U.S. BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re **DOVE VALLEY SCOTTSDALE, LLC,** **Debtors**	In Chapter 11 proceedings Case No.: 11-11450 **UNDER ADVISEMENT DECISION CONFIRMING DEBTOR'S SECOND AMENDED PLAN OF REORGANIZATION**

I. Introduction

In December 2007, investing in undeveloped commercial real estate in North Scottsdale looked to be a solid business decision. Real estate values in this affluent neighborhood had been on a constant uptick for years due to the ongoing influx of new homeowners and continued commercial investment from around the globe. It was in this environment that Dove Valley Scottsdale LLC ("Dove Valley") borrowed several million dollars from First National Bank of Olathe in order to develop 13 acres of commercial property. It seemed like a wise decision at the time.

Then the real estate bust of 2008 hit Arizona. Hard.

Now, four years later, the property remains undeveloped; Dove Valley is in bankruptcy; and, literally, neither the Debtor nor Sunflower Bank[1] wants the property. Who, under the Bankruptcy Code, must take the property? The answer in this case is: The Bank.

II. Background and Facts

The pertinent facts are largely undisputed.

The Debtor, an LLC, was formed for the purpose of purchasing and developing 13.31 acres of commercially-zoned real property located at the southeast corner of Dove

[1] Sunflower is the successor in interest to FNBO or, at the least, the party entitled to enforce the original loan obligation.

Valley Road and Scottsdale Road in Scottsdale, Arizona ("Property"). The Debtors members are Mastro Properties, LLC and LGE/Biltmore Dove, LLC.[2] The Debtor has few assets. It owns the Property; a bank account with less than $50; and a Bobcat tractor ("Bobcat"). The Property and the Bobcat are the cornerstones of this dispute.

The Property is encumbered by a loan with Sunflower Bank ("Sunflower") for $9,118,000 which the parties renewed and extended on May 7, 2010 ("Loan"). As part of extending the Loan, Sunflower obtained guarantees from LGE Corporation, Richard Lund, Mary Ann Lund, Dennis Mastro, Jane Mastro, Jeff Mastro,[3] Jodi Mastro, Michael Mastro, Brenda Mastro, and Scott Turillo ("Guarantors"). The Loan matured on May 7, 2011. On April 1, 2011, Sunflower declared default based on the Debtors failure to: 1) pay 2010 ad valorem taxes, 2) furnish Guarantors' financial statements; 3) give notice of default on 2010 ad valorem taxes; 4) develop the Property; and 5) provide evidence of progress under the "Development Plan". Sunflower extended the Guarantors' deadline to provide financials several times before declaring default.

The value of the Property is unknown, but Sunflower possesses three appraisals:[4]

Integra Realty Resources
- Appraisal Date: February 22, 2011
- Cover Letter Date: March 2, 2011
- Valuation: $8,700,000
- Bank Checklist?[5]: Yes – "The appraisal reasonably or fully conforms to regulations and USPAP, is mathematically correct, and the opinion of market value is, [sic] credible."

Scott Neibling Valuation Group
- Appraisal Date: April 29, 2011
- Cover Letter Date: May 11, 2011
- Valuation: $2,610,000
- Bank Checklist?: No

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[2] The members of Mastro Properties are Jeffrey J. Mastro, Michael D. Mastro, and Dennis Mastro The Debtor does not know the members of LGE/Biltmore Dove LLC, but believes they are LGE, Inc. and Richard Lund

[3] Listed as "Jeff" not "Jeffrey" in the note attached to Sunflower's proof of claim.

[4] The Court admitted the appraisals not for the truth of their content, but for the fact that Sunflower possesses them.

[5] This refers to whether the appraisal had been reviewed against an internal checklist at the Bank.

Appraisal Technology, Inc.

- Appraisal Date: April 8, 2011
- Cover Letter Date: April 15, 2011
- Valuation: $8,700,000
- Bank Checklist?: Yes – "The appraisal does not fully conform to regulations and/or USPAP and/or has minor errors or omissions, but the opinion of market value is credible nonetheless."

The Debtor has not attempted to sell or market the Property during the bankruptcy.

The Bobcat, acquired in February 2011, is encumbered by a secured loan of $12,465 in favor of Key Construction, LLC, an entity that had been doing work for an affiliate of the Debtor. The Debtor used the Bobcat once, moving dirt from one part of the Property to another, as a deterrent against potential trespassers.

The Property and the Bobcat are two of the three secured claims against the Debtor. An accountant, Donald R. Leo & Company, LTD, holds the third for $5,000, secured by a retainer of equal amount.

The Debtor has these unsecured claims: $217,999 to Sunflower and $46,805.07 to all others.

The Debtor filed for bankruptcy on April 22, 2011; proposed its original plan soon afterwards on May 4, 2011 ("Original Plan"); and proposed to liquidate the Property from the start. Sunflower objected to the Leo and Key Construction claims in the Original Plan's disclosure statement soon after and moved to terminate exclusivity. Language in the motion to terminate exclusivity presaged the two proposed plans: "If permitted, Sunflower Bank intends to immediately propose a viable competing plan that provides for marketing and selling the Property; does not require a contested evidentiary valuation hearing; and treats all creditors other than Sunflower Bank exactly as they are treated in the current proposed plan." The Court granted Sunflower's motion to terminate exclusivity on July 13, 2011. The Debtor filed its second amended plan on July 27, 2011 ("Debtor's Plan) and Sunflower filed its amended plan on August 3, 2011 ("Sunflower's Plan").

Sunflower has commenced an action on the guarantees in Kansas that is still pending.

The Debtor's Plan is a "dirt for debt" plan under which the Debtor returns the Property to Sunflower, there is no valuation hearing, and Sunflower is paid $100,000 for its unsecured claim. The Debtor has separately classified Key Construction and Leo and asserts that they are consenting impaired classes. Key has agreed to a payment of $10,000 in full satisfaction of its claim and Leo has agreed to reduce its claim by $250 and receive payment of the remainder through five equal monthly installments as an offset against its retainer.

The Sunflower Plan proposes an eight month marketing period with an asking price for the Property of $8.7 million. If there is a lower offer for the Property and Sunflower wishes to sell, the Debtor can bring the offer to the Court to determine if it is a fair offer. If the Property does not sell during the marketing period, Sunflower has sixty days thereafter to exercise its rights and remedies with respect to the Property. If the Property remains unsold, a §363 auction will be held. Additionally, Sunflower will fund up to $200,000 for costs of the Debtor to continue operations during the marketing period. Key and Leo are paid in full under the Sunflower Plan. Sunflower is not paid $100,000 for its unsecured claim.

In most other respects, the plans are remarkably similar. For instance, with the exceptions of "Allowed Claim," "Consummation Contribution," and "Disbursing Agent" the definitions are exactly the same or substantially similar. Further, the only difference in classification (not treatment of the class) is that the general unsecured claims and the unsecured claims of Sunflower are classified as 3-A and 3-B in the Debtor's Plan and as Class 3 and Class 4 in Sunflower's Plan.[6]

[6] Interests are then classified as Class 4 in the Debtor's Plan and Class 5 in Sunflower's Plan.

III. Analysis

A. Indubitable Equivalent?

A plan is fair and equitable to a class if it provides "for the realization by such holders of the indubitable equivalent of such claims." 11 U.S.C. §1129(2)(b)(iii). Does a "dirt for debt" plan satisfy this requirement where the entirety of the property is returned to the secured creditor? Yes. As stated in *Matter of Sandy Ridge Development Corp.*, 881 F.2d 1346, 1350 (5th Cir. 1989) "common sense tells us that property is the indubitable equivalent of itself." This is not a situation, like *In re Arnold & Baker Farms*, 85 F.3d 1415 (9th Cir. 1996), where the Debtor is trying to transfer a portion of the Property in partial satisfaction of the debt. Instead, the Debtor is returning complete title to Sunflower. It necessarily follows that, "the value of the secured portion of an undersecured creditor's total claim is *by definition* equal to the value of the collateral securing it. Therefore, a creditor necessarily receives the indubitable equivalent of its secured claim when it receives the collateral securing that claim." *Id.* at 1423 (emphasis in original).

Sunflower seems to acknowledge the persuasiveness of *Sandy Ridge* as its "dirt for debt" analysis has evolved over the course of these proceedings. While originally arguing that the Debtor's Plan was not filed in good faith *because* it is a "dirt for debt" plan, Sunflower now argues that a "dirt for debt" plan does not automatically equate to a plan filed in good faith.

While its former reasoning is flawed, Sunflower's latter reasoning is correct. While holding that a "dirt for debt" plan satisfies the indubitable equivalence test, *Sandy Ridge* remanded to the bankruptcy court to determine if the plan was otherwise filed in good faith. This Court too will examine good faith.

B. Good Faith

A plan must be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). "A plan is proposed in good faith where it achieves a result consistent with the objectives and purposes of the Code." *In re Sylmar Plaza, L.P.*, 314

F.3d 1070, 1074 (9th Cir. 2002). Courts should look to the totality of the circumstances when determining good faith. *Id.*; *Sandy Ridge* at 1353.

i. Debtor's Plan

Sunflower questions the good faith in the Debtor's Plan on three main points: 1) returning the Property to Sunflower 2) the Debtor's Plan is meant to benefit the third-party guarantors; and 3) claims manipulation.

Sunflower repeatedly claims that forcing Sunflower to retake ownership of the Property instead of attempting a sale shows a lack of good faith. Sunflower is worried that the Debtor's lack of marketing could be due to problems with the Property such as zoning, environmental, or other unknown problems. Moreover, according to Sunflower, properties tend to sell at a higher value when owned by a private party as opposed a bank.

The Court is not persuaded by Sunflower's arguments. The facts here are simple: the Debtor purchased the Property to develop it; in the current economic crisis development became impracticable, if not impossible; and the Debtor has no purpose other than to develop the Property. By returning the Property to Sunflower, the Debtors are simply taking advantage of an explicit provision of the Code. Choosing one Code provision over another, §1129(b)(2)(A)(iii) over §1129(b)(2)(A)(ii), does not indicate a lack of good faith; it's simply what debtors do. "'[T]he fact that a debtor proposes a plan in which it avails itself of an applicable Code provision does not constitute evidence of bad faith.'" *Sylmar Plaza, L.P.* at 1075 (quoting *In re PPI Enters., Inc.*, 228 B.R. 339, 347 (Bankr. D. Del. 1998). Under such facts, turning the Property over to Sunflower is consistent with the objectives and purposes of the Code.

Next, Sunflower argues that the true purpose of the Debtor's Plan is to benefit the third party Guarantors. However, this is not a case where the Debtor is trying to release the liability of guarantors. *See In re Lowenchuss*, 67 F.3d 1394, 1401 (9th Cir. 1994) (under §524(e) a court cannot release third parties from liability). Jeffrey Mastro plainly testified that the Debtor's Plan does not release the Guarantors' liability and the Plan itself is clear on that point. Importantly, Sunflower has not clearly articulated how a

transfer of the Property from the Debtor to Sunflower negatively impacts its Kansas case against the Guarantors. On the other hand, the Debtor, in explaining why it believes Sunflower's Plan lacks good faith, explains what it believes are Sunflower's motives – charging 18% interest on the potential deficiency claim against the Guarantors for as long as possible. In short, Sunflower's claim that the Debtor's plan lacks good faith on this point fails.

Debtor must demonstrate the acceptance of at least one impaired class of claims. 11 U.S.C. §1129(a)(10). Under the Debtor's Plan, both Key Construction and Leo are impaired classes that voted in favor of the Debtor's Plan. Sunflower Bank attacks the classification on two legal fronts – lack of good faith under §§1126(e) and 1129(a)(3) – with the same underlying contention: that the claims were artificially created by the Debtor in anticipation of filing bankruptcy. Sunflower reaches this conclusion by questioning the timing of the creation of the secured debts and the impairment of each creditor in the Debtor's Plan.

The Debtor entered into both secured transactions in February 2011. This date, according to Sunflower, is no accident as the Loan matured in May 2011. By mid-February, Sunflower argues, the Debtor: had not paid property taxes; failed to develop the Property as agreed; and knew it had a February 15, 2011 deadline to provide financials to Sunflower – financials which, after a series of deadline extensions, were never delivered.

The treatment of each claim, Sunflower urges, also shows a lack of good faith. Prepetition, Leo billed the Debtor $1,824, but was not paid from the $5,000 retainer. Leo has now agreed to reduce his claim by $250 and pay itself from the retainer over five months. The Debtor's Bobcat purchase from Key Construction is equally suspicious to Sunflower. By the Debtor's own admission, it purchased the Bobcat only as a means to move dirt on the Property to discourage trespassers and has only been used once. These secured transactions, concludes Sunflower, couldn't paint a clearer picture of claims created in anticipation of bankruptcy. The Court disagrees.

This is not technically a gerrymandering case. Indeed, each of these secured claims must be separately classified, as each is not substantially similar to any other claim. Rather, Sunflower Bank makes two arguments based on lack of good faith. First, it asks the Court to *designate* Key Construction's and Leo's acceptances as having not been procured in good faith under §1126(e).[7] Due to the entitlement of a creditor to vote on a plan, "the burden on the objecting creditor to sustain [1126(e)] designation is heavy." *In re Greenwood Point, LP*, 445 B.R. 885, 898 (Bankr. S.D.Ind. 2011). In determining good faith under 1126(e), the Ninth Circuit has described the analysis as "fluid" with "no single factor" to be considered." *In re Fighter Ltd.*, 118 F.3d 635, 639 (9th Cir. 1997). "Prior cases can offer guidance, but, when all is said and done, the bankruptcy court must simply approach each good faith determination with a perspicacity from the data of its informed practical experience in dealing with bankrupts and their creditors." *Id.* at 639-40.

Similarly, as discussed above, courts are to look at the totality of the circumstances when determining good faith under 1129(a)(3), "including the debtor's pre-filing conduct." *In re Quigley Co. Inc.*, 437 B.R. 102, 125 (Bankr. S.D.N.Y. 2010). "[T]he act of impairment in an attempt to gerrymander a voting class of creditors is indicative of bad faith." *In re Hotel Associates of Tucson*, 165 B.R. 470, 475 (9th Cir. BAP 1994). "'An alteration which is clearly intended only to create an impaired class to vote in favor of a plan so that a debtor can effectuate a cramdown ... will not be allowed.'" *In re L & J Anaheim Associates*, 995 F.2d 940, 943 n. 2 (9th Cir. 1993) (quoting *In re Club Associates*, 107 B.R. 385, 401 (Bankr.N.D.Ga.1989)).

Putting all of this together, the question becomes whether the Debtor incurred the debts pre-petition primarily with the intent of satisfying the consenting impaired class requirement or, at the least, conjured up a treatment of the claims primarily to allow it to

[7] 1126(e) states:

> On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title.

As there is no evidence in the record that either of the creditors acted not in good faith, the 1126(e) argument is necessarily that the Debtor's procurement of the accepting vote was not in good faith.

confirm a plan over Sunflower's objection. Viewing the totality of the circumstances, the Court is unconvinced of either scenario. Yes, the Debtor was in financial straits at the time of the transactions, but Jeffrey Mastro credibly testified regarding the purposes and treatment of at least the Key claim.[8] He also testified that the Bobcat was only used once, but the creation of barriers on the Property was effective and it has not been needed since. The circumstances are not sufficiently suspect to disqualify the vote of that class. Further, as noted, this is not a gerrymandering case. The evidence shows that the debt to Key is a properly documented secured claim and therefore is a valid separate class. Finally, the Court determines that the Debtor's pre-petition purchase and use of the Bobcat met a legitimate business need and was not used simply for bankruptcy planning purposes.

Finally, the fact that another payment proposal might have led to a different result doesn't make the proposed treatment not in good faith. That issue has been directly addressed by the Ninth Circuit Bankruptcy Appellate Panel in *Hotel Associates of Tucson* as follows:

> We do not believe it is the bankruptcy court's role to ask whether alternative payment structures could produce a different scenario in regard to impairment of classes. Denying confirmation on the basis that another type of plan would produce different results would impede desired flexibility for plan proponents and create additional complications in the already complex process of plan confirmation. Moreover, nowhere does the Code require a plan proponent to use all efforts to create unimpaired classes. [citation omitted]. Such a requirement should not be imposed by judicial fiat.

Id. at 475

Finally, even if Key could not satisfy the consenting impaired class requirement, Class 3A, the unsecured creditors other than Sunflower's deficiency claim, would. The BAP's recent decision in *In re Loop 76*, --- B.R. ----, 2012 WL 603812 (9th Cir. BAP (Ariz.) February 23, 2012) is directly on point, holding that separate classification of a *guaranteed* deficiency claim and general unsecured creditors is appropriate under Section 1122. That is the case here. And, as to good faith, no serious argument has been made that it would be appropriate to designate the votes of the unsecured class or that this

[8] The Court agrees that the explanation of the treatment of the Leo claim is muddled at best.

separate classification was not in good faith.

For the foregoing reasons, the Debtor's Plan meets the good faith requirements of both §§ 1126(e) and 1129(a)(3).

ii. Sunflower's Plan

Under the totality of the circumstances, the Court concludes that Sunflower did not carry its burden of proof that its plan was filed in good faith. Why? Under the Sunflower Plan the Court may be called upon to hold a valuation hearing even though Sunflower objected to the Original Plan because it called for a valuation hearing. Further, the Sunflower Plan proposes a three-phase process to market and sell the Property that never assures the ultimate transfer of the Property from the Debtor. Thus, despite its title, the Sunflower Plan is not a liquidating plan because the Debtor might still possess the Property upon completion.

A careful review of the Sunflower Plan is warranted.

Phase One – Marketing: During the first phase, a broker will market the Property with an asking price of $8,700,000 for eight months. Any offer of $8.7 million or more will be accepted by Sunflower, but an offer of less than $8.7 million requires acceptance by the bank and the Debtor. If only one party wants to accept an offer of less than $8.7 million the offer is then brought to the Court to decide if the offer is "reasonable in light of the available facts. Parties need not obtain or present appraisals to the Bankruptcy Court for such a summary determination." Sunflower Plan p. 8. If deemed reasonable by the Court, the sale occurs; if not marketing continues.

The Court is not troubled by the $8.7 million asking price. While it is obvious to the Court that Sunflower does not believe the Property is worth $8.7 million, the Debtor does and Sunflower's Plan is designed to test the Debtor's opinion of value.

However, the process to determine "reasonableness" of a less than $8.7 million offer is problematic. The Original Plan, filed within two weeks of the bankruptcy filing, proposed liquidation with a valuation hearing. Sunflower opposed the Original Plan, in part, because it wanted to avoid the time and expense of a valuation hearing. Now, under

the Sunflower Plan, the Court may be called upon to determine the reasonableness of an offer. How, the Court ponders, will it determine the reasonableness of an offer without knowing the value of the Property? The Sunflower Plan states that the Court will do so "in light of the available facts." But what facts are available to the Court to make such a determination? The appraisals, which show Property value somewhere between $2.6 million and $8.7 million, would be available only if properly admitted in a future valuation hearing. They were admitted at the confirmation hearing, but not for the truth of the matters asserted, but only to show that the bank possessed them. Under the facts of this case, the Property is valued somewhere between unknown – Mr. Yohe's testimony and $8.7 million – Mr. Mastro's testimony. Any future appraisal would also have to be admitted to be considered. Sunflower may think the Court can determine value without a valuation hearing, but if asked to determine the reasonability of an offer, *the Court* will need a valuation hearing.

Phase Two – Waiting: If the Property does not sell in eight months, Sunflower gets two months to plan its next move. Under Sunflower's Plan, upon confirmation the §362(a) stay lifts, but Sunflower will not exercise its rights and remedies concerning the Property during this time. Upon the expiration of the Marketing Period, Sunflower will have the right, but not the obligation, to exercise its rights and remedies. During this time Sunflower has no other responsibilities.

Phase Three – Auction: If Sunflower does not exercise its rights by the end of the expiration period an auction is to be held by the Broker in accordance with §363 and subject to Court approval. Sunflower shall have the right to credit bid.

The Court first notes the lack of detail regarding the contemplated auction. For instance, is there a minimum bid price, must bidders pre-qualify, what are the noticing requirements for the sale, what is the anticipated timeline for the sale, etc.? Aside from these open questions, there remains a fatal flaw with the proposed auction: what happens if there are no bidders? Under the Sunflower Plan the Broker "shall sell" the Property, but

what if there is no buyer? While Sunflower has the right to credit bid, but it is not obliged to do so.

Under Sunflower's Plan, there is the very real possibility that 22 months[9] after filing for bankruptcy the Debtor will be no closer to liquidating than it was when it filed its petition – a liquidation it proposed two weeks into the case.

In the end, this is not a liquidating plan because liquidation is really only an option not a requirement. If it were to serve Sunflower's interests nearly two years from now to decline to credit bid, it could do so, leaving the Property in the same purgatory in which it finds itself stranded today.

Good faith implies fundamental fairness and respect for all parties' interests. Sunflower's Plan does not meet that marker and therefore its Plan cannot be confirmed.

C. Competing Plans:

Even if the Court were to find that Sunflower's Plan had met its good faith burden, it would confirm the Debtor's Plan. Pursuant to §1129(c), only one plan can be confirmed. In making its choice, the Court is to consider "the preferences of creditors and equity security holders in determining which plan to confirm." *Id.* As suggested by Sunflower, the Court should consider "(1) the type of plan; (2) the treatment of creditors and equity security holders; (3) the feasibility of the plan; and (4) the preferences of creditors and equity security holders." *In re Greater Bay Hotel & Casino, Inc.*, 251 B.R. 213, 245 (Bkrtcy. D.N.J. 2000) (quotation omitted).

The Court incorporates its analysis regarding good faith into its analysis regarding competing plans.

Here, Sunflower's Plan fails on points one and three as the Court has serious concerns regarding the type of plan Sunflower proposed and whether, if implemented, the stated goal of liquidation will be completed, thus raising the question of feasibility. Second, Sunflower, the lone impaired secured creditor, will be treated as it wishes under

[9] Eleven months from filing to plan confirmation; one month from plan confirmation to effective date; eight months from effective date to waiting period; and two months from waiting period to auction (11+1+8+2=22).

Sunflower's Plan while forcing the Debtor to retain the Property, and all associated liability, over an extended period of time. The statute makes clear that, while Sunflower is the biggest creditor, its preferences are not the only ones worthy of consideration in a competing plan scenario. This factor cuts against confirmation of Sunflower's Plan as all other creditors and equity holders prefer the Debtor's Plan. In sum, the stated goal of liquidating the Property will be more quickly and efficiently accomplished under the Debtor's Plan.

IV. Conclusion

The Court will confirm Debtor's Plan and deny confirmation of Sunflower's Plan. Counsel for Debtor is to upload a form of order.

So ordered.

Dated: March 28, 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