U.S. BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

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| **In re**<br>**TWO BROTHERS XI, INC. et al,**<br>**Debtors.** | In Chapter 11 proceedings<br><br>Case No.: 10-23048<br><br>**UNDER ADVISEMENT DECISION SETTING VALUE FOR PURPOSES OF THE PLAN FOR ONE BROTHER 1, INC., TWO BROTHERS I, INC., AND TWO BROTHERS VII, INC.** |

## I. Introduction

The Debtors and SummitBridge Credit Investment LLC ("SummitBridge") have two very different approaches to valuing the Debtors' gas station/convenience stores ("C-Stores")[1]. The Debtors urge the Court to recognize the realities of the marketplace and value them using a "bulk volume discount" on the grounds that those are the only types of C-Stores sales that are currently occurring. Using this approach, the Debtors value the C-Stores at $2,415,000. SummitBridge, by comparison, asks the Court to value the Debtors as they will be operated under the Plan – as a going concern. Using this approach, the lender values the C-Stores at $4,800,000.

There are two basic decisions the Court must make: 1) as a legal matter, what standard of valuation should the Court use under § 506(a); and 2) as a factual matter, what value should the Court find under the appropriate valuation standard.

[1] The three C-Stores affected by this decision are those operated by the so-called "March Debtors" and are known as OB I, TB I and TB VII.

## II. Facts

The underlying facts are relatively undisputed. The numbers and assumptions used in each appraisal (Tolson for the Debtor and Kleinman for SummitBridge), on the other hand, are highly disputed.[2]

There are three C-Stores, each corresponding to one of the Debtors, being valued:

One Brother 1, Inc. ("OB I") (Case No. 11-7955):

1. Valero convenience store and gas station located at 1959 East Broadway, Mesa, AZ 85204
2. Sits on roughly 21,000 square feet at the corner of Broadway and Gilbert Roads
3. Zoned C-2
4. C-Store square footage is between 2,470 (Kleinman) and 2,656 SF (Tolson)
5. Fuel Canopy is 3,360 SF
6. Built 1984; upgraded 2007;

Two Brothers I, Inc. ("TB I") (Case No. 11-7952):

1. In the Zone Gas convenience store, wash tunnel, and gas station located at 3565 East Broadway, Mesa, AZ 85204
2. Sits on roughly 51,00 square feet at the Corner of Broadway and Val Vista
3. Zoned C-2
4. C-Store square footage is between 4,383 SF (Kleinman) and 4,590 (Tolson)
5. Fuel Canopy square footage is between 4,446 (Tolson) and 4,661 (Kleinman)
6. Car wash square footage is between 989 (Kleinman) and 1,020 ( Tolson)
7. Built 1997; and

Two Brothers VII ("TB VII") (Case No. 11-7954):

1. Valero convenience store and gas station located at 1925 N. Scottsdale Road, Tempe, AZ
2. Sits on roughly 28,000 square feet at the corner of McKellips and Scottsdale Roads
3. Zoned CCS
4. C-Store square footage is between 2,952 (Tolson) and 3,022 (Kleinman)
5. Fuel Canopy SF is 3,720
6. Built 1997.

SummitBridge has a lien and security interest in the stations and related assets owned by OB I, TB I, and TB VII with debt totaling approximately $6.2 million on all three stores.

Under the Debtors' plan filed July 22, 2011 (Dkt #548) ("Plan"), the Debtors propose to retain their interest in the stores, operate them as going concerns, and pay creditors from the proceeds of operations. For each store, the SummitBridge debt is bifurcated, the secured portion paid on a 30 year amortization at 4% with a ten year

[2] The Debtors used their appraiser's value in the Plan. Saad Saad, the Debtors' Vice-President, values the C-Stores at $1,639,000. The Court puts little weight in this opinion of value because it is premised on the wrong standard; as such, the Court will compare the competing appraisers' opinions.

balloon, and the unsecured portion paid from excess cash flow *pro rata* with all other unsecured claims, including inter-company and insider claims. The Plan purports to pay all debts in full.

**III. Legal Standards**

As framed in the joint pretrial statement, the Court is being asked to value OB I, TB I, and TB VII "for the purpose of the Plan and treatment of [SummitBridge's] secured claim thereunder." Before reviewing the content of the appraisals to determine value, the Court will first determine the prism through which to view them: bulk sale discount or fair market value.

The Debtors urge the Court to determine fair market value and then apply a bulk sale discount as this is a practical approach to the realities of the marketplace. According to the Debtors, the Court should ask: who's buying C-Stores and at what price? The Debtors answer their own question: corporate or Wall Street buyers with independent money looking to purchase several stores at once. According to the Debtors, these investors are seeking troubled assets, expect a deep discount, and have short marketing terms. This bulk sale approach simply recognizes the realities of the marketplace, conclude the Debtors, whereas SummitBridge's fair market approach ignores the realities. However, the Debtors' closing brief contains no legal support for using this approach where a debtor, under a plan, proposes to retain and use the collateral valued.

Comparatively, SummitBridge, claiming consistency with controlling law, applies fair market value without any discount. The Ninth Circuit requires a debtor to appraise secured assets it plans to retain at "fair market value." *In re Taffi*, 96 F.3d 1190, 1192 (9th Cir. 1996). Fair market value "is the price which a willing seller under no compulsion to sell and a willing buyer under no compulsion to buy would agree upon after the property has been exposed to the market for a reasonable time." *Id.* at 1192. Pursuant to 11 U.S.C. § 506(a)(1), bankruptcy courts determine the value of a creditor's secured claim in reference to two factors: (1) the debtor's proposed use or liquidation of the collateral to be valued and (2) the purpose of the valuation. *In re Pletz*, 221 F.3d 1114, 1118 (9th Cir. 2000).

SummitBridge has the better of the argument. According to 11 U.S.C. § 506(a)(1)[3] the "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." *Taffi*[4] and *Pletz*[5] are clear: fair market value under § 506 is the price which a willing seller, under no compulsion to sell, and a willing buyer, under no compulsion to buy, would agree upon; the factors used to determine value are the Debtor's proposed use and the purpose of the valuation.

What is the Plan here? The Debtors plan to retain the collateral and operate the gas stations as a going concern. A bulk sales valuation does not match the purpose as contemplated in the Plan, whereas a market value approach would. Remember, "[v]aluation must be accomplished within the actual situation presented." *Taffi*, 96 F.3d at 1192. The Court understands the Debtors' argument that a "bulk discount" is the reality of the market and therefore that is the fair market value. The Court simply disagrees with this approach under the case law. Accordingly, the Court will value the property using a market value approach without a bulk sales discount.

**IV. Appraisals Review**

Once the bulk discount is removed, the difference in value between the two appraisals drops significantly:

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[3] Section 506(a)(1) reads:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

[4] "[W]hen the proposed use of the property is continued retention by the debtor, the purpose of the valuation is to determine how much the creditor will receive for the debtor's continued possession. Hypothetical sales costs are not to be considered because no sale is intended." *Taffi*, 96 F.3d at 1192

[5] "When the Debtor continues to use and occupy property subject to a lien, the purpose of valuation is to determine what the creditor should receive in exchange for the Debtor's continued possession." *In re Pletz*, 221 F.3d at 1118.

*Original Appraisals Value*

| Store | Kleinman | Tolson |
|---|---|---|
| OB I | $1,300,000 | $ 535,000 |
| TB I | $1,950,000 | $1,120,000 |
| TB VII | $1,550,000 | $ 760,000 |
| Total | $4,800,000 | $2,415,000 |

*Value without Bulk Sale Discount*

| Store | Kleinman | Tolson |
|---|---|---|
| OB I | $1,300,000 | $ 890,000 |
| TB I | $1,950,000 | $1,600,000 |
| TB VII | $1,550,000 | $1,015,000 |
| Total | $4,800,000 | $3,505,000 |

Despite the remaining $1.3 million gap, the appraisals' conclusions aren't as different as they appear when some key adjustments are made.

Both appraisers, as is standard, consider the cost, sales, and income approach when determining value. Which approach should be given the most weight? For two of the three C-Stores (OB I and TB VII) Tolson gives the greatest weight to sales; in the other (TB I) he gives "ample" weight to income, secondary weight to cost, and does not indicate the weight given to sales. For all three C-Stores Kleinman gives the most weight to income. The Court agrees with Kleinman's approach, primarily because under the Plan each of the C-Stores is to be operated as a going concern, thereby aligning the income approach with the purpose of the valuation. The Debtors suggest in their closing brief that the income approach is flawed because "a store that sells is either unprofitable or difficult to manage; because operators simply do not sell profitable stores that are easy to manage." This is exactly why the income approach is the correct approach – the Debtors do not want to sell and the Plan does not so provide.

The appraisers reach the following valuations using the income approach:

| Store | Kleinman | Tolson |
|---|---|---|
| OB I | $1,370,000 | $885,000 |
| TB I | $1,950,000 | $1,680,000 |
| TB VII | $1,560,000 | $1,015,000 |
| Total | $4,880,000 | $3,580,000 |

The Court notes that the numbers are close matches to the appraisers' (pre-bulk) reconciled valuations. Kleinman's and Tolson's different conclusions as to value can be explained by examining the treatment of furniture, fixtures, and equipment ("FF&E")[6] and the selection of the gross profit multiplier ("GPM").

Tolson backs out the FF&E; Kleinman includes it; and the amount of value allocated to FF&E by each is very different.[7] Tolson stated during cross that the FF&E is taken out of the income analysis because "you're not talking about hard numbers" so you have to take the value of the equipment and put a capitalization rate on the equipment. Therefore, though unclear in the appraisals, Tolson indicated during cross that FF&E is not included in his reconciliation of value. This explanation is unclear at best and confusing at worst. At bottom, Tolson does not make a convincing case for excluding FF&E from his valuation methodology. Therefore, the Court will not "back out" any number for FF&E from the valuations otherwise indicated.

Once this change is accounted for, Kleinman and Tolson appraisals are closer yet:

*Reconciliation Value*

| Store | Kleinman | Tolson |
|---|---|---|
| OB I | $1,300,000 | $1,030,000 |
| TB I | $1,950,000 | $1,682,500 |
| TB VII | $1,550,000 | $1,137,500 |
| Total | $4,800,000 | $3,850,000 |

*Income Value*

| Store | Kleinman | Tolson |
|---|---|---|
| OB I | $1,370,000 | $1,110,000 |
| TB I | $1,950,000 | $1,805,000 |
| TB VII | $1,560,000 | $1,200,000 |
| Total | $4,880,000 | $4,115,000 |

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[6] As defined by Tolson in his OB I appraisal, FF&E is:

> The movable property of a business enterprise not classified as stock or inventory or leasehold improvements; frequently found in the ownership of hotels or motels, restaurants, assisted-living facilities, service stations, car washes, greenhouses and nurseries, and other service-intensive properties. Furniture, fixtures, and equipment frequently wear out much more rapidly than other components of those properties.

p. 11 (citing to Appraisal Institute, the Dictionary of Real Estate Appraisal, 105 (4th Ed. 2002)).

[7] *Value Attributed to FF&E*

| Store | Kleinman | Tolson | Tolson Income FF&E Deduction |
|---|---|---|---|
| OB I | $275,000 | $140,000 | $215,000 |
| TB I | $400,000 | $ 82,500 | $125,430 |
| TB VII | $275,000 | $122,500 | $186,245 |

Next, the Court will consider the choice of GPM as it also affects value. Kleinman uses a multiplier of 4.5:

| Store | Gross Profit | Multiplier | Value |
|---|---|---|---|
| OB I | $304,850 | 4.5 | $1,371,825 |
| TB I | $439,840 | 4.5 | $1,979,280 |
| TB VII | $347,300 | 4.5 | $1,562,850 |
| Total | | | $4,913,955 |

Tolson uses a multiplier of 3.54:

| Store | Gross Profit | Multiplier | Value |
|---|---|---|---|
| OB I | $330,000 | 3.5[8] | $1,155,000 |
| TB I | $510,400 | 3.54 | $1,806,816 |
| TB VII | $283,100 | 3.54 | $1,002,174 |
| Total | | | $3,963,990 |

Kleinman has better gross profit numbers; they are more current and the analysis more complete. The multiplier, however, is too high given the complete range of comparables found by the appraisers. An average of the two chosen is 4.18; this number fits nicely in the range of 3.52 to 5.52 set by the two reports and takes into account the nature and condition of the stores in question. Using this approach, the Court reaches the following value:

| Store | Gross Profit | Multiplier | Value |
|---|---|---|---|
| OB I | $304,850 | 4.18 | $1,274,273 |
| TB I | $439,840 | 4.18 | $1,838,531 |
| TB VII | $347,300 | 4.18 | $1,451,714 |
| Total | | | $4,564,518 |

Finally, the Court notes that Kleinman's reconciled values are generally lower than his income values.[9] The Court will incorporate a similar reduction in value on a per C-store basis. Therefore, the Court concludes the values of the stores for plan confirmation purposes as:

| Store | Income Value | Court's Adjusted Value |
|---|---|---|
| OB I | $1,274,273 | $1,200,000 |
| TB I | $1,838,531 | $1,840,000 |
| TB VII | $1,451,714 | $1,440,000 |
| Total | $4,564,518 | $4,480,000 |

[8] While referencing a 3.54 multiplier, Tolson used a multiplier of 3.5 on the OB I appraisal.

[9]

| Store | Income Value | Reconciled Value |
|---|---|---|
| OB I | $1,370,000 | $1,300,000 |
| TB I | $1,950,000 | $1,950,000 |
| TB VII | $1,560,000 | $1,550,000 |

**V. Conclusion**

Based on the foregoing, the Court assigns value as follows for the purposes of Plan valuation:

| Store | Value |
|---|---|
| OB I | $1,200,000 |
| TB I | $1,840,000 |
| TB VII | $1,440,000 |
| Total | $4,480,000 |

Counsel for SummitBridge is to upload a form of order.

**So ordered.**

Dated: March 29, 2012

CHARLES G. CASE II
UNITED STATES BANKRUPTCY JUDGE

COPY of the foregoing mailed by the BNC and/or
sent by auto-generated mail to:

All creditors and interested parties