ABCO Recycling, LLC

On June 30, 2015, ABCO Recycling, LLC (“ARCO Recycling”) filed a construction lien with the County Recorder for McKenzie County. (Leier Aff., Ex. C.) The lien indicates that ARCO Recycling made contributions to the Real Property, but does not describe them. It also states that ARCO Recycling contracted with Great American Lodge, LLC and that the work was from March 11, 2015 to May 22, 2015. The total amount alleged to be due is \$14,136.93.

The Court's Order Granting Plaintiff's Motion for Temporary Restraining Order, Dated May 5, 2015 (Dkt. No. 5) and the Receivership Order (Dkt. No. 20) both contain a provision prohibiting any person or entity, including any creditor or claimant against any of the Defendants or the Relief Defendants from taking any action to interfere with the asset freeze, "including, but not limited to, the filing or continuance of any lawsuit, liens or encumbrances" impacting the Receivership Assets. (Dkt. No. 20, at IV.D.) Therefore, this lien was improperly filed after the asset freeze was put in place and without leave of Court.

3. Wutke, LLC, d/b/a Bakken Fence Co.

On June 12, 2015, Wutke, LLC, d/b/a Bakken Fence Co. ("Wutke") filed a construction lien with the County Recorder for McKenzie County. (Leier Aff., Ex. D.) The lien states that Wutke furnished materials and construction services for improvements to the Real Property pursuant to an agreement with NDD but does not further describe the work. Wutke claims a lien in the amount of \$39,536.94, plus interest.

As with the ABCO Recycling lien, this lien was filed after the asset freeze was put in place and Wutke did not seek leave of Court.

4. Great American 3-15, LLC

Great American 3-15, LLC ("Great American") made a loan to Relief Defendant NDD Holdings 1, LLC in the principal amount of \$2,900,000. This loan closed on or about March 30, 2015. Great American previously filed a motion to intervene and motion for relief from the asset freeze. (Dkt. Nos. 79 and 83.) The Court denied both these motions. (Dkt. No. 93.)

As part of the loan documentation, NDD Holdings 3, LLC executed a Collateral Assignment of Lessee's Interest in Lease and Rents ("Collateral Assignment"). (Leier Aff., Ex. E.) The Collateral Assignment purports to assign to Great American the rent and lease payments

of guest and tenants in the housing units purportedly located on the Real Property.² Great American has informed the Receiver of its position that the Collateral Assignment allows Great American to make a claim on the income from the modular units, even if such units are sold. The Receiver does not agree with Great American's position. The Receiver and Great American have reached an agreement in principle to resolve Great American's claim. As part of the agreement, Great American will give up any and all rights it has under the Collateral Assignment. The Receiver expects to present the settlement agreement to the Court for its approval in the near future.

5. Stoneart OFS, LLC

As noted above, on March 25, 2015, Stoneart filed a construction lien with the McKenzie County Recorder. The lien states that Stoneart furnished "grading, stone based material, installed water and sewer piping and set mobile homes and other site improvements" on the Real Property pursuant to a contract with Defendant NDD. (Leier Aff., Ex. F.) In the lien, Stoneart claims an amount due of \$388,620.88, plus interest. Stoneart is owned by the Purchaser, who has informed the Receiver that the current principal balance claimed by Stoneart is \$214,675.00. As part of the Purchase Agreement, Stoneart will release its lien at closing and the Purchaser will receive a setoff from the purchase price for the current balance of the lien.

The Receiver has provided notice and copies of its Motion, this Memorandum in Support, and the Leier Affidavit to all parties on the Court's electronic service list, to all known entities that have filed a lien or other encumbrance, as identified above, and to the owners of the Real Property.

² The address for the real property identified in the Collateral Assignment is listed as "13021 Highway 85 Williston, North Dakota, 58801." The Real Property is not located at 13021 Highway 85, nor is it located in Williston.

ARGUMENT

I. THE COURT SHOULD APPROVE THE SALE OF THE SALE ASSETS.

A. The Court Has Discretion to Approve the Sale and the Receiver's Judgment is Entitled to Discretion.

A common-law equity receiver has the power to dispose of the property of the receivership estate. *See Jones v. Village of Proctorville*, 290 F.2d 49, 50 (6th Cir. 1961). The sale of property by a receiver is normally governed by 28 U.S.C. §§ 2001-2004. A receiver's sale of non-real property assets in the United States is governed by 28 U.S.C. § 2004, which provides that "[a]ny personalty sold under the order or decree of any court of the United States shall be sold in accordance with section 2001 of this title, unless the court orders otherwise." 28 U.S.C. § 2004. Section 2004 affords the Court wide discretion to approve the terms and procedures used to sell personal property so as to maximize the proceeds from such sale. *See U.S. v. Stonehill*, 83 F.3d 1156, 1160 (9th Cir. 1996) (holding that Section 2004 permitted the district court to dispense with appraisal requirement for the sale of personal property).

It is well-settled that the goal of a receiver charged with liquidating assets is to obtain the highest and best value for the assets available under the circumstances. *Fleet Nat'l Bank v. H&D Entm't, Inc.*, 926 F. Supp. 226, 239-40 (D. Mass. 1996) (citing *Jackson v. Smith*, 254 U.S. 586 (1921)). The paramount goal in any proposed sale of property of the estate is to maximize the proceeds received by the estate. *See, e.g. Four B. Corp. v. Food Barn Stores, Inc.*, 107 F.3d 558-564-65 (8th Cir. 1997).

Courts uniformly hold that a receiver's business judgment is entitled to "great judicial deference." *See, e.g., Golden Pac. Bancorp v. F.D.I.C.*, 2002 WL 31875395, *9 (S.D.N.Y. Dec. 26, 2002), *aff'd sub nom*, 375 F.3d 196 (2nd Cir. 2004) (recognizing receivers are afforded

deference in corporate decision making); *In re JFD Enter., Inc.*, 2000 WL 560189, *5 (1st Cir. 2000) (“Courts have much discretion on whether to approve proposed sales, but the trustee’s business judgment is subject to great judicial deference.”).

In determining whether to approve a sale, the Court may take into account the unique facts and circumstances surrounding the proposed sale, including the precarious financial condition of the assets sold. *Tanzer v. Huffines*, 412 F.2d 221, 222-23 (3d Cir. 1969) (approving expedited sale in the absence of financial appraisal and limited notice in light of corporation’s deteriorating financial condition).

B. The Purchase Agreement is in the Best Interests of the Receivership.

The Court should approve the proposed sale of the Sale Assets to the Purchaser because it is in the best interests of the Receivership and will result in the highest and best price for the assets. The Receiver has marketed the GAL Watford West assets and attempted to solicit offers. He accepted the highest and best offer he received and has negotiated a Purchase Agreement to consummate the sale. GAL Watford West is not being sold as a going-concern. Instead, the Receiver is selling the assets, which will then be removed from the Real Property. Based upon the analysis from the appraiser, the Receiver believes that this offer is fair and reasonable.

Further, time is of the essence given the challenges facing the oil and gas industry and the issues facing these particular assets. If the Receiver does not complete this sale and instead attempts to solicit additional offers, there is a distinct possibility that a sale would not occur this year. This would likely result in the continued reduction in the value of the assets. In addition, another North Dakota winter will cause further deterioration of the modular units.

Given the weakened oil market in western North Dakota, the drastically declining need for man-camp-type housing units in North Dakota and Montana, and local government resistance

to such facilities, it is in the best interest of the Receivership to accept the Purchaser's offer to purchase the Sale Assets. Based upon the foregoing, the Receiver believes there is more than a sufficient basis to confirm the sale of the Sale Assets to the Purchaser, as being in the best interests of the Receivership.

II. THE COURT SHOULD AUTHORIZE CONVEYANCE OF THE SALE ASSETS FREE AND CLEAR OF ALL LIENS AND ENCUMBRANCES.

As part of the Purchase Agreement, the Receiver has agreed to convey the Sale Assets to the Purchaser free and clear of liens and encumbrances. It has long been recognized that a federal court may order the sale of receivership property free and clear of liens and encumbrances under appropriate circumstances. *Regions Bank v. Egyptian Concrete Co.*, 2009 WL 4431133, at *7 (E.D. Mo. Dec. 1, 2009). *See also Mellen v. Moline Malleable Iron Works*, 131 U.S. 352, 337 (1889) (“[T]he removal of alleged liens or incumbrances upon property, the closing up of affairs of insolvent corporation, and the administration and distribution of trust funds, are subjects over which courts of equity have general jurisdiction.”); *Miners’ Bank of Wilkes-Barre v. Acker*, 66 F.2d 850, 853 (3d Cir. 1933) (“A court of equity under proper circumstances has power to order a receiver to sell property free and clear of all incumbrances”); *Pennant Mgmt. Inc. v. First Farmers Financial, LLC*, 2015 WL 4511337, at *4-5 (N.D. Ill. July 24, 2015) (stating that receivers have broad authority to administer the property in the receiverships and that a federal court presiding over the receivership may authorize the assets to be sold free and clear of liens and related claims). Thus, the Court is authorized to order the property to be conveyed free and clear of all liens and encumbrances.

A. Under the Present Circumstances, it is Appropriate to Convey the Sale Assets Free and Clear of All Liens and Encumbrances.

A lien search by the Receiver and other due diligence revealed five potential liens or other alleged security interests associated with the Sale Assets. As detailed above, these potential lien holders are Harper, ARCO Recycling, Wutke, Great American, and Stoneart. In conjunction with the closing of the Purchase Agreement, Stoneart has agreed to release its lien as set forth in the Purchase Agreement. In addition, the Receiver has reached an agreement in principle with Great American, by which Great American will give up any rights it may have under the Collateral Assignment.

The Court should approve the sale of the Sale Assets free and clear of all liens and encumbrances of whatever nature. The ability of the Receiver to sell the Sales Assets is substantially impacted by these encumbrances. In addition, the Receiver has legitimate concerns that most, if not all, of these liens are not valid. For example, the ARCO Recycling and Wutke liens were filed after the asset freeze was put in place, in violation of the Court's Receivership Order. In addition, the Receiver does not interpret the Collateral Assignment to provide Great American with any secured interest in the Sale Assets. The two items purported to be assigned to Great American are: (1) all of NDD Holdings 3 LLC's interest in the lease for the Real Property; and (2) a security interest in a bank account into which rent payments were to be deposited. The Collateral Assignment does not purport to convey any interest in the Sale Assets.

Regardless, the Court need not make determinations as to the validity of those liens now. When the Receiver submits a proposed distribution plan to the Court for its consideration, these purported lien holders, along with all other creditors and parties-in-interest, will have the opportunity to present their arguments to the Court. The Court will then be able to evaluate the

validity of these claims at that time and determine whether any creditors have a priority interest in any of the funds realized from the sale of the Sale Assets.

The net value of the Sale Assets continues to decline. The Purchaser does not intend to operate a man-camp on the Real Property. Instead, he will remove the modular housing units and the rest of the Sale Assets from the Site. To accomplish this before another North Dakota winter causes additional wear-and-tear on the Sale Assets, the sale should be approved free and clear of all liens and encumbrances. Without the protections afforded to the Purchaser of a sale free and clear of liens and other encumbrances, the Purchaser would not have offered to pay the consideration set forth in the Purchase Agreement, and may have not made any offer. In order to maximize the benefit to the Receivership Estate, the sale should occur as soon as possible.

The approval of the Purchase Agreement and the consummation of the sale free and clear of liens and encumbrances is appropriate pursuant to 28 U.S.C. §§ 2001 and 2004, the Receivership Order, and equity, and is in the best interests of the Receivership Estate, creditors, and other parties-in-interest. Therefore, the Court should approve the sale free and clear of all liens and encumbrances.

CONCLUSION

The Receiver respectfully requests the Court to authorize and confirm the sale of the Sale Assets to the Purchaser in accordance with the terms of the Purchase Agreement attached as Exhibit A to the Leier Affidavit and to enter the Order attached as Exhibit 1 to the Motion.

Dated: October 18, 2016

FOX ROTHSCHILD LLP

By: s/ Ranelle Leier
Gary Hansen (MN #40617) admitted *pro hac vice*
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