UNITED STATES BANKRUPTCY COURT

IN AND FOR THE DISTRICT OF ARIZONA

WHC, LLC, **Debtor.**	**Chapter 11 proceedings** **Case No. 2:09-bk-17092-CGC** **UNDER ADVISEMENT DECISION RE MOTION FOR RELIEF FROM STAY**

I. Introduction

This is a Motion For Relief From the Automatic Stay pursuant to 11 U.S.C. §362(d)(1)-(3) and Rules 4001 and 9014 of the Federal Rules of Bankruptcy Procedure. Biltmore Holdings Financial, LLC ("Biltmore") holds the first priority secured lien against parcels of real property which the Debtor WHC, LLC ("Debtor" or "WHC") assembled for development near 7th Avenue and Grant Street, Phoenix, Arizona ("Property"). The 48 parcels are described in an Amended Deed of Trust recorded April 2, 2009, at Instrument Number 2009-0291740, records of Maricopa County, Arizona. The total assemblage is irregularly shaped and is located north and south of Grant Street between 7th and 4th Avenues just south of the primary downtown Phoenix area. Though not yet accomplished, part of the Debtor's original intent was to seek abandonment of some of the interior streets to consolidate the parcel.

The matter was tried to court on November 4, 2009 and was deemed under advisement after completion of post-trial briefing on November 13, 2009.

II. Facts

A. The Loan

On November 8, 2007, Biltmore lent Debtor the principal amount of $13,000,000.00 ("Loan"). As evidence of the Loan, on November 8, 2007, Debtor, as maker, executed a

Promissory Note in the original principal amount of $13,000,000.00 ("Note"). As security for the repayment of the Loan, on November 8, 2007, Debtor, as trustor, executed a Deed of Trust And Assignment of Rents With Security Agreement and Financing Statement (Fixture Filing) for the benefit of Biltmore, as beneficiary ("Deed of Trust"), providing a first priority lien against the Property, among other things, in favor of Biltmore. The Deed of Trust was recorded on November 9, 2007, as Instrument No. 2007-1208113, records of Maricopa County, Arizona. The Property is Debtor's sole asset.

The Loan matured on January 8, 2009; Debtor did not pay. Due to the default, Biltmore instituted a trustee's sale ("Trustee's Sale") of the property by causing a Notice of Trustee's sale to be recorded on April 16, 2009, as Instrument No. 2009-0339357, records of Maricopa County, Arizona. The Trustee's Sale was scheduled for Friday, July 16, 2009. Through postponement, the sale was re-scheduled for July 23, 2009. Debtor filed this Bankruptcy proceeding on July 22, 2009, the day prior to the rescheduled trustee's sale.

B. Proceedings in the Bankruptcy Case

Excluding any claim of Biltmore, Debtor listed unsecured claims of $523,810.37 on Schedule F of its Bankruptcy Schedules, of which about $300,000 are non insider claims. The Debtor filed its Disclosure Statement and Plan of Reorganization on October 28, 2009 ("Plan"), 98 days after the filing of the case..

The Debtor checked the "single asset real estate" box in the "Nature of Business" section of its bankruptcy petition. This is a "single asset real estate case" as defined in 11 U.S.C. § 101(5IB). Biltmore sought an immediate order lifting the stay because the Plan was filed more than 90 after the case was filed. *See* 11 U.S.C. § 352(d)(3). The Court denied that relief and continued the stay until completion of the final hearing and rendering of the Court's decision conditioned on the payment of $6000 to Biltmore, which payment was made.

The Debtor objected to Biltmore's claim on November 4, 2009, the day of the final hearing. In essence, the objection is that Biltmore fraudulently induced Debtor to incur the debt, wrongfully controlled the disbursement of funds from certain reserve accounts, did not properly account for funds in certain reserve accounts, wrongfully encouraged and allowed Debtor to purchase a parcel after the loan had matured, and wrongfully refused to pay for certain development costs Debtor believed necessary. As the objection was filed on the day of trial, no response was of record at that time. Biltmore has since filed a brief response. The Debtor has not filed a motion to estimate the Biltmore claim for purposes of plan confirmation.

Debtor put no "hard money" in the acquisition of the various parcels; all purchases were 100% financed by Biltmore. Biltmore acquired a majority of the funds lent via a loan from the Bank of Olathe to which it has collaterally assigned its security documents. From the proceeds of the loan, Biltmore established an interest reserve to service the debt for one year and an acquisition reserve to acquire additional properties in the assemblage. Notwithstanding have put no money in the acquisition of the property, the Debtor has incurred development related costs.

C. The Proposed Plan

The Property is the largest contiguous assemblage of land in the greater downtown area. The Debtor originally envisioned a mixed use development for residential, commercial and office purposes on the Property. But, under Debtor's Plan, the vision has shifted. Debtor proposes to sell, within 12 months, part of the Property to an affiliated company, Contractor's Abatement Services, Inc. ("Contractor's Abatement") for approximately $1.3 million and another parcel, within 18 months, to a developer for $2.4 million, contingent upon the developer being the successful bidder for a "build to suit" lease with the General Services Administration for an immigration processing center. All proceeds, net of sales expenses and closing costs, would be remitted to Biltmore.

The Plan values the property at $4.2 million based upon the opinion of Debtor's principal, John Witt, that it is currently worth $7.65 per square foot. The Plan bifurcates Biltmore's claim into a secured claim of $4.2 million and an unsecured claim not to exceed

$4 million which is separately classified from other unsecured creditors. The difference between the sum of these two claims and the unpaid principal of the Biltmore loan ($13 million - $8.2 million = $4.8 million) presumably results from a setoff of Debtor's claimed damages as alleged in the claim objection.

Key to the Plan is $1 million in DIP financing due in 36 months from Pinsonneault Holdings secured by a priming first lien on all parcels. Biltmore has made clear it would not consent to being primed. And, the Debtor has not yet filed a motion making the case that Biltmore would be adequately protected within the meaning of Section 364(d)(1) if Biltmore was primed – and didn't try to make that case at the Final Hearing. Rather, Debtor elicited testimony from the Pinsonneault representative that it would "consider" lending without a first lien subject to "negotiations" with Biltmore. No further details were given. The proceeds of the DIP loan would be used for two purposes–first to fund an interest reserve to pay Biltmore $294,000 over one year (7% interest on principal of $4.2 million) and second to pay for development costs and ongoing expenses. The interest carry on the DIP loan ($8,333 per month) would be paid through a monthly advance from Contractor's Abatement to the Debtor.

The remaining parcels would be transferred to New WHC of which Old WHC would own 51% and Biltmore 49%. The Plan proposes to pay non-insider unsecured claims in full, on a delayed basis (Class 3) and Biltmore's unsecured claim (capped at $4 million) (Class 4) through distributions to New WHC (of which Biltmore would receive 49%, until its capped claim is paid in full) and from Old WHC's 51% distributions in New WHC after repayment of the DIP loan.

The Plan's proposed treatment of the $4.2 million secured claim is less clear. Even if the two sales described above were to occur and 100% of the proceeds were available to pay down the secured claim (an unlikely event given the acknowledged necessity to pay ordinary brokerage and closing costs), they would yield together only $3.7 million, leaving $500,000 unpaid. To the Court's eye, the Plan does not explain how the remaining $500,000 is to be paid. If those funds are to come from the continuing sales described in paragraph 7.01(e) of the Plan[1], then the treatment of the unsecured class 4 claim would have to be reduced.

III. Analysis

A. The Motion for Relief from Stay

Under 11 U.S.C. § 362(d), a motion for relief from automatic stay will be granted by terminating, modifying, or conditioning such stay either (1) "for cause, including the lack of adequate protection of an interest in property of such party in interest;" or (2) the debtor has no equity in the property and the "property is not necessary to an effective reorganization." 11 U.S.C. § 362(d)(1), (2). These two provisions are disjunctive; only one is required to lift the stay. *In re Sun Valley Ranches, Inc.*, 823 F.2d 1373, 1376 (9th Cir. 1987). Further, "section 362 gives the bankruptcy court wide latitude in crafting relief from the automatic stay." *In re Delaney-Morin*, 304 B.R. 365, 369 (9th Cir. BAP 2003). Under § 362(g), the secured creditor has the burden of proof on the issue of a debtor's equity in a property. A debtor carries the burden on all other issues, including whether there is a reasonable possibility of a successful reorganization within a reasonable period of time. *See, e.g., In re Development, Inc.*, 36 B.R. 998, 1005 (Bank.D.Haw.1984); *see also In re Sun Valley Ranches, Inc.*, 823 F.2d at 1376 (stating that besides the issue of the debtor's equity in the property, the burden of proof lies with the debtor).

B. Section 362(d)(2) and (d)(3)[2]

1. Lack of Equity

A creditor must show that a debtor lacks equity in the property, and under § 362(d)(2)(A) equity is "the difference between the property value and the total amount of

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[1]The paragraph number is missing in the filed copy; in any event, this is subparagraph (e) of Article VII of the Plan.

[2]The "effective reorganization" provisions of (d)(2) and (d)(3) conflate and therefore are discussed together.

liens against it." *Stewart v. Gurley*, 745 F.2d 1194, 1195 (9th Cir. 1984). Particularly, equity is the "value, above all secured claims against the property that can be realized from the sale of the property for the benefit of all unsecured creditors." *Pistole v. Mellor (In re Mellor)*, 734 F.2d 1396, 1400 n. 2 (9th Cir. 1984).

Here, the only expert testimony presented on the issue of value came from Randall Clemons, offered by Biltmore. His opinion was that the property has a value of $12 million. The face amount of the original Biltmore loan was $13 million and Debtor acknowledged that no principal reductions had been made.

Mr. Clemons' testimony and report were aggressively attacked by the Debtor on the following issues, among others:

- Mr. Clemons admitted to material misstatements of fact, in particular that the property appraised included an apartment house not owned by the debtor and that the total acreage identified in the appraisal exceeded the property owned by the debtor.
- Mr. Clemons acknowledged that the material misstatements of fact meant that the appraisal may not conform to USPAP or be consistent with the requirements of his state license.
- Mr. Clemons acknowledged that his appraisal was for property as if vacant, even though several parcels have structures on them.

If the only evidence of no equity were Mr. Clemons' appraisal and if the Debtor were asserting that the value exceeded the amount of the liens, then Debtor's argument that the creditor failed to carry its burden would have some teeth. Clearly, the appraisal presented had some serious mistakes that need correction; at the same time, it is obvious that, once corrected, the opinion of value would be lower, not higher. The difficulty for the debtor is that it acknowledges a lack of equity by valuing the property itself at $4.2 million and seeking to confirm a cram down plan based on that value. In the Court's view, it would turn Section 362(g)(1) on its head to conclude stay is relief is not warranted because the movant has not carried its burden where the debtor has conceded the point. Therefore, the Court concludes that the first prong of Section 362(d)(2) has been met.

<u>2.</u> <u>Necessary for an Effective Reorganization</u>

a. The Law

Nevertheless, to lift the stay the Court must find that the Property is not necessary for an effective reorganization under § 362(d)(2)(B). As it is the Debtor's sole property, it is certainly necessary to reorganization; the question remains whether such reorganization would be effective.

Thus, the key issue is whether the Debtor meets the "effective reorganization" requirement. A debtor must show that there is "a reasonable possibility of an effective reorganization within a reasonable time." *In re Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 375-76 (1988). A relief from stay hearing should not be converted into a confirmation hearing under the "effective reorganization" requirement, but a debtor must show that "a proposed or contemplated plan is not patently unconfirmable and has a realistic chance of being confirmed." *In re Sun Valley Newspapers, Inc.*, 171 B.R. 71, 75 (9th Cir. BAP 1994) (quoting *John Hancock Mut. Life Ins. v. Route 37 Bus. Park Assoc.*, 987 F.2d 154, 157 (3d Cir. 1993)). The burden is a "moving target" that gets more difficult to prove as the bankruptcy case progresses. *Id.* (quoting *In re Holly's Inc.*, 140 B.R. 643, 700 (Bankr.W.D.Mich. 1992)). The relief from stay should be granted if reorganization of the business is not feasible or because creditor dissent makes a successful plan unlikely. *See Timbers of Inwood*, 484 U.S. at 375-76.

b. The Facts

The issue presented is whether the Plan meets the relatively low bar of not being "patently unconfirmable" and having a "realistic chance of being confirmed" within a reasonable period of time. For the reasons set forth below, the Court concludes it does not.

Much of the Debtor's evidence at the trial dealt with issues that are tangential at best to the question presented by the motion. For example, the Debtor presented Steve Durkee with the apparent purpose of showing that Biltmore had mismanaged the accounting of the reserve accounts and that the Debtor's plan to obtain abandonment of certain interior streets was feasible. The reserve account evidence was conclusory and not illuminating; further, the issue is fundamentally irrelevant to the question of whether the stay may be lifted. Likewise, the issues whether Biltmore acted wrongfully in the making of the loan, wrongfully refused to release funds from the "acquisition reserve" to fund development costs, and wrongfully pushed for the acquisition of the "donut parcel" post-maturity may be relevant to a claim by the Debtor against Biltmore but not to whether the stay should be lifted.[3]

On the issues that count for purposes of Section 362(d)(2), the reality is that the Debtor failed to introduce evidence to meet the "necessary for an effective reorganization" standard. In brief:

- The Plan cannot meet the requirement of Section 1129(a)(10) of a consenting impaired class. No evidence was presented to justify the separate classification of Biltmore's deficiency claim. In the absence of the separate classification, the Debtor could not proceed to cram down under Section 1129(b). Separate classification without such a justification is not allowed under controlling case law.
- The Plan is wholly dependent upon a finding of value of $4.2 million. As the record stands, without any expert testimony justifying this value, this result is unlikely.
- The Plan has no provision for payment of $500,000 of the secured claim.
- The Plan depends upon the approval of the $1 million DIP facility which, as presented, is not possible. Although there was discussion of a non-priming lien, such evidence was couched in terms of "negotiations" with Biltmore. The DIP loan would, in effect, divert $700,000 of collateral value from Biltmore to other purposes and create the additional risk that comes with every junior lien position. No credible explanation was offered of how Biltmore's interest would be adequately protected in this scenario as required by Section 364. Without the DIP loan, the Plan fails.
- The treatment of Biltmore's deficiency claim is unfairly discriminatory compared to the treatment of Class 3 even if Debtor's proposed set-off of $5 million is accepted for purposes of this motion; this problem is even greater were the full amount of the deficiency included in Class 4.
- The Plan inappropriately discharges third parties (Mr. Witt and Contractor's Abatement) contrary to applicable Ninth Circuit law.
- A serious question is raised whether the Plan satisfies the absolute priority rule in the absence of either the opportunity for a competing plan or a public auction of the post-confirmation equity.

In short, this is not a plan that could be fixed with a tweak here and a tweak there. It

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[3]Indeed, the Debtor remains free to pursue any claims it believes it may have against Biltmore in a court of competent jurisdiction whether Biltmore forecloses or not.

is fundamentally flawed and therefore "facially unconfirmable." As such, the requirements of Section 362(d)(2) have not been met and Biltmore is entitled to relief from the automatic stay.

If the Debtor satisfied (d)(2), the question would then be presented whether Biltmore's interests were adequately protected as required by section (d)(1). Under the circumstances, that inquiry is not required.

IV. Conclusion

For the foregoing reasons, the Court will terminate the automatic stay. Counsel for Biltmore is to submit a form of order; the fourteen day stay will not be waived.

So ordered.

DATED: December 11, 2009

CHARLES G. CASE II
UNITED STATES BANKRUPTCY JUDGE

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