U.S. BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re **TWO BROTHERS XI, INC., et al.** **Debtors**	)	In Chapter 11 proceedings Case No.:10-23048 **MEMORANDUM DECISION RE: PLAN CONFIRMATION**

I. Introduction

Like many family-owned and operated businesses, the Debtors saw their profits dwindle during the recent recession. Now, after almost three years of contentious litigation, the Debtors view the market as beginning to recover and propose three plans of reorganization; one for each group of Debtors (the "September Debtors," "March Debtors" and "May Debtors"). Each group of Debtors seeks to cram down a plan of reorganization over the objection of their respective senior secured creditors: Enterprise Bank & Trust ("Enterprise"), General Electric Capital Asset Business Funding Corporation ("General Electric") and SummitBridge Credit Investments LLC ("SummitBridge") (collectively the "Senior Secured Creditors").

The Senior Secured Creditors, however, do not share such an optimistic view of the economy and, initially, each filed a competing plan of reorganization proposing to liquidate the Debtors' assets for the benefit of creditors. However, Enterprise and General Electric recently withdrew their plans, citing an inability to pay the Debtors' rising

administrative expenses in full on the Effective Date. Thus, SummitBridge is the only remaining Senior Secured Creditor now proposing a competing plan of reorganization.

II. Facts

The affiliated Debtors operate nine gas stations and convenience stores.[1] All but one Debtor is named Two Brothers ("TB") and correspondingly numbered according to the property it owns and operates.[2] There are three secured creditors, each of whom has liens on the assets of a different group of stations, commonly clustered by the filing date.

The September Debtors include the gas stations/convenience stores which filed bankruptcy under Chapter 11 on September 2, 2010. These Debtors are: TBV, operating the station located at 2635 W. Deer Valley Road, Phoenix, Arizona (the "Deer Valley Property"), TBVI, operating the station located at 28 North Signal Butte Road, Apache Junction, Arizona (the "Signal Butte Property), TBIX, operating the station located at 3981 E. Guadalupe Road, Gilbert, Arizona (the "Guadalupe Property"), and TBX, operating the station located at 3565 E. Broadway Road, Mesa, Arizona (the "Broadway Property"). Enterprise is the senior secured creditor for each of the September Debtors.

The March Debtors include the gas stations/convenience stores which filed bankruptcy under Chapter 11 on March 25, 2011. These Debtors are: TBI, operating the station located at 3565 E. Broadway Road, Mesa, Arizona (the "3565 Broadway Property"), TBVII, operating the station located at 1925 N. Scottsdale Road, Tempe, Arizona (the "Scottsdale Road Property"), and One Brother 1 ("OB1"), operating the

[1] The same management operates several other stations not currently in bankruptcy, including some owned by debtors previously in bankruptcy but whose cases were subsequently dismissed following settlement with their senior secured lender, Atlantic National Bank. The bankruptcy cases of Saad Nemer Saad, Inc., TBXI and TBXII were dismissed on May 6th, 2011 (*see* case no. 2:10-bkc-23048-CGC, 2:10-bkc-23056-CGC and 2:10-bkc-23057-CGC).
[2] One of the March Debtors is named One Brother 1 ("OB1").

station located at 1959 E. Broadway, Mesa, Arizona (the "1959 Broadway Property"). SummitBridge is the senior secured creditor for each of the March Debtors.

The May Debtors include the gas stations/convenience stores which filed bankruptcy under Chapter 11 on May 4, 2011. These Debtors are: TBII, operating the station located at 4328 E. Chandler Boulevard, Phoenix, Arizona (the "Chandler Property") and TBIII operating the station located at 1003 N. 32nd Street, Phoenix, Arizona (the "32nd Street Property"). General Electric is the senior secured creditor for each of the May Debtors.[3]

A related company, Two Brothers Distributing, Inc. ("TBD") is an Arizona Corporation that acts as the distributor for the Debtors that operate Valero stations and oversees the operations of all Debtors, including payment of overhead expenses. Thus, TBD is the sole supplier of gas and related products to all the Debtors, except TBV which operates a BP gas station.

A. Ownership and Management of the Debtors and Related Entities

Ali Saad is a Director and President of TBII, TBV, TBVI, TBVII, TBIX and is in charge of day-to-day operations for all the Debtors. Saad Saad is a Director and Vice President of TBII, TBVI, TBVII, and TBIX and is President of TBI, TBIII, TBX and OB1 and is in charge of all aspects of business operations, building construction and maintenance for all of the debtors. Moreover, Ali Saad is the President, CEO and Director and Saad Saad is the Vice President and Director of TBD.

[3] GE also asserts that its deficiency claim from its interest in non-debtor TBVIII's property (a dark property) is secured by the assets and receivables of the May Debtors and is part of their secured claim. The Court rejects this contention that GE's interest in TBVIII is cross-collateralized by the assets of the May Debtors. Moreover, the Court notes that GE made no effort to minimize its deficiency claim because it did not attempt to appoint a receiver or otherwise try to prevent TBVIII from "going dark" to preserve going concern value.

Houeida and Nada Saad, sisters of Ali Saad and Saad Saad, as well as Elizabeth Sinohara are the shareholders of the various Debtors. Their interests in the Debtors are as follows:

- TBI - Houeida Saad 50%, Nada Saad 50%
- TBII – Houeida Saad 25%, Nada Saad 75%
- TBIII – Houeida Saad 33%, Nada Saad 67%
- TBIV – Houeida Saad 50%, Nada Saad 50%
- TBV - Houeida Saad 50%, Nada Saad 50%
- TBVI - Houeida Saad 50%, Nada Saad 50%
- TBVII - Houeida Saad 25%, Nada Saad 26%, Elizabeth Sinohara 49%
- TBIX - Houeida Saad 50%, Nada Saad 50%
- TBX - Houeida Saad 33%, Nada Saad 34%, Elizabeth Sinohara 33%
- OB1 - Houeida Saad 25%, Nada Saad 26%, Elizabeth Sinohara 49%

Nada Saad and Houeida Saad are also the only shareholders of TBD, each owning a 50% interest.

B. The Debtors' Plans

The September Debtors, March Debtors and May Debtors all propose substantially the same plan of reorganization. All Debtors filed their initial plans and disclosure statements on July 20, 2012 (Dkt. # 994, 995, 996). Supplements to their disclosure statements were later submitted (Dkt. # 1083, 1084, 1087) and revised supplements were then filed on August 23, 2012. (Dkt. # 1091, 1093, 1095). The Court approved each Debtor's disclosure statement a few days later.

The Debtors' plans propose to reorganize and pay all claims in full with the profits generated from future operations. The Debtors' plans also provide that if the Debtors are unable to make any required payment to creditors under the plans, their shareholders will provide additional funding as needed to cover the shortfalls. However, the Debtors project that cash flows generated from future business operations will be

sufficient to make all proposed payments under the plan and, thus, no additional funding will be needed to cover any shortfalls.

i. Classification and Treatment of Claimants

Each of the Debtors' plans provide for substantially the same classification and treatment of claims. These plans only differ in the amount of claims and the identity of the claimants.

Each plan places administrative claims and priority tax claims in separate classes and provides for payment of these claims in full on the Effective Date. However, Debtors' counsel, Aiken Schenk Hawkins & Ricciardi, P.C., and TBD have agreed to accept payment of their administrative claims over time to the extent the Court determines it is necessary or appropriate to make the Debtors' plans feasible. The Debtors' plans accordingly also allow for payment of its attorney's fees in monthly payments of 8% interest and a reduction of principal until paid in full.

The Senior Secured Creditors' secured claims are also placed in a separate class in each of the Debtors' plans. The plans provide for payments on these secured claims amortized over 30 years with 4% interest paid in equal monthly payments with a balloon payment due 10 years after the Effective Date.

The Senior Secured Creditors' unsecured deficiency claims are placed in separate classes by themselves and will be paid from the Debtor's excess cash flow, on a semi-annual basis, pro-rata with other general unsecured claims until paid in full.

Unsecured claims in excess of $2,000 are placed in a class of general unsecured claims and unsecured claims less than $2,000 are placed in a separate administrative convenience class. The general unsecured claims will be paid on the same basis and share

pro rata with the Senior Secured Lender's deficiency claim. The administrative convenience claimants are also paid from the Debtor's excess cash flow, on a semi-annual basis but will be paid in full prior to any distributions to other unsecured creditors.

ii. Proposed New Value Contribution

The Debtors' plans also place equity interests of the Debtor into a separate class. The plans provide that these equity holders shall retain their equity interests and, in consideration for retaining those interests, shall infuse sufficient funds, as determined by the Court, to pay all administrative claims and priority claims in full on the Effective Date. Moreover, to the extent that there is a funding shortfall for any required payments to secured creditors under the plan, the equity holders shall further remit funds necessary to cover any shortfall. These additional contributions of funds shall be made in proportion to the equity holders' ownership interests in the debtors and constitute an equity contribution, not a loan. Each equity holder submitted binding declarations detailing this funding commitment as well as their financial ability to make these contributions based on their individual percentage ownership interest in each Debtor.

iii. Voting

A review of the ballots submitted reflects that of the Senior Secured Creditors voted their impaired secured and deficiency claims to reject the plans. Most other impaired secured claimants and general unsecured creditors did not vote on the plans. Impaired insider claimants such as TBD, PSG, pre-petition lenders and equity holders voted to accept the plans.

Except as specifically described immediately below, the only non-insider impaired accepting class for any of the Debtors was the administrative convenience class

of unsecured creditors. The non-insider accepting impaired classes include: 1) secured creditor of TBI, National Car Wash Systems, which accepted the March Debtors' plan; 2) BP West Coast Products, LLC, holding a secured claim in TBV's Deer Valley Property as well as a unsecured executory contract claim with TBV, accepted the September Debtors' plan; 3) secured creditor of TBV, Porsche Financial Services, accepted the September Debtors' plan; and 4) secured creditor of TBII, National Car Wash Systems, accepted the May Debtors' plan.

C. The SummitBridge Plan

SummitBridge filed its Disclosure Statement and Plan of Reorganization on June 20, 2012. (Dkt # 945 and 946, respectively). About a month later, SummitBridge filed a Supplement (Dkt # 1088) and then another Amended Supplement to its Disclosure statement a few days later. (Dkt # 1098). Thereafter, on August 28th, 2012, the Court approved the SummitBridge disclosure statement.

The SummitBridge plan proposes to appoint a Plan Administrator to oversee the business operations of the Debtors pending a sale of the assets of the Debtors with the proceeds of the sale distributed to creditors.

i. Classification and Treatment of Claimants

The SummitBridge plan places administrative claims, tax and other priority claims in separate classes. The plan provides that the administrative claims are paid, as soon as reasonably practicable after, the latest of the Effective Date, the date such administrative claim becomes an allowed administrative claim or the date such administrative claim becomes payable pursuant to any agreement between the reorganized debtors and the holder of such administrative claim. The other priority claims

shall be paid, as soon as reasonably practicable after, the latest of the initial distribution date, the date such claim becomes an allowed claim or the date such claim becomes payable pursuant to any agreement between the reorganized debtors and the holder of such claim.

The SummitBridge plan also places the SummitBridge senior secured claim in a separate class. This secured claim is paid in monthly payments at an interest rate to be determined by the Court until the property serving as collateral is sold. Once the property is sold any proceeds shall be distributed to SummitBridge up to the value of the secured claim and SummitBridge shall have a deficiency claim classified as a general unsecured claim for any remainder. SummitBridge shall have the right to pursue any default remedies under their loan agreement.

Unsecured claims less than $2,000 are placed in a separate administrative convenience class that shall receive twenty-percent of their allowed claims at the later of the initial distribution date or the date such claims become allowed convenience claims. General unsecured claims greater than $2,000 are placed in a separate class and shall receive a pro rata distribution of the proceeds of the sale of the Debtors' assets after priority claims and secured claims are paid in full.

Equity holders shall retain their interests in the Debtor under the SummitBridge plan but will not be entitled to direct or remove the Plan Administrator.

ii. Voting

A review of the ballots submitted reflect that the impaired classes of claims that rejected the SummitBridge plan included the unsecured creditors, the convenience claimants, National Car Wash Systems (a secured creditor of TBI), and equity holders.

The only impaired accepting classes were SummitBridge and Aberon Fund I, LLC (a secured creditor of TBVII).

III. Discussion

Not all classes of claims voted to accept the plans in this case. Accordingly, before the Court can decide whether to confirm one of the competing plans in the case of the March Debtors, or the Debtors' plans in the case of the September and May Debtors, the Court must determine whether any or all of the plans of reorganization satisfy the confirmation requirements of §1129(a) and §1129(b).

A. Debtors' Plans

The Senior Secured Creditors argue that the Debtors' plans are not confirmable under §1129(a) and §1129(b) on several grounds. Their primary objections include (1) the plans do not provide fair and equitable treatment of their claims, (2) the plans are not feasible, (3) the plans violate the absolute priority rule, (4) the plans improperly classify their deficiency claims, and (5) no non-insider impaired class accepted each plan. The Senior Secured Creditors also allege that the plans were not proposed in good faith, unfairly discriminate against their secured claims and assume unreasonable executory contracts.

a. Fair and Equitable

Section 1129(b) provides the requirements to confirm a non-consensual plan of reorganization. One condition to confirmation is that the plan must be "fair and equitable" to each class of claims or interests that are impaired and have not accepted the plan. Section 1129(b)(2)(A) provides the minimum requirements required to find a plan fair and equitable with regard to an objecting impaired class of secured claims.

i. SummitBridge, Enterprise and GE Treatment and Interest Rate

There is no dispute that the Senior Secured Creditors voted their impaired secured claims to reject the Debtors' plans, and thus, the plans must be fair and equitable, as described in § 1129(b)(2)(A), with regard to these secured claims. Section 1129(b) requires:

> **(2)** For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
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> **(A)** With respect to a class of secured claims, the plan provides—
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> **(i)**
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> **(I)** that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
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> **(II)** that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
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> **(ii)** for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
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> **(iii)** for the realization by such holders of the indubitable equivalent of such claims.

The Debtors argue that their plans satisfy (i) in this case because they provide they fully amortize the claims of the Senior Secured Creditors over 30 years, with a 10 year balloon, with interest at 4% in accordance with the requirements of *Till v. SCS Credit Corp*., 541 U.S. 465 (2004). The Senior Secured Creditors do not agree that their treatment is fair and equitable, contending that a 4% interest rate to be paid on their

secured claims under §1129(b)(2)(A) fails to include an upward adjustment for risk factors at issue here as required by *Till* and, instead, a 8% rate of interest is appropriate.

A plurality of the Supreme Court in *Till v. SCS Credit Corp*. held that a formula approach, adjusting the national prime interest rate based on risk of non-payment, should be used to calculate the adequate rate of interest on a cramdown loan under a chapter 13 plan.[4] The lack of a controlling majority opinion in *Till* has made its application problematic over the years. Thus, while *Till*'s reasoning is instructive, it does not exist in a vacuum, given otherwise controlling Ninth Circuit authority on the topic. Therefore, the Court will look both to Supreme Court and Ninth Circuit precedent to determine the appropriate interest rate.

The formula approach under *Till* is aimed at treating "similarly situated creditors similarly, and to ensure that an objective economic analysis would suggest the debtor's interest payments will adequately compensate all such creditors for the time value of their money and the risk of default." *Id*. at 477. In other words, this is an objective analysis which does not take into account a specific "creditor's circumstances or its prior interactions with the debtor." *Id*. at 479.

The starting point under the formula approach is the national prime rate, "which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the loan's opportunity costs, the

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[4] Although *Till* was a chapter 13 case, its holding also applies to this chapter 11 case. The cramdown provisions in Chapter 13, 11 U.S.C. § 1325(a)(2)(5)(B)(ii), and in Chapter 11, 11 U.S.C. § 1129(b)(2)(A)(i)(II), contain identical language – "value, as of the effective date" which requires a court to discount deferred payments back to their present value so that the secured "creditor receives disbursements whose total present value equals or exceeds that of the allowed claim." *Till*, 541 U.S. at 469, 474. Accordingly, the Supreme Court noted that it is "likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an interest rate under any [cramdown] provision[]." *Id*.

inflation risk, and the relatively slight default risk." *Id*. If a bankruptcy court could be certain that "a debtor would complete his plan, the prime rate would be adequate to compensate any secured creditors forced to accept cramdown loans." *Id*. at 479 n. 18. In applying a formula approach, a bankruptcy court begins with a low estimated interest rate and the burden of proving the need for any increase in the adjusted interest rate then falls squarely on the creditors. *Id*. at 479. As the Ninth Circuit noted:

> The appropriate discount rate must be determined on the basis of the rate of interest which is reasonable in light of the risks involved. Thus, in determining the discount rate, the court must consider the prevailing market rate for a loan of a term equal to the payout period, with due consideration of the quality of the security and the risk of subsequent default.

In re Camino Real Lanscape Contrs., 818 F.2d 1502, 1504 (9th Cir. 1987).

The amount of an upward adjustment to the prime rate depends on factors such as "the circumstances of the estate, the nature of the security, the duration and the feasibility of the reorganization plan." *Till,* 541 U.S. at 479. The Ninth Circuit also considers prevailing market rates for loans with similar security, maturity and risk of default when determining the appropriate rate. *Camino Real*, 818 F.3d at 1505.

Following the adjustment, the cramdown interest rate should be "high enough to compensate the creditor for its risk but not so high as to doom the plan." *Till,* 541 U.S. at 480. If a plan would, however, require an upward adjustment resulting in an "eye-popping" rate of interest, the plan is likely not feasible and should not be confirmed. *Id*. 480-81.

Both the Debtors' and the Senior Secured Creditors' experts agree no efficient market exists with which to compare a similar loan to the Debtors and that the formula approach under *Till* should be used to determine the appropriate rate of interest. The

Debtors' expert, Thomas Vivaldelli, opined that the appropriate rate of interest should be 4%. Mr. Vivaldelli applied the formula approach under *Till* by starting with the national prime rate of 3.25% and then including an upward adjustment of .75% to arrive at a 4% rate of interest.

However, Mr. Vivaldelli failed to consider many risk factors contemplated in *Till*. Mr. Vivaldelli did not make any additional risk adjustments for the fact that the Debtors are in bankruptcy and have a higher risk of default based on their financial situation because he believed that these factors are already built into the prime rate.[5] Of course, there is some logic to this since, by definition, all debtors to whom the test of *Till* will be applied are in bankruptcy. However, that doesn't mean that all cram down plans pose the same level of risks to secured lenders.[6]Similarly, no adjustment was made for the risk of nonpayment during a plan duration of 10 years or for the risk that the shareholders of the Debtors would be incapable of making their new value contributions or for the risk that the Debtors would not be able to refinance their loans at the end of 10 years. Rather, Mr. Vivaldelli opined that these risks are already included in the prime rate.

Mr. Vivaldelli misinterprets the *Till* decision. The Supreme Court specifically stated that an upward adjustment above the prime rate is appropriate for debtors in bankruptcy because most debtors "typically pose a greater risk of nonpayment than solvent commercial borrowers." *Till,* 541 U.S. at 479. *Till* also provides that the duration

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[5] In fact, Mr. Vivaldelli testified at the confirmation hearing that if Judge Case and Warren Buffet were both in bankruptcy, there would not be an upward adjustment for the greater risk that Judge Case would default as opposed to Warren Buffet because that risk of default is already built into the prime rate.

[6] In this case, in particular, the Court's determination below that the balloon payment should be earlier and, in case of several of the stores, that the property values should be higher increases the risk to the lenders because of the increased debt service payments that result.

of the plan and feasibility of the plan (i.e. the ability of the Debtors to refinance their loans and the investor's ability to pay administrative expenses) are factors requiring an upward adjustment of risk.

Mr. Vivaldelli also defends his 4% interest rate by comparing the collateral in this case, gas stations, to the more risky truck serving as collateral in *Till* to reason that the upward adjustment in this case should be less than the 1.5% adjustment in *Till*. However, while *Till* did provide that the nature of the collateral is a risk factor to consider, the Supreme Court specifically stated that it was not actually deciding what the appropriate risk adjustment should be in that case. *Id*. at 480. Instead, the Supreme Court noted that bankruptcy courts usually provide for an adjustment of 1-3% above the prime rate. *Id*.

The Senior Secured Creditors' expert, Chris Linscott, on the other hand, opined that an 8% interest rate was appropriate. Mr. Linscott reasoned that an adjustment of 4.75% above the prime rate was appropriate in this case to account for feasibility risks associated with the Debtors' plans. Adjustments were made primarily due to the risks associated with the Mr. Linscott's view that the Debtors would not be as profitable as they project and that a large investment is needed by shareholders to fund shortfalls under the plan. Also, there was an adjustment made to account for the substantial risks with whether the Debtors would be able to successfully refinance their obligations at the end of 10 years when similar loans require a 60-80% loan to value ratio and the Debtors' loan to value ratio is currently 100%.

After applying the formula approach consistent with *Till*, the Court finds that the Debtors' proposed interest rate is too low and the Senior Secured Creditors' rate is too

high. It appears that Mr. Vivaldelli made a small upward adjustment to the prime rate because he believed that that the prime rate is too high and already included many of the risks contemplated by Mr. Linscott. The Court, however, will not question the national banks' basis in determining the prime rate nor the Supreme Court's direction to begin with the prime rate when applying the formula approach.

Conversely, Mr. Linscott overestimated the feasibility risks in this case. The 4.75% rate adjustment is well above the range that bankruptcy courts usually apply using the formula approach. Thus, exceptional risks would have to be present in this case to apply that adjustment. Here, while there are clearly some risks associated with feasibility, contrary to Mr. Linscott's opinion, there is evidence that the economy is improving and that the Debtors have competent management in place. Moreover, binding commitments to fund any shortfalls under the plan have been submitted to the Court by the shareholders of the Debtors.

The Court, instead, averages the two proposed interest rates and finds that a cramdown rate of 6% is appropriate in this case and consistent with *Till*. The premium of 2.75% is at the upper end of, but still within, the "normal" range of 1% to 3% identified by the Supreme Court.

In addition to the interest rate, the Senior Secured Creditors oppose the Debtors' proposed 30 year amortization period with a 10 year balloon payment. Instead, the Senior Secured Creditors propose a 15 year amortization period with a 5 year balloon payment.

Here, the loans are secured by commercial real estate which historically holds its value or appreciates in value. Thus, a longer amortization period is appropriate in this case. However, the Court finds that the Debtors' proposed 30 year amortization period

and 10 year balloon are substantially longer repayment terms than what would be available to other commercial borrowers. Instead, a term of 25 years with a 7 year balloon payment is more appropriate both because it will more quickly decrease the principal due at the time of the balloon and shorten the time period when the risk of non-payment will be imposed on the Senior Secured Creditors.

Accordingly, the Court finds that plan treatment of the claims of the Senior Secured Creditors amortized over 25 years at 6% interest with a balloon payment due in 7 years would satisfy the fair and equitable requirements of the Bankruptcy Code.

ii. March Debtors' Value

SummitBridge's claims are secured by the March Debtors' properties. The value of the March Debtors' properties are fixed pursuant to the *Order re Motion to Value Secured Claims of SummitBridge* (Dkt. #926) and accompanying under advisement decision (Dkt. # 865) providing that the fair market value of the 3565 Broadway Property is $1,840,000, the value of the Scottsdale Road Property is $1,440,000 and the value of the 1959 Broadway Property is $1,200,000.

iii. September Debtors' Value

Enterprise's claims are secured by the value of the September Debtors' properties: the Deer Valley Property, the Signal Butte Property, the Guadalupe Property and the Broadway Property. The September Debtors presented testimony from its expert, Roy Tolson, and owner Saad Saad as evidence of the "as is" going concern value of these properties. Enterprise, on the other hand, did not present any competing valuations.

Saad Saad testified that in his opinion the Deer Valley Property is worth $1,150,000, the Signal Butte Property is worth $975,000, Guadalupe Property is worth

$1,100,000, and the Broadway Property is worth $950,000. Although an owner may testify to value, and Mr. Saad has considerable experience in the convenience store market, he is not an independent expert and his opinions do not necessarily comport with the required "fair market value" analysis required under Section 506 precedent. Accordingly, the Court will consider but give less weight to Mr. Saad's opinion.

Mr. Tolson testified that the Deer Valley Property is worth $1,055,000, the Signal Butte Property is worth $1,050,000, the Guadalupe Property is worth $1,200,000 and the Broadway Property is worth $1,150,000. Mr. Tolson considered the cost, sales and income approach in determining the fair market value of these properties; giving most weight to the cost and income approaches. A bulk sale discount was then applied to reflect the reality of the marketplace where potential buyers want to purchase several stores at once and expect a deep discount.

According to 11 U.S.C. § 506(a)(1) the "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." The fair market value under § 506 is the price a willing seller, under no compulsion to sell, and a willing buyer, under no compulsion to buy, would agree on. *In re Taffi*, 96 F.3d 1190, 1192 (9th Cir. 1996).

Under the September Debtors' plans, the Debtors are to retain the collateral and operate each of the stations as a going concern. A bulk sales valuation does not match the purpose as contemplated in the plans, whereas a market value approach would. Consistent with the Court's prior decision rejecting a bulk sales valuation of the March

Debtors' properties (Dkt #865), the Court will value the property using a market value approach without a bulk sales discount.[7]

Prior to applying the bulk volume discount, Mr. Tolson valued the properties as $1,550,000 for the Deer Valley Property, $1,225,000 for the Signal Butte Property, $1,460,000 for the Guadalupe Property, and $1,350,000 for the Broadway Property. The cost and income approaches to valuation were given the most weight in Mr. Tolson's valuation of these properties. The cost and income approaches are consistent with the Debtors' plans which contemplate operating the stores as a going concern. However, the Court will not adopt these values in full, given that Tolson made these conclusions in light of his view that a bulk discount should be applied. Rather, the Court will lower the values modestly to take into account Mr. Saad's views on the actual value of the properties in the marketplace. Accordingly, the Court finds that the following values for the September Debtors' stores:

- $1,300,000 for the Deer Valley Property;
- $1,100,000 for the Signal Butte Property;
- $1,350,000 for the Guadalupe Property; and
- $1,250,000 for the Broadway Property

iv. May Debtors Value

Competing valuations of the May Debtors' properties, the Chandler Property and the 32nd Street Property, were presented at the confirmation hearing. GE's claims are

[7] This issue was discussed at length in the Court's memorandum decision concerning value of the SummitBridge collateral (Dkt # 926). The reasoning of that decision is incorporated herein.

secured by the value of these properties. GE presented testimony provided by expert Brian Coup and the Debtors presented expert testimony of Mike Kearns.[8]

1. 32nd Street Property

Mr. Coup opined that the going concern value of the 32nd Street Property was $2,250,000 whereas Mr. Kearns testified that he believed that the property was worth only $1,640,000. Both appraisals valued the property using a combination of the cost, sales comparison and income capitalization approaches. However, Mr. Coup gave most weight to the income and sales approaches whereas Mr. Kearns gave most weight to the income and cost approach.

Both experts disagreed which sales are comparable in terms of geography and, therefore, Mr. Coup came out with a higher valuation under the sales approach. Similarly, both experts disagreed as to which comparable land sales to use to value the land of the subject property under the cost approach. After analyzing comparable land sales, Mr. Coup opined that the land should be valued at $18 per square foot whereas Mr. Kearns valued the land at only $10 per square foot.

The Court, however, finds that the comparable land sales used by Mr. Kearns provide a more accurate indication of the value of the land of the 32nd Street Property. While both experts used comparable sales purchased for investment or commercial use, the comparable sales used by Mr. Kearns were closer in location to the 32nd Street property. Accordingly, the Court believes that Mr. Kearns' valuation using a price of $10

[8] Saad Saad also testified for the Debtor that in his opinion the 32nd Street Property is worth $1,450,000, the Chandler Property is worth $1,400,000. The Court will treat Mr. Saad's opinion in the same way as with Enterprise.

per square foot to be more accurate because it better reflects the traffic and competition faced by the subject property.

While both experts also used an income approach to value the property, their applications of that approach varied greatly. Mr. Kearns first applied a gross profit multiplier ("GPM") to projected gross income, then capitalized net operating income and finally averaged those two numbers to come to his direct capitalization value. Mr. Coup, on the other hand, first applied a capitalization rate to EBITDAR, then applied a capitalization rate to excess earnings remaining after servicing tangible assets, and then produced a discounted cash flow analysis to present value the estimated future earnings. Mr. Coup then averaged these three numbers to come to his value under the income approach.

Although it is difficult to compare these two applications of the income approach because different measures of income are used, the Court does find that the main differences in each approach stem from Mr. Coup projecting higher net income associated with the property than Mr. Kearns' projections. However, Mr. Coup did not have any data for the years 2010 and 2011 to base his projections and therefore had to annualize income and expenses from 2009 onward. The problem with this approach is that the Debtor's income for 2009 was higher than in 2010 and 2011 leaving Mr. Coup's projections likely inflated. Accordingly, the Court finds that Mr. Kearns' projections are more accurate because they were based on actual data for 2010 and 2011.

Thus, because Mr. Kearns used superior comparable properties in his calculation of the land value for the subject property in applying the cost approach and used more

accurate income projections, the Court finds that the 32nd Street property has a fair market value of $1,640,000 consistent with Mr. Kearns' appraisal.

2. Chandler Property

Following an appraisal of the Chandler Property, Mr. Coup determined that the property should be valued at $2,250,000 whereas Mr. Kearns valued the property at $1,670,000.

Predictably, these experts disagree with which sales are comparable and therefore Mr. Coup comes out with a higher valuation under the sales and cost approaches. However, unlike the comparables used in valuing the land of the 32nd Street Property, the comparable properties used in this case are all appropriate.

Nevertheless, Mr. Coup did not have any actual data for the income of the Chandler Property for the years of 2010 and 2011 and therefore had to extrapolate from the high year of 2009. Thus, the Court must find that Mr. Kearns' valuations of the Chandler Property are more accurate under the income approach because he used actual data from 2010 and 2011.

However, when applying the income, Mr. Kearns failed to account for any additional value for the Quick Serve Restaurant ("QSR") space associated with the Chandler Property whereas Mr. Coup added $80,000 to account for the QSR space. Mr. Coup opined that, although the QSR area is now closed, it is an additional potential income stream for the Chandler Property. Therefore, Mr. Coup concluded that the QSR space adds $80,000 of value to the Chandler Property under the income approach because the QSR space can be leased to a QSR operator. Mr. Kearns valuation, on the other hand,

recognized that the QSR space is inoperable and could not generate sufficient income to cause it to have any value.

The Court finds that the QSR space provides additional value to the Chandler Property. 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 after a reasonable time." *In re Taffi*, 96 F.3d at 1192. Mr. Coup testified that there are no competing stations near the Chandler Property with a QSR area, which make the property more attractive to prospective purchasers. The Court agrees with this testimony and finds that, although the QSR space is currently closed, it provides additional value to the property due to the additional potential income stream. Accordingly, a valuation of the Chandler Property using the income approach should include an additional $80,000 for the QSR space.

Accordingly, the Court will add $80,000 to Mr. Kearns' valuation of the Chandler Property to come to a value of $1,750,000.

b. Absolute Priority Rule

The Senior Secured Creditors also allege that the Debtors' plans are not fair and equitable because the absolute priority rule is violated in that equity holders retain their interests under the plans without contributing new value.

Section 1129(b)(2)(B) codifies the judge-made absolute priority rule which must be satisfied for the plan to be "fair and equitable." Section 1129(b)(2)(B) provides that a "plan is fair and equitable" if:

> (B) With respect to a class of unsecured claims –
>
> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such

claim; *or*
(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

Accordingly, the absolute priority rule provides that junior classes cannot receive property unless senior classes are paid in full.

Here, although the Debtors' plans purport to be "full payment" plans, unsecured creditors are not being paid the present value of their claims.[9] Thus, the Debtor's plans would violate the absolute priority rule because junior equity holders retain their interests unless the plans satisfy an exception to the rule. Here, the Debtors contend that the binding commitments of equity to fund any shortfalls under the plan satisfy the new value exception to the absolute priority rule.[10]

If the equity holders submit value that is "1) new, 2) substantial, 3) money or money's worth, 4) necessary for a successful reorganization and 5) reasonably equivalent to the value or interest received" then they meet the new value exception and do not violate the absolute priority rule because they did not receive their interests "on account of" their prior equitable ownership. *In re Bonner Mall P'ship*, 2 F.3d 899, 908 (9th Cir. 1993).

After reviewing the amended declarations filed in this case, the Court finds that in consideration for retaining their equity interests, each shareholder submitted binding

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[9] A claim's present value is the sum of its principal plus an additional interest component to compensate for the time value of money and the risk of nonpayment. *In re Perez*, 30 F.3d 1209, 1214–15 (9th Cir. 1994). The Debtors' plans in this case do not propose to pay interest on its unsecured claims. Accordingly, the unsecured creditors are not being paid the present value of their claims.

[10] While some circuits refuse to recognize a new value exception to the absolute priority rule, the Ninth Circuit has expressly adopted the new value exception. *See generally In re Bonner Mall P'ship*, 2 F.3d 899 (9th Cir. 1993). Also, although the Supreme Court addressed the availability of a new value corollary or exception in *Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle P'ship.*, 526 U.S. 434 (1999), it did not establish a clear-cut rule. Thus, this Court will follow otherwise applicable Ninth Circuit precedent.

commitments to remit funding based on their percentage ownership in each Debtor to "encompass the amounts necessary to pay administrative claims owing as of the Effective Date." (Dkt. # 1357, 1358, 1359, 1360, 1361, 1362, 1363, 1364, 1365). After considering the estimated amount of administrative claims owed on the Effective Date, the initial contributions due based on each shareholder's pro rata share shall be as follows:

- **Houeida Saad:**
  - TBI - $65,397.84
  - TBII - $27, 814.34
  - TBIII - $10,306.35
  - TBVI - $42,553.50
  - TBVII - $26,048.15
  - TBIX - $29,216.78
  - TBX - $40,231.54
  - OB1 - $33,705.75
- **Nada Saad:**
  - TBII - $55,68.69
  - TBIII - $30,919.04
  - TBV - $29,781.43
  - TBVI - $42,553.50
  - TBVII - $26,048.15
  - TBIX - $29,216.78
  - TBX - $40,231.59
  - OB1 - $33,705.75
- **Elizabeth Shinohara:**
  - TBX - $40,231.59
  - OB1 - $67,411.51

These shareholders also committed to provide "additional funding as is necessary" to cover any future shortfalls in required payments on secured claims under the plan.

The shareholders are thus committed to remit funds that are new and substantial amounts of money which are reasonably equivalent to their interests received in the reorganized debtors.[11] However, for these contributions to be considered "money or

[11] These shareholders appear to actually contribute more than reasonably equivalent value to their interests in the reorganized Debtors. The Court questioned these shareholders to determine their motivations for agreeing to commit such large investments in a business that has been unprofitable and now is in

money's worth" they must be made on the Effective Date of the plans. *In re Ambanc La Mesa Ltd. P'Ship*, 115 F.3d 650, 655 (9th Cir. 1997). Thus, the Court shall require each shareholder to deposit their pro rata share of the administrative expenses owed by each Debtor in a separate dedicated account no later than the Effective Date for the plans to be confirmed.

The Court also finds that these contributions are necessary for a successful reorganization. The additional funds are considered necessary if they are "essential to the success of the undertaking." *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 117 (1939) (overruled on other grounds).

The shareholders' initial contributions covering all administrative expenses due are necessary to confirm the Debtors' plans because administrative expenses must be paid in full on the Effective Date of the plans pursuant to § 1129(a)(9). Further, because the Court has imposed a 6% interest rate on plan payments to secured creditors instead of the 4% rate contemplated in the Debtors' plan budget, there will likely be substantial shortfalls under the plan so that these commitments to cover shortfalls will be necessary to complete the required plan payments apart from the contributions needed to pay administrative expenses on the Effective Date.

The Court finds that the shareholders' commitment to pay their share of administrative expenses on the Effective Date of the plan as well as to fund future shortfalls under the plan is sufficient new value if the shareholders commit to deposit their initial contributions in a separate dedicated account on the Effective Date.

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bankruptcy. The shareholders cited personal reasons as well as confidence in the Saad brothers' management abilities to run the business successfully.

Accordingly, the Debtors' plans do not violate the absolute priority rule if they are amended pursuant to this decision.

c. Feasibility

One of the most hotly contested issues at the confirmation hearing was whether the Debtors' plans are feasible. Section 1129(a)(11) requires a finding that the plan is not likely to be followed by liquidation or further need for reorganization as a prerequisite to confirmation of a plan. The debtor bears the burden of showing that the plan meets all of the requirements for confirmation, including feasibility, by a preponderance of the evidence. *In re Bashas' Inc.*, 437 B.R. 874, 902 (Bankr. D Ariz. 2010).

The feasibility requirement prevents courts from confirming "visionary schemes," *see Pizza of Hawaii, Inc. v. Shakey's, Inc. (Matter of Pizza of Hawaii, Inc.)*, 761 F.2d 1374, 1382 (9th Cir. 1985), instead reserving confirmation for those plans that have a reasonable probability of success. *Wiersma v. Bank of the West (In re Wiersma)*, 227 Fed Appx. 603, 606 (9th Cir. 2007) (not selected for Fed. Rep.) citing *Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 787 F.2d 1352, 1364 (9th Cir. 1986). When considering whether a plan is feasible, courts consider "(1) the adequacy of the capital structure; (2) the earning power of the business; (3) economic conditions; (4) the ability of management; (5) the probability of the continuation of the same management; and (6) any other related matter which determines the prospects of a sufficiently successful operation to enable performance of the provisions of the plan." *Wiersma v. O.H. Kruse Grain & Milling (In re Wiersma)*, 324 B.R. 92, 113 (9th Cir. BAP 2005) *aff'd in part, rev'd in part on other grounds*, 483 F.3d 933 (9th Cir. 2007).

Here, the Debtors' plans propose to pay all claims in full over time with shareholders committing to provide additional funding as needed to cover any shortfalls in required payments to secured creditors and other priority claimants. Further, the Debtors' plans contemplate refinancing their secured debt 10 years[12] after the Effective Date of the plans. Accordingly, to determine if the plans are feasible, the Court must analyze the past performance of the Debtors to determine whether it is reasonably probable that the Debtor can meet its projections to fund its plan and whether the shareholder commitments are sufficient to cover shortfalls, if any, in required payments under the plans. Moreover, it must be reasonably likely that the Debtors can successfully refinance their obligations.

i. Ability to Meet Plan Projections

The Senior Secured Creditors argue that it is improbable that the Debtors will be able to make the proposed plan payments in the future and that their projected income and expenses are not consistent with past performance.

While there was disagreement concerning the amount of the discrepancy, the Court finds that there is a negative discrepancy between the Debtors' past performance and their projected income and expenses.

At the confirmation hearing, the Debtors' feasibility expert, Mr. Welch, opined that the Debtors would have sufficient cash flow to fund the required payments on secured debts as well as other priority plan payments. Mr. Welch also produced a report comparing the Debtors' actual versus projected performance for the months of May 2012

[12] The Debtors' plans contemplate a balloon payment 10 years after the Effective Date. However, the Court determined *supra* that a balloon payment due 7 years after the Effective Date is consistent with the fair and equitable requirements of the Bankruptcy Code and will not confirm a plan with a balloon date in excess of that amount.

to October 2012. (Exhibit TB #83). Mr. Welch testified that his report reflects that the projected debt service plus the projected plan payments combined are greater than the net free cash that was actually available for the months of May 2012 to October 2012. However, Mr. Welch elaborated that, while there is a negative variance, the amount of the variance in the report may not be accurate because the administrative expenses at that time were unknown and Mr. Welch did not know whether some plan expenses were being paid out of the budget for operating expenses. Accordingly, while Mr. Welch's report indicates there is a negative variance in the amount of the cash flows to pay expenses, the report does not provide an accurate calculation on how much of a variance it really is.

After analyzing the actual performance of the Debtors between May 2012 and August 2012, the Senior Secured Creditors' feasibility expert, Mr. Linscott, opined that the Debtors would have been short $47,210 in required payments to secured creditors in the first four months of its plan if it went effective in May 2012 and the unsecured creditors would not have been paid anything although the plan projected that they would be paid $78,158. Moreover, Mr. Linscott concluded that the Debtors' projected profits are unrealistic because they exceed both the Debtors' past performance and industry averages. Accordingly, Mr. Linscott testified that he believes that the Debtors' plans are not feasible. However, Mr. Linscott's opinion on feasibility did not consider the shareholder commitments to fund any shortfalls that may arise under the plan.

Despite disputes between the experts concerning the amount of any shortfalls that may arise under the plans, the Court finds that there will be substantial shortfalls in required payments under the Debtors' plans if they are revised pursuant to this decision.

The Court adjusted the Debtor's proposed cramdown interest rate upwards to 6%. All parties agree that this upward adjustment to the proposed interest rate will result in a substantial shortfall in plan payments which will have to be covered by the Debtors' shareholders.

ii. Shareholder Commitments

The Debtors' shareholders presented convincing testimony at the confirmation hearing solidifying their desire to see the Debtors' businesses succeed. Moreover, each shareholder provided written binding commitments to fund their pro-rata share of the amounts necessary to pay all administrative claims owed on the Effective Date and to provide additional funding as needed to cover any shortfalls in payment of secured creditors. Further, the equity interests certified that they have sufficient resources to available to support those contributions.

The Senior Secured Creditors argue that the Debtors' plans are not feasible because the shareholders have not submitted sufficiently binding commitments to fund any shortfalls that may arise under the plans. In each of the written commitments submitted to the Court, the shareholders stated that "a determination about a funding shortfall for secured creditors would be made by the specific Debtor." (*See* Dkt. #1358, 1359, 1360, 1361, 1362, 1363, 1364, 1365). The Senior Secured Creditors interpret this language to mean that the shareholders, who also make up the board of directors for each Debtor, would then consult with one another to determine how much to fund. Accordingly, the Senior Secured Creditors reason that the funding commitments, as described, are effectively non-binding because the individuals responsible for triggering the commitments are the same individuals who would be obligated to pay.

The Court, however, does not interpret the commitments to mean that the board of directors would determine in their discretion how much of the shortfall should be funded. Instead, the commitments merely indicate that the board of directors or officers of each Debtor will determine whether there will be a shortfall in required plan payments thereby automatically triggering the required infusion of funds by the shareholders. There is no discretion that can be used in this case: each Debtor determines whether it can make the required plan payments and, if the board of directors determines it cannot, the shareholders are required to fund their pro rata share of the deficiency.

Further, the Senior Secured Creditors contend that these are non-binding commitments because the shareholders did not provide a guaranty or letter of credit enabling the Senior Secured Creditors to enforce these shareholders' promises to pay. Such direct access to third party guarantees is not required to satisfy the feasibility requirement. While the Senior Secured Creditors may not have any recourse to enforce these promises personally against the shareholders, any missed payments under the Debtors' plans will trigger a default providing the Senior Secured Creditors with the ability to realize upon their collateral.

Lastly, the Senior Secured Creditors argue that, even if the Court finds that the shareholders submitted binding commitments to cover any shortfalls under the plans, the Debtors' plans are not feasible because the shareholders do not have sufficient resources to make those required contributions. The shareholders disclosed that they collectively have access to $1.2 million in assets to fund the Debtors' plans. The Senior Secured

Creditors reason that these resources are insufficient to cover $818,277.88 in administrative expenses[13] and the additional shortfalls that will occur during the plans.

The shareholders have presented evidence that they can pay administrative expenses in full on the Effective Date and will have close to $400,000 to cover any of the unknown future shortfalls in plan payments. Moreover, the shareholders testified that they would be willing to personally borrow additional funds as needed to fund the Debtors' plans. However, as previously discussed, the three changes required by this decision--increased interest rate, shorter amortization and, on balance, higher collateral values—will increase the required debt service and likely create substantial shortfalls under the Debtors' plans. Thus, while this decision is premised on the Court's determination that the shareholders are committed to seeing the Debtors' business succeed, the Court will postpone making a decision whether the shareholders have the resources to cover the shortfalls incurred under the plans until the Debtors' submit modified plans of reorganization.

iii. Ability to Refinance

The Senior Secured Creditors' also argue that the Debtors' plans are not feasible because they will not be able to successfully refinance their debt to fund the proposed balloon payment due 7 years after the Effective Date. "[A] plan that proposes a final balloon payment requires credible evidence that obtaining future financing is reasonably likely." *In re VDG Chicken, LLC*, 2011 WL 3299089 at *6 (9th Cir. B.A.P. 2011).

[13] Although the Court has required that an amount sufficient to cover unpaid administrative costs must be deposited as a condition of confirming an amended plan, the Debtors are not required to use those funds to pay administrative claims if the claim holders agree (as they have) to receive payments over time. Therefore, those amounts can also be included within funds available to pay any debt service shortfalls.

The Debtor's feasibility expert, Mr. Welch, predicted that currently the prevailing loan-to-value ratio needed by lenders to refinance the secured debt is 50-70% and the Senior Secured Creditors' expert, Mr. Linscott, similarly opined that a 50-60% LTV would be needed to refinance.

Nevertheless, Mr. Welch also testified that it is very difficult to determine what LTV ratio lenders will require in the future. The Court agrees with Mr. Welch that it is very difficult to predict which loans would be available to the Debtors in 7 years. However, after making reasonable assumptions based on the real estate market in Arizona and the LTV ratios currently required by lenders to refinance, the Court believes it is reasonably likely that refinancing options will be available to the Debtors 7 years after the Effective Date.

Assuming that the Debtors' properties increase in value at an uncompounded rate of 3% per year[14] and assuming that the Debtors will make all the required payments under their amended plans to pay secured debt with 6% interest and amortized for 25 years, the Court finds that the LTV for the debt to be refinanced 7 years after the Effective Date would be around 70%[15]. This LTV is within the range lenders currently require to provide refinancing. Accordingly, the Court finds that it is reasonably likely that refinancing options will be available to the Debtors 7 years after the Effective Date if the Debtors amend their plans consistent with this decision and make the payments required hereunder[16].

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[14] Of course, it is impossible to predict future appreciation with precision. But an uncompounded 3% on average growth rate is well within historical patterns for commercial property in Arizona.

[15] This calculation takes into account principal reductions through amortization as well as property value appreciation.

[16] Of course, if the Debtors default at some future date, the creditors will retain the amounts already paid, including principal reductions paid through amortization, and be able to realize on their collateral.

d. Improper Classification

The Senior Secured Creditors also contend that the Debtors' plans violate § 1122(a) because they place the Senior Secured Creditors' deficiency claims in a class separate from other general unsecured claims in an attempt to gerrymander votes in favor of the plans.

While the Code does not expressly prohibit separately classifying substantially similar claims, § 1122(a) prohibits placing dissimilar claims in the same class. Section 1122(a) provides that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." However, the "one clear rule" is that "thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan." *In re Barakat*, 99 F.3d 1520,1525 (9th Cir. 1996) (quoting *In re Greystone III*, 995 F.2d 1274, 1279 (5th Cir. 1991)). Thus, a debtor may separately classify substantially similar claims if a business or economic justification for separating the claims is provided. *In re Loop 76*, 465 B.R. 525, 536 (9th Cir. B.A.P. 2012).

Generally, a secured creditor's deficiency claim is substantially similar to other general unsecured claims. *In re Barakat*, 99 F.3d 1520, 1526 (9th Cir. 1996) (reasoning that deficiency claims are "simply legally created recourse debt"). However, if the secured creditor has a non-debtor source of repayment on its deficiency claim, such as a guarantee, then the deficiency claim is not considered substantially similar to other unsecured claims. *In re Loop 76*, LLC, 465 B.R. 525, 541 (9th Cir. B.A.P. 2012).

Here, the one or more members of the Saad family provided guarantees for each of the Senior Secured Creditors' claims. (*See* 12/5/12 Tr. at 183; 225; *see also* Dkt. #

239). Accordingly, the Senior Secured Creditors have non-debtor sources of repayment on their deficiency claims so that they are not substantially similar to other general unsecured claims. Thus, the Debtors' plans do not improperly classify the deficiency claims separately from other unsecured claims.

e. Impaired Accepting Class

When not all classes of claims have accepted a plan, §1129(a)(10) requires that, as a condition to confirmation, at least one non-insider impaired class accept the plan. The Debtors argue that their plans satisfy §1129(a)(10) because the impaired convenience classes of creditors have accepted the plan. However, to permissively classify the convenience class separately from other unsecured creditors, it must be reasonable and necessary to aid in the administration of the Debtors' cases. 11 U.S.C. § 1122(b). The Senior Secured Creditors contend the Debtors' plans improperly classify the convenience class under §1122(b) because there is no purpose behind the convenience class other than to attempt to fabricate an impaired consenting class.

The Senate Report to §1122(b) noted that it is common practice to payoff small claims in cash in a reorganization. S. Rep. No. 989, 95th Cong., 2d Sess. 118 n.26 (1978). Thus, normally a convenience class is paid in full under the plan and is unimpaired under §1124. This then relieves the debtor's administrative burden of soliciting and tallying votes for this class because, as the class is unimpaired, the class is not entitled to vote on the plan. However, it is permissible to impair a convenience class, as the Debtors have in this case, as long as a reduction of administrative costs is still accomplished. 7-1122 *Collier on Bankruptcy* P 1122.03.

"Generally, an administrative convenience class is one where the claims are so small in amount and large in number as to make dealing with them burdensome." *In re Tucson Self Storage, Inc.*, 166 B.R. 892, 898 (9th Cir. B.A.P. 1994). Placing these claims in a separate class would provide an administrative convenience, for example, if these small claims could be paid their percentages upon confirmation rather than paid over time. *See Troy Sav. Bank v. Travelers Motor Inn.*, 215 B.R. 485, 489 (N.D.N.Y. 1997) (permitting a separate classification of claims under $250 to be paid in full upon confirmation, as compared to larger unsecured claims to be paid over time).

Here, each of the Debtors' plans separately classifies administrative convenience claims consisting of unsecured claims in the amount of $2,000 or less. The plans provide for substantially the same treatment as all other classes of unsecured claims: that these claimants shall be paid a pro-rata share from the Debtor's excess cash flow on a semi-annual basis, in two equal payments. However, the convenience class has priority so that it is paid prior to the other classes of unsecured claims.

The creditors composing the convenience class are trade creditors with whom the debtors will continue to do business. Placing these trade creditors in separate convenience classes that are paid prior to other unsecured claims increases the probability that these trade creditors will be paid in full on a timely basis. Further, paying these small claims in full prior to other unsecured creditors decreases the administrative burden of paying these claims over time and relieves the Debtors of the burden of having to add these claims to the amount of debt it must later refinance. Thus, the Court finds that the separate classification of these trade creditors is based on an administrative convenience and does not violate §1122(b).

Finally, while the necessity for a consenting impairment is a technical requirement under the Code, it is not a substantive right of an objecting creditor. If there is such a class, no matter how small or how seemingly insignificant, the statutory mandate is met. *See In re Rhead*, 179 B.R. 169, 177 (Bankr. D. Ariz. 1999). Moreover, use of artificial impairment alone is not evidence of bad faith. "Congress made cram down available to debtors; use of it to carry out a reorganization cannot be bad faith." *Matter of Sun County Development*, *Inc*., 764 F.2d 406, 409 (5th Cir. 1985). Instead, "good faith must be viewed in light of the totality of circumstances surrounding establishment of a Chapter 11 plan." *Id*. at 408.

f. Other Objections to the Debtors' Plans

i. Unfair Discrimination

The Senior Secured Creditors also allege that the Debtors' plans unfairly discriminate against their claims because the plans provide for only 4% interest to be paid on the Senior Secured Creditors' claims whereas the plans propose to pay the Debtors' attorney's fees with 8% interest if its attorneys accept payment of their administrative claims over time rather than in full on the Effective Date.

To confirm a nonconsensual plan, aside from meeting the fair and equitable requirements, the plan proponent must show that the plan does not discriminate unfairly with respect to each impaired claim or interest that has not accepted the plan. 11 U.S.C. § 1129(b)(1). In other words, a debtor is permitted under the Code to discriminate amongst classes as long as it is not unfair.

The Ninth Circuit has provided four criteria for discrimination to be fair: "(1) the discrimination must be supported by a reasonable basis; (2) the debtor could not confirm

or consummate the Plan without the discrimination; (3) the discrimination is proposed in good faith; and (4) the degree of the discrimination is directly related to the basis or rationale for the discrimination." *In re Ambanc La Mesa Ltd. P'Ship*, 115 F.3d 650, 656 (9th Cir. 1997).

The Debtors' plans satisfy these criteria. The two classes at issue are not of the same priority. The Senior Secured Claims are in classes by themselves whereas the claims held by the Debtors' counsel are unclassified administrative claims. Section 1129(a)(9) entitles an administrative claimant to payment in full on the effective date of the plan unless the claimant accepts different treatment. The higher interest rate proposed to be paid on the Debtors' attorney's fees likely served as an incentive for the Debtors' counsel to agree to accept payments of its administrative claim over time rather than in full on the Effective Date. Accordingly, the discrimination was reasonable to encourage Debtors' counsel to agree to payments over time without violating 1129(a)(9).

ii. Assumption of Unreasonable Executory Contracts

An objection to confirmation of the Debtors' plans alleging that the Debtors' plans assume unreasonable executory contracts with TBD in violation of §1129(a)(4). Section 1129(a)(4) provides that "[a]ny payment made or to be made by . . . the debtor . . . for services or for costs and expenses in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable." This provision requires a bankruptcy court to control fees and costs incurred which relate to confirmation and the chapter 11 case. The legislative history of §1129(a)(4) states that:

> Paragraph (4) is derived from section 221 of present law. It requires that any payment made or promised by the proponent ... for services or for

> costs and expenses in, or in connection with, the case, or in connection with the plan and incident to the case, be disclosed to the court. In addition, any payment made before confirmation must have been reasonable, and any payment to be fixed after confirmation must be subject to the approval of the court as reasonable.

H.R. Rep. 95-595, at 412 (1977). Some examples of costs incurred in connection with the chapter 11 case are professional fees, fees paid to a financing to fund the plan, and fees paid to a liquidating agent or plan administrator. *See* 7 *Collier on Bankruptcy* P 1129.02[4].

Here, the basis of the Senior Secured Creditors' objection is that the executory contract with TBD is unreasonable. However, the contract with TBD is not incidental to this bankruptcy case and the Court has previously found the key elements of the TBD arrangement to be reasonable in the context of the trustee motion trial. Instead, it is a contract to provide fuel to the Debtors' gas stations in the future. Accordingly, §1129(a)(4) is inapplicable.

Nevertheless, a bankruptcy court must approve executory contracts under § 365(a). When deciding whether to approve the assumption or rejection of an executory contract, bankruptcy courts apply a business judgment test to decide whether assumption or rejection would be beneficial to the estate. In applying the business judgment standard, a bankruptcy court should approve the debtor's decision to assume or reject the contract unless the debtor's decision "is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice." *In re Pomona Valley Medical Group, Inc.*, 476 F.3d 665, 670 (9th Cir. 2007) (quoting *Lubrizol Enter. v. Richmond Metal Finishers*, 756 F.2d 1043, 1047 (4th Cir. 1985)).

Here, no evidence was presented at the confirmation hearing tending to prove that the contracts with TBD are unreasonable. Moreover, the Court previously found insufficient evidence that the services provided by TBD were unreasonable when it denied the Senior Secured Creditors' motion to appoint a chapter 11 trustee. (Dkt. # 913). Accordingly, the Court find that the Debtors' decision to assume its contracts with TBD were within its sound business judgment.

iii. Not Proposed in Good Faith

Finally, the Senior Secured Creditors contend that the Debtors' plans are not proposed in good faith because the plans place the interests of the Debtors and insiders above creditors by proposing to pay millions of dollars in insider claims that are currently subject to numerous objections made by the court-appointed examiner.

These insider claims, however, have not yet been found to be invalid. The Debtors' proposal to pay currently valid claims held by insiders, even though those claims have been objected to by the examiner, is not evidence of bad faith. And, if the examiner's objections are upheld, there will be no need to pay the claims.

B. <u>SummitBridge Plan</u>

The Debtors present numerous objections to confirmation of the SummitBridge plan. These objections focus on allegations that (1) the plan violates §1129(a)(9) because it does not provide for payment of administrative claims in full on the Effective Date, (2) the plan is not feasible, and (3) the plan is not proposed in good faith and is not in the best interests of creditors. The Debtors further assert that the plan improperly proposes the appointment of a Plan Administrator in violation of applicable provisions of the Code and no non-insider impaired class has accepted the plan.

a. *Payment of Administrative Expenses in Full on Effective Date*

The Debtors object to the SummitBridge plan on various grounds; however, their primary objection is that the SummitBridge plan does not propose to pay all administrative expenses in full on the Effective Date. Specifically, the Debtors allege that the plan only provides that it might pay all administrative claims in full on the Effective Date.

Section 1129(a)(9) provides that administrative claims must be paid in full on the effective date of the plan unless the claimants agree to different treatment. The administrative expenses of the March Debtors fluctuate and thus SummitBridge is hesitant to commit to pay the administrative expenses in full on the Effective Date when they do not know what the amount of administrative expenses will be. However, the SummitBridge representative, Mr. Kilcoin, testified at the confirmation hearing that he is prepared to fund $818,277.88 - the amount of administrative expenses owed as of October 31, 2012. (*See* Exhibit TB 89). Further, Ms. Shinohara testified that the amount of administrative claims due as of December 1, 2012 should be "within the same range" of those claimed as of October 31, 2012.

Accordingly, because the amount of administrative claims due on the Effective Date should be within the range SummitBridge is committed to pay, the SummitBridge plan satisfies § 1129(a)(9).

b. Other Contested Issues

Most of the other objections presented by the Debtors can be categorized as arguments that the plan is not proposed in good faith or in the best interests of creditors. The Debtors allege that the plan is not proposed in good faith or in the best interests of

creditors because it proposes to liquidate the assets of the Debtors which will lead to a lower return to creditors than a plan of reorganization. Specifically, the Debtors contend that the appointment of a Plan Administrator is not in the best interests of creditors because the proposed Plan Administrator would be costly and the does not have sufficient experience to operate the gas stations profitably.

However, the Court finds that the proposed Plan Administrator has sufficient experience overseeing the operations of gas stations pending a sale of their assets. Further, while a liquidation may not result in full payment to all of the Debtors' creditors, the plan contemplates that a reorganization is not feasible and a liquidation would result in a higher return to creditors. Accordingly, SummitBridge proposed the plan in good faith because it believes that it will provide a greater return to creditors than a reorganization.

The Debtors further argue that the appointment of the proposed Plan Administrator is, in substance, a proposal to appoint a bankruptcy trustee. The Debtors reason that the proposed appointment of the Plan Administrator is improper because the Court previously denied SummitBridge's motion to appoint a bankruptcy trustee. However, the Court denied the motion to appoint a trustee because there was not sufficient evidence of a conflict of interest with TBD or failure of the Debtors' officers of fulfilling their fiduciary obligations. The Plan Administrator is proposed here, not because of any alleged breach of fiduciary duty, but instead to operate the stations and to facilitate a successful sale of the Debtors' assets. Thus, the SummitBridge plan is not proposing to appoint a trustee in the form of the Plan Administrator.

Finally, the Debtors contend that the SummitBridge plan is not confirmable because there is no non-insider impaired accepting class of claimants. The Debtors reason that the creditor body at large does not support the plan and, while SummitBridge voted its impaired claim in favor of the plan, SummitBridge should be considered an insider.

Section 101(31)(B) defines an "insider" when a debtor is a corporation as a "(i) director of the debtor; (ii) officer of the debtor; (iii) person in control of the debtor; (iv) partnership in which the debtor is a general partner; (v) general partner of the debtor; or (vi) relative of a general partner, director, officer, or person in control of the debtor." If Congress' intended "insider" in §1129(a)(10) to refer to an insider of the plan proponent rather than insider of the debtor, as the term is defined in the Code, Congress would have included the words "insider of the plan proponent." Accordingly, because the Debtors are corporations and SummitBridge is not an insider of the Debtors as defined in §101(31)(B), SummitBridge's impaired vote to accept the plan satisfies §1129(a)(10).

IV. Which Plan is in the Best Interests of Creditors and Equity?

The Debtors' plans are not confirmable at this point because, as discussed *supra*, the interest rate is too low, the valuations of the September and May Debtors' properties are too low, the proposed balloon payment is too distant, and the plans do not contemplate the initial shareholder contributions to be deposited in a separate dedicated bank account on the Effective Date. However, if the Debtors modify these portions of their plans pursuant to this decision, the plans will likely be confirmable, pending the Court's feasibility determination considering the higher payments under the modified plans.

Although the SummitBridge plan is currently confirmable, the Court finds that confirmation of the modified Debtors' plans (if filed) is preferable because such plans would be more beneficial to creditors as a whole and equity holders. Among the primary goals of a reorganization under chapter 11 are the preservation of asset values, jobs and the repayment of as much of the creditor body as is reasonably possible. In this case, the Debtors' plans propose to do all three by paying all claims in full while continuing to operate their businesses. The SummitBridge plan, on the other hand, would result in the sale of all of the Debtors' businesses potentially leaving the Saads and their employees without jobs and would likely result in only partial payment to the Senior Secured Creditors and priority claimants and no payments to other creditors. In sum, the Debtors' plans are preferable because they will benefit all creditors and equity interests whereas the SummitBridge plan only benefits some creditors.

The Court nevertheless recognizes the Senior Secured Creditors' concerns that the Debtors' will not be able to make their required plan payments, that the shareholders will not be able to cover shortfalls under the plan or that the Debtors will not be able to later refinance their debt so that they will be able to make their required balloon payment. However, these concerns are alleviated by the fact that a failure of the Debtor to do any of these things will constitute a default enabling the Senior Secured Creditors to take possession and dispose of their collateral. The Senior Secured Creditors may then, in essence, implement their contemplated plan to liquidate their collateral for their benefit. However, if there is no default, then the objecting creditors will receive the full value of their collateral plus payment on their unsecured deficiency claims.

V. Conclusion

After analyzing the confirmation requirements of §1129(a) and (b), the Court finds that the Debtors' plans may be confirmable if the interest rates, valuations of property, repayment terms and proposed shareholder contributions are revised pursuant to this decision. However, a further feasibility determination must be made taking into account the increased debt service under the revised plans. Moreover, while the SummitBridge plan is presently confirmable, the Court elects to delay confirmation of that plan pending a determination whether the Debtors' amended plans of reorganization (if filed) are feasible.

Thus, the Court shall deny confirmation of the SummitBridge plan and the Debtors' plans without prejudice. The Debtors have 30 days from the entry of this decision to amend their plans of reorganization. Failure to amend the plans within this time period shall result in relief of the automatic stay in favor of the secured creditors GE and Enterprise; SummitBridge will have the option to withdraw its competing plan and gain relief from the automatic stay or ask the Court to confirm the competing plan. On the other hand, if the Debtors timely submit amended plans of reorganization, the Court will determine whether to confirm the plans as modified or require additional evidence of feasibility, given the higher plan payments that must be made. Accordingly, a status hearing on confirmation is set for February 19th, 2013 at 11:00 am to determine what further proceedings, if any, required before a final decision on confirmation, such hearing to be vacated if the amended plans are not timely filed.

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2 **So ordered.**
3 Dated: January 16, 2013

CHARLES G. CASE II
UNITED STATES BANKRUPTCY JUDGE

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