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Already owed thousands, Kara Homes contractors now told to pay back what they already got

Contractors who lost hundreds of thousands of dollars when Kara Homes failed over two years ago are being told they must turn over money Kara paid them before the builder filed for bankruptcy.

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As a young contractor, Matt Esposito did a lot of work for Kara Homes.

When the East Brunswick-based builder went belly up in October 2006, Esposito Group LLC in Old Bridge, a paving and excavation company, lost its biggest customer and was owed \$296,000.

"We were put in a really bad place," said Esposito, 32. He had to take out lines of credit to pay his suppliers, which he is still paying off.

The tough economy has taken its toll and now Esposito faces another crisis. The trustee in charge of paying unsecured creditors is trying to recover \$293,000 Kara paid Esposito within the 90 days before the company filed for bankruptcy.

"We got paid for the work that we did," Esposito said.

"It is impossible for us to pay. We would be forced to claim bankruptcy." His company employs 15 to 25 people.

"For the past three years, just because of the (Kara) bankruptcy, I've been working every day, every hour of every day, just to survive," he said.

Esposito is not alone. The Kara Homes Liquidating Trust, which is responsible for scraping together Kara assets and filling a pot of cash for unsecured creditors, is going after payments Kara Homes made to other contractors before the bankruptcy.

Robert W. Zimmermann, owner of RWZ Inc. Stairs and Rails in Lakewood, worked in 26 Kara developments, making his company one of the largest unsecured creditors.

Kara Homes paid his company \$268,000 in the 90 days before the builder filed for bankruptcy. The trustee wanted the money back, a figure that has been negotiated down to about \$168,000.

"I have taken a \$1.2 million hit in this and now they are trying to collect another \$168,000," Zimmermann said. "That is almost \$1.5 million. What company could survive that?"

He had 63 employees when Kara filed for bankruptcy, and coupled with the other effects of the poor economy, is now down to 17 workers.

"With the economy the way it is, there's not a lot of work out there, and now they are coming back to me and asking me for \$168,000?" Zimmermann said. "I don't have that kind of money."

What's happening

The payments to contractors were made for work they did for Kara Homes. So what's happening?

It turns out that this is part of the bankruptcy process.

Bankruptcy rules allow for the recovery of money that was paid by a failed company in the 90 days before the company filed for bankruptcy, said Warren A. Usatine, a lawyer with Cole Schotz in Hackensack representing the Kara Homes Liquidating Trust. "One of the basic tenets of bankruptcy is that everybody gets treated the same."

The assumption is that an insolvent company which makes a payment during that time period allows a creditor to get more than it would have had the beleaguered company filed for bankruptcy right before the payment was made, Usatine said.

"Generally, the idea is you want to get all that money back into the estate and then everybody who gives up money gets a claim," Usatine said. "You make it as if they didn't get the payment, give them a claim against the estate for the payment and that money goes into the pot and is distributed to everyone" equally.

It creates "a bigger pot for everybody to share," he said.

The process occurs in "virtually every (bankruptcy) case," he said.

It can seem ironic. Contractors, like home buyers, are unsecured creditors, all seeking to get as much as they can for their claim. And now, contractors say that they, unsecured creditors, are being sued by the trust that represents their interests.

"I have to pay their fees to sue me . . . because I am an unsecured creditor," said Perry Cormier, owner of Home Remodeling Concepts in Fairfield. "It makes no sense."

The trust began going after the money last October, shortly before a two-year statute of limitations expired. "A lot of them have already been settled," Usatine said. "A lot of them we are trying to settle. Others will probably have to be litigated."

There are some times when contractors can keep the payments they got, such as when a payment is paid on schedule, said Lawrenceville bankruptcy lawyer Timothy P. Duggan of Stark & Stark, who represented Yardville National Bank in the Kara case.

But, he said, "If the payment is substantially late, the creditor is exposed to having to give back the money."

It's a "very matter-of-fact" type of analysis performed by a trustee, Duggan said of the process. "It doesn't matter that they got the goods, they used to the goods, or your services were spectacular."

Source of funds

It can generate dividends for creditors, he said. "In many bankruptcy cases, this is the largest source of funds to pay other unsecured creditors."

Bankruptcy lawyer Brett Wiltsey of Dilworth Paxson in Cherry Hill, who represents eight contractors, including Esposito, said he is in settlement negotiations to resolve the cases.

"We do have valid legal defenses that we have raised," he said.

Their survival is at stake, he said.

"Many of my clients, I don't think have the wherewithal to pay it back," Wiltsey said. "If I am not successful, they are going to close their doors. You can imagine the construction industry right now; taking more construction jobs off the streets is not a positive."

E.L. Pierson Contracting and Trucking of Pitts-grove, Salem County, dug basements and put in building pads for Kara Homes. When Kara went bankrupt, the company was owed \$283,000, said owner Emory Pierson. Now the trustee wants him to return \$290,000 Kara paid before the bankruptcy.

But the money Kara paid was used for payroll, fuel, suppliers and taxes, he said. "Nobody is giving me that back," he said.

It threatens his business. "With the times that we're in right now, it's a good chance it will put me out of business," Pierson said. "I can't understand for the life of me how this can be and how it can go. The poor little guy has to suffer, always has to suffer."

Not fair

It's not fair, Esposito said. There are invoices backing up the payments, he said. "People are out there right now and they have my asphalt on their driveways, they have our asphalt on their roadways," he said. "That's material that I paid for. That's labor that we paid for."

Home Remodeling Concepts was owed \$1.118 million by Kara when it filed for bankruptcy. The trustee wanted more than \$400,000 paid back, Cormier said. The amount was reduced to about \$50,000, Cormier said. "No one knew that they were going to file (for bankruptcy) so how's it our problem that they gave us a check?"

"The contractors have no rights, no nothing," he said. His company worked to help get people into their homes, he said.

Meanwhile, creditors still have not received any payments from the scraps of Kara Homes. Former customers, suppliers and contractors are still waiting for their share of funds, which includes a \$2.25 million pot of money set aside when Kara emerged from bankruptcy as Maplewood Homebuilders. It amounts to about 9 cents on the dollar.

Creditors filed a glut of claims against Kara Homes. Of the total \$402.6 million in claims filed against Kara, about \$295 million were from unsecured creditors, according to court records. More than 1,050 claims were filed.

The process of working through all the claims is "almost complete," Usatine said. "It was a mess, a total mess."

There were more than 55 Kara developments involved in the case and duplicate claims, he said. "Trying to sort all that out was very, very time-consuming and difficult."

Once complete, there will be a partial distribution of money to unsecured creditors, he said.

The remainder will come from a pot of money set aside when Kara's assets were sold as well as the return of payments made to creditors before the bankruptcy, Usatine said.