

Motion to Modify Stay, Alternatively, for Adequate Protection Filed by Safeco Insurance Company of America (the “Safeco Lift Stay Motion”).

By the Safeco Lift Stay Motion, Safeco Insurance Company of America (“Safeco”) seeks entry of an order modifying the automatic stay (the “Stay”) to permit Safeco to (i) settle and resolve claims by obligees under bonds issued by Safeco at the request of the Debtors, and (ii) allowing Safeco to cancel bonds issued by Safeco on behalf of any Debtor. Alternatively, Safeco requests adequate protection to protect its interests related to the Safeco Bonds (as defined below).

The Safeco Bonds. In the course of obtaining approvals from governmental entities for subdivision developments, the Debtors are often required to post bonds or letters of credit guaranteeing that any improvements undertaken by the Debtors comply with local regulations and/or development orders. The Debtors obtained certain of these bonds from Safeco (the “Safeco Bonds”), under which the Debtors are obligated to ensure that any improvements comply with local specifications and, if the Debtors fail to do so, various governmental agencies (the “Obligees”) are entitled to make claims against the Safeco Bonds. The Debtors maintain that, as of July 31, 2008, the Safeco Bonds totaled \$38.2 million.

The Surety Motion. As the Committee may recall, among the motions the Debtors filed on August 4, 2008 (the “Petition Date”) was a motion (the “Surety Motion”) seeking to, among other things, prevent surety companies from giving notice, modifying, or cancelling any surety bonds without first obtaining relief from the Stay (the “Stay Relief Requirement”).¹ At a hearing held on August 5, 2008, Safeco objected to the approval of the Stay Relief Requirement. On August 6, 2008, the Court entered an order approving the Surety Motion on a final basis, but only approving the Stay Relief Requirement on an interim basis. On August 27, 2008, the Court extended the interim applicability of Stay Relief Requirement until the hearing set for September 10, 2008 (the “Hearing”). Prior to the Hearing, Safeco and two other sureties (collectively, the “Sureties”) filed objections (each, an “Objection”) to the Stay Relief Requirement and the Debtors filed a reply to the Objections (the “Reply”).

Safeco’s Objection. In its Objection and at the Hearing, Safeco argued, among other things, that the Safeco Bonds are not property of the Debtors’ estates because the benefit of the Safeco Bonds inures to the Obligees and not to the Debtors. As a result, according to Safeco, the Stay should not apply to the Safeco Bonds and the Debtors should not be entitled to compel Safeco to maintain the Safeco Bonds without providing adequate protection.

Debtors’ Reply. In their reply and at the Hearing, the Debtors maintained that the Safeco Bonds are a form of insurance policy and, as such, case law establishes that the Stay prevents Safeco from modifying or cancelling the Safeco Bonds without obtaining relief from the Stay.

¹ In addition, on the Petition Date, the Debtors filed four complaints (the “Complaints”) commencing adversary proceedings against Safeco seeking judgments for causes of action with respect to cancellation of four Safeco Bonds. On October 9, 2008, Safeco moved to dismiss the Complaints.

The Hearing. After presenting their arguments at the Hearing, the parties agreed that the Court's approval of the Stay Relief Requirement should be extended further on an interim basis until October 22, 2008 in order to give the parties an opportunity to negotiate a consensual form for a proposed order.

The Safeco Lift Stay Motion. On October 10, 2008, Safeco filed the Safeco Lift Stay Motion. In the Safeco Lift Stay Motion, Safeco claims that certain General Agreements of Indemnity between the Debtors and Safeco, dated February 26, 2001 and October 5, 2005 (together, the "Indemnity Agreements"), give Safeco the exclusive right to settle claims on any Safeco Bond. Safeco further asserts that if it is not permitted to resolve claims against the Safeco Bonds in the ordinary course, they will face increased losses in the form of interest, fees, and other claims, and such losses will increase the liability of the Debtors' estates to indemnify Safeco pursuant to the terms of the Indemnity Agreements.

In addition to the legal arguments presented in their Objection and at the Hearing, in the Safeco Lift Stay Motion, Safeco asserts that, upon information and belief, the Debtors do not intend to assume certain of the underlying obligations which required the procurement of the Safeco Bonds, thus rendering such bonds moot. Accordingly, to the extent the Debtors have no intention of performing any of the obligations to which any Safeco Bond relates, Safeco asserts it is entitled to cancel or terminate the applicable Safeco Bond. Safeco further asserts that, under the terms of the Indemnity Agreements, (i) the Debtors expressly agreed that they would procure the discharge of Safeco from any Safeco Bond and (ii) Safeco has the right to cancel any Safeco Bond at its discretion. In fact, Safeco alleges that the Debtors have previously requested that Safeco cancel a Safeco Bond, recognizing Safeco's right to do so. Thus, Safeco asserts that the Debtors have no equity interest in the Safeco Bonds and cannot use them in the reorganization without Safeco's consent and, thus, the Stay should be lifted to allow Safeco to cancel any Safeco Bond.

Alternatively, Safeco claims it is entitled to adequate protection in the form of (i) an order that the Stay extends to claims by Obligees against Safeco, and (ii) collateral in the full amount of the penal sum of every Safeco Bond that it is not permitted to cancel (estimated by Safeco to be \$45 million), or, at a minimum, (a) entry of an order for timely assumption or rejection by the Debtors of the underlying bonded obligations to allow a determination of which of the referenced Safeco Bonds can be cancelled or non-renewed, and (b) entry of an order compelling the Debtors to assume the Indemnity Agreements.