



THE CITY OF KEY WEST
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COVER MEMO

Date: August 8, 2024

To: City Commission

CC: Todd Stoughton, Interim City Manager
Ronald Ramsingh, City Attorney

From: Jim Young, Director of Code Compliance,
Brett Marks, Esq. Bankruptcy Counsel

Re: Michael McMahon Bankruptcy Settlement Agreement related to
Code Compliance Liens

Background

I. Michael Joseph McMahon and Sergei Nikoshchenkov (the “Debtors”) filed for Chapter 11 relief in the United States Bankruptcy Court for the Southern District of Florida on 2/13/23 (the “2023 Chapter 11 Case”).

II. Debtors’ Current Asset Base and Secured Claims (all real estate described below is located in Key West, Florida)

- 28 Seaside South Court (Homestead Property)- This property is valued at \$1,000,000 (according to Bankruptcy Schedules). Subject to first mortgage in the amount of \$653,000 (Deutsche Bank) and secured claims of City of Key West and Monroe County

- 107 Front Street Apt. #217 (Rental Property)- This property is valued at \$4,000,000 (according to Bankruptcy Schedules)- Subject to first mortgage in the amount of \$2,640,000 (US National Bank) and secured claims of City of Key West and Monroe County. On 8/3/23, the Bankruptcy Court entered an Order approving the sale of this property for \$3,750,000. According to the closing statement, the mortgage and various county taxes were paid in full as well as various association fees. City of Key West received \$1,268.13 for an unpaid utility bill. The balance of the sale proceeds was \$693,473.92 which is sitting in an attorney trust account and available to pay the claims of creditors. From this fund is where the Debtors propose to settle with City of Key West.

- 100 Admirals Lane (Rental Property)- This property is valued at \$1,850,000 (according to Bankruptcy Schedules)- Subject to secured claims of Monroe County and City of Key West, but no mortgage of record.
- Miscellaneous Personal Property- Vehicles, home furnishings and \$250,000 claim against the USA

III. City of Key West Proof of Claim

- City of Key West filed a “secured” claim in the 2023 Chapter 11 Case for \$1,527,794.37 (the “City of Key West Claim”)
- The City of Key West Claim was filed secured because it claims its claim attaches to real estate owned by the Debtors valued at \$3,750,000
- The City of Key West Claim is based on a series of code violations committed by the Debtors
- The largest portions of the City of Key West Claim are two “Orders Imposing Liens as follows: A) “06-841” for \$23,825 which has ballooned to \$150,000 based on continued fines of \$25.00 per day since 10/6/2009; and B) “08-3359” for \$105,756.50 which has ballooned to \$1,299,506.50 based on “daily fines”.
- The remaining portions of the City of Key West Claim are for more code violations based on orders entered 2012, 2016, 2017, 2018 and 2019. These code violation claims also include sums for penalties and interest.
- According to Memo from City of Key West dated 5/22/24, the code violations are for: replacing a window without a permit, failure to have business tax receipt, failure to obtain short term rental license, renting a property for less than 30 days and advertising for short term rentals without approval by City of Key West
- According to Memo from City of Key West dated 5/22/24, the Debtors are now in compliance for the property located at 28 Seaside Drive

IV. The Debtors’ Objection to City of Key West Claim

- On 8/15/2023, the Debtors filed an Objection to the City of Key West Claim arguing the claim was inflated and should be based on “reliable figures”. In particular, the Debtors argue that the claim should be reduced because: A) the have corrected all code violations; B) transient license fines should have been handled by Air BNB; C) the claims should be separated out based on which parcel of real estate owned by the Debtors was subject to each claim; D) penalties and excessive daily fines should be stricken or equitably subordinated; and E) the Debtors dispute they received proper notice of the claims.
- More recently, the Debtors have argued that the portion of the City of Key West Claim based on code violations from 2006 and 2008 were dealt with and discharged in their prior bankruptcy case from 2009 discussed further below (see Supplemental Reply Brief of the Debtors filed on 10/14/23)

V. City of Key West Written Response to Debtors’ Objection to Claim

- On 9/14/23, City of Key West filed its Response to Objections to Claims

- City of Key West argued that the claim was based on code violations and has nothing to do with garbage, trash, sanitary sewer service or storm water
- City of Key West further argued that the claim is not a tax lien, but a code violation
- City of Key West also argued that the fines and penalties were not excessive and that the Debtors received proper notice of the code violations and proceedings which resulted in the orders imposing the fines and penalties
- City of Key West has not yet briefed the legal issue of whether the 2006 and 2008 code violations were already dealt with in the 2009 Bankruptcy (discussed further below)

VI. Status of Objection to City of Key West Claim

- The Bankruptcy Court has not yet ruled on the Objection to the City of Key West Claim and the matter is not currently set for hearing

VII. Prior Chapter 11 Filing

- Michael McMahon previously filed a Chapter 11 case in the United States Bankruptcy Court for the Southern District of Florida on 2/13/2009 (the “2009 Chapter 11 Case”).
- City of Key West was scheduled as an unsecured creditor for \$21,825.00 for “code violations” (this number is close to the \$23,825.00 claim for the order in 06-841)
- City of Key West filed a claim for \$3,188.49 based on “unpaid utilities”
- City of Key West did not assert a claim for the code violations found in 06-841 order or 08-3359 order (Note that this Order was entered in 2010, but arise from a filing in 2008 so would have been subject to the 2009 Chapter 11 case)
- On 1/14/15, the Bankruptcy Court confirmed McMahon’s 4th Amended Chapter 11 Plan
- The 4th Amended Plan provided that creditors would receive 50% of their allowed claim
- City of Key West did not appear in the 2009 Chapter 11 Case or object to the 4th Amended Plan
- The Confirmation Order provides in pertinent part:
- Paragraph 10: “Any judgment obtained in any court other than this Court is null and void as a determination of the liability of the Debtor with respect to debts dischargeable or determined by this Court to be discharged under 11 U.S.C. § 1141.”
- Paragraph 11: “All creditors whose debts are discharged by this Order and all creditors whose judgments are declared null and void (if any) are enjoined from commencing, continuing, or employing any action, process, or act to collect, recover, or offset any such debts as personal liability of the Debtor, or from property of the Debtor, whether or not discharge of such Debtor is waived.”
- Paragraph 12: “All creditors are also enjoined from commencing, continuing, or employing any action, process, or act to collect, recover, or offset any debts, or enforce any liens against the Debtor on account of any debt that existed as of the Petition Date.”

- McMahon ended up making all payments under the Chapter 11 Plan and the Court issued a final decree in 2021.

VIII. The Debtors' Settlement Proposal on the Objection to City of Key West Claim

- Debtors propose to pay City of Key West \$125,000 in satisfaction of all past due code violations (presumably as a lump sum payment)

IX. Analysis

The Debtors asset base is sufficient to pay City of Key West almost the full amount of its claim based on the values of 100 Admirals Lane (valued at \$1,850,000 with no mortgage), 1065 Morse Road (valued at \$500,000 with no mortgage) and the approximate \$693,473.92 held from the sale of the Front Street Property. The claims other than City of Key West and Monroe County are relatively minor in amounts owed. If the City of Key West Claim was allowed in full and City of Key West could force a sale of the remaining properties, City of Key West would recoup a substantial portion of the City of Key West Claim. The open question is whether the Bankruptcy Court will allow the City of Key West Claim in full or reduce the claim substantially based on the Objection to Claim filed by the Debtors.

A significant impediment for City of Key West to have its claim allowed in full is that the most substantial portions of the claim relate to the 06-841 code violation order for \$23,825 which has ballooned to \$150,000 and the 08-3359 code violation order for \$105,756.50 which has ballooned to \$1,299,506.50. The code violation orders were entered before the 2009 Chapter 11 and Key West was required to file a claim against this Debtor for these code violations; however, City of Key West did not file a claim for these code violations back in 2009, only for unpaid utilities. The 2009 Chapter 11 Case culminated in a confirmed Chapter 11 Plan. 11 U.S.C. § 1141(a) of the Bankruptcy Code provides that "Except as provided in subsections (d)(2)1 and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan." Thus, City of Key West may be barred from pursuing claims for the 06-841 and 08-3359 code violations because it did not assert claims for these violations in the 2009 Chapter 11 case and is arguably now bound by Section 1141(a) of the Bankruptcy Code from doing so.

In addition, the Debtors could argue that the City of Key West Claim is excessive based on the sums claimed owed for the 06-841 and 08-3359 code violations. While the Debtors have not specifically argued the following, both the Excessive Fines Clause of the Eighth Amendment to the United States Constitution and the Excessive Fines Clause of Section 17 of Article I of the Florida Constitution could result in the Bankruptcy Court concluding that these portions of the City of Key West claim are excessive and reduce the City of Key West Claim as a result. While

we did not do a deep dive into these defenses (based on the limited budget we were provided to provide this analysis), we note that courts have concluded that: “A fine is excessive ‘if it is grossly disproportional to the gravity of a defendant's offense.’” Wilton Manors, 175 F.3d at 1309 (quoting United States v. Bajakajian, 524 U.S. 321, 334 (1998)). Indeed, “[t]he touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality.” Bajakajian, 524 U.S. at 334. “Well-settled Florida decisional authority provides that a statutorily authorized civil fine will not be deemed so excessive as to be cruel or unusual unless it is so great as to shock the conscience of reasonable men or is patently and unreasonably harsh or oppressive.” Locklear v. Fla. Fish & Wildlife Conservation Comm'n, 886 So. 2d 326, 329 (Fla. 5th DCA 2004) (citing Amos v. Gunn, 94 So. 615 (1922)). Bankruptcy Courts are courts of equity, and we doubt that the Debtors will be forced to sell real estate and pay the City of Key West on its claim based on continuing fines from 2006 and 2008. Here, the 06-841 claim has ballooned 700% and the 08-3359 code violations have ballooned to over 1200% of the original claim. We believe there is a good chance that the Bankruptcy Court could find the current amount of these claims excessive or unconscionable.

Lastly, for the purposes of analysis, the Debtors own significant non-exempt assets and now appear to have the finances necessary to fund significant litigation against the City of Key West all the way through trial and the appeals process. It may also be in the City of Key West's interest to settle now as it could receive the \$130,000 payment quickly rather than wait out the Debtors' Chapter 11 cases to see what happens or have a trial and then likely appeals of the City of Key West claim which could take months or years to complete.

X. Conclusion

We have conferred with the Subchapter V Trustee in this case to obtain her position on settlement and see if the Bankruptcy Court has made any statements critical of the City of Key West Claim. While the Subchapter 5 Trustee is biased because she wants to see a plan confirmed and get paid her fees, she did tell us that the Bankruptcy Court views the City of Key West, and any governmental creditor for that matter, as an entity with different motivations than a normal creditor. To the Bankruptcy Court, the City of Key West's incentive should be to get something corrected, which goal has already been achieved according to the Sub-Chapter 5 Trustee. Thus, on top of the legal impediments stated above, we may not have the most sympathetic judge to consider our claims.

During Mr. McMahon's ownership of said properties, Code Compliance staff processed the following code cases, as detailed in **Table 1, Table 2 and Table 3**.

Table 1: Case History, 28 Seaside South Court¹

DATE	NARRATIVE										
02/27/2013	Case No.:12-0822. Respondent McMahon was found in violation of City Ordinance Section 66-87, renting subject property without the required non-transient rental business tax receipt by the Code Compliance Special Magistrate. Administrative cost of \$250.00 and a fine of \$4.99 was assessed. Total owed \$254.99.										
11/16/2016	Case No.:16-1303. Respondent McMahon was found in violation of City Ordinance Sections 18-601 and 122-1371(d)(9), renting the subject property without the required transient rental business tax receipts by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a fine of \$3,500.00 was assessed. Total owed \$3,750.00.										
10/18/2017	Case No.:17-1212. Respondent McMahon was found in violation of City Ordinance Sections 18-601 and 122-1371(d)(9), renting the subject property without the required transient rental business tax receipts by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a fine of \$10,433.00 was assessed. Total owed \$10,683.00.										
08/10/2016 01/27/2017	The following Liens were recorded with the Monroe County Clerk of Courts against the former property owner: <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>Book/Page No.</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>2810/172</td> <td>\$254.99</td> </tr> <tr> <td>2836/1650</td> <td>\$3,750.00</td> </tr> <tr> <td>2880/1304</td> <td>\$10,683.00</td> </tr> <tr> <td style="text-align: right;">TOTAL</td> <td>\$14,687.99</td> </tr> </tbody> </table>	Book/Page No.	Amount	2810/172	\$254.99	2836/1650	\$3,750.00	2880/1304	\$10,683.00	TOTAL	\$14,687.99
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2810/172	\$254.99										
2836/1650	\$3,750.00										
2880/1304	\$10,683.00										
TOTAL	\$14,687.99										

Table 2: Case History, 100 Admirals Lane

DATE	NARRATIVE
01/24/2007	Case No.:06-0841. Respondent McMahon was found in violation of City Ordinance Section 102-152, installing reflective window tinting without the required HARC Certificate of Appropriateness by the Code Compliance Special Magistrate. Administrative cost of \$150.00 and a daily fine of \$250.00 was assessed. Total owed \$150,000.00.
05/18/2009	Case No.:08-3359. Respondent McMahon was found in violation of City Ordinance Sections 66-87, 18-601 and 18-602, renting the subject property without the required business tax receipts, by the Code Compliance Special Magistrate. Administrative costs of \$250.00, a onetime fine of \$5006.50 and a daily fine of \$250.00 was assessed. Total owed \$1,299,506.50.
03/29/2017	Case No.:17-0166. Respondent McMahon was found in violation of

¹ All facts are taken from available public records. However, due to the passage of time, some information may not be available.

	City Ordinance Sections 18-601 and 122-1371(d)(9), renting the subject property without the required business tax receipts, by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a onetime fine of \$4,500.00 was assessed. Total owed \$4,750.00.												
11/15/2017	Case No.:17-1154. Respondent McMahan was found in violation of City Ordinance Sections 18-601 and 122-1371(d)(9), renting the subject property without the required business tax receipts, by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a onetime fine of \$9,532.63 was assessed. Total owed \$9,782.63. No lien filed.												
11/15/2017	Case No.:17-1187. Respondent McMahan was found in violation of City Ordinance Sections 18-601 and 122-1371(d)(9), renting the subject property without the required business tax receipts, by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a onetime fine of \$8,067.25 was assessed. Total owed \$8,317.25. No lien filed.												
09/26/2018	Case No.:18-1024. Respondent McMahan was found in violation of City Ordinance Sections 18-601 and 122-1371(d)(9), renting the subject property without the required business tax receipts, by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a onetime fine of \$15,000.00 was assessed. Total owed \$15,250.00.												
04/24/2019	Case No.: CC2019-0083. Respondent McMahan was found in violation of City Ordinance Sections 18-601 and 122-1371(d)(9), renting the subject property without the required business tax receipts, by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a onetime fine of \$20,500.00 was assessed. Total owed \$20,750.00. No lien filed.												
11/06/2009 06/29/2010 04/05/2017 11/14/2019	The following Liens were recorded with the Monroe County Clerk of Courts against the former property owner: <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: center;">Book/Page No.</th> <th style="text-align: center;">Amount</th> </tr> </thead> <tbody> <tr> <td>2439/408</td> <td style="text-align: right;">\$150,000.00</td> </tr> <tr> <td>2472/1909</td> <td style="text-align: right;">\$1,299,506.50</td> </tr> <tr> <td>2847/1501</td> <td style="text-align: right;">\$4,750.00</td> </tr> <tr> <td>2994/929</td> <td style="text-align: right;">\$15,250.00</td> </tr> <tr> <td style="text-align: right;">TOTAL</td> <td style="text-align: right;">\$1,469,506.50</td> </tr> </tbody> </table>	Book/Page No.	Amount	2439/408	\$150,000.00	2472/1909	\$1,299,506.50	2847/1501	\$4,750.00	2994/929	\$15,250.00	TOTAL	\$1,469,506.50
Book/Page No.	Amount												
2439/408	\$150,000.00												
2472/1909	\$1,299,506.50												
2847/1501	\$4,750.00												
2994/929	\$15,250.00												
TOTAL	\$1,469,506.50												

Table 3: Case History, 107 Front Street

03/29/2017	Case No.:17-0162. Respondent McMahan was found in violation of City Ordinance Sections 66-87, 18-601 and 18-602, renting the subject property without the required business tax receipts, by the Code Compliance Special Magistrate. Administrative costs of \$250.00 and a onetime fine of \$4,500.00 was assessed. Total owed \$4,750.00.						
04/05/2017	<p>The following Liens were recorded with the Monroe County Clerk of Courts against the former property owner:</p> <table border="1" data-bbox="414 588 1477 703"> <thead> <tr> <th data-bbox="414 588 950 630">Book/Page No.</th> <th data-bbox="950 588 1477 630">Amount</th> </tr> </thead> <tbody> <tr> <td data-bbox="414 630 950 672">2847/1500</td> <td data-bbox="950 630 1477 672">\$4,750.00</td> </tr> <tr> <td data-bbox="414 672 950 703" style="text-align: right;">TOTAL</td> <td data-bbox="950 672 1477 703">\$4,750.00</td> </tr> </tbody> </table>	Book/Page No.	Amount	2847/1500	\$4,750.00	TOTAL	\$4,750.00
Book/Page No.	Amount						
2847/1500	\$4,750.00						
TOTAL	\$4,750.00						

Mitigation Factors

The following criteria was considered by Staff in evaluating the lien mitigation request:

A. The nature and gravity of the violation.

B. Any actions taken by the Respondent to correct the violation.

None that staff is aware of or that McMahan has provided to staff.

C. The length of time between the previously ordered compliance date and the date the violation was brought into compliance.

None that staff is aware of or that McMahan has provided to staff.

D. Any actual costs expended by the Respondent to cure the violation as provided by supporting documentation.

None that staff is aware of or that McMahan has provided to staff.

E. Any other prior or current violations committed by the Respondent on the subject property or upon any other property owned by the Respondent within the City.

There are currently no code violations on the property, or any other properties owned by McMahan.

F. Owner’s Justification for the requested lien mitigation.

None has been provided to staff at this time.

G. Any other factors.

None that staff is aware of or that McMahan has provided to staff.

Recommendation

Staff's recommendation is to accept the settlement for \$125,000 to compensate the City of Key West for its additional outside counsel expense and other expenses and time incurred for having to deal with the Debtors' Chapter 11 case.