SIGNED.

Dated: July 10, 2012

Randolph J. Haines

Randolph J. Haines, Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re	Chapter 11
BATAA/KIERLAND, LLC,	CASE NO. 2:11-bk-05850-RJH
Debtor.	MEMORANDUM DECISION RE: CONFIRMATION OF AMENDED PLAN OF REORGANIZATION

On May 29 and 30, 2012, the Court held a two day evidentiary hearing on confirmation of Debtor's Amended Plan of Reorganization. After closing arguments and some preliminary comments, the Court took the matter under advisement.

In this decision the Debtor is sometimes referred to as "Kierland I," to distinguish it from its commonly owned affiliate, Kierland II, who owns the adjacent property and the parking garage that was designed for their joint use. The only creditor who objected to the Debtor's plan of reorganization, JPMCC 2007-CIBC 19 East Greenway, LLC, is referred to as the "Lender," although it apparently is not actually a "lender" at all, but rather purchased the secured debt from the Bank of America, who had acquired the debt from the Canadian Imperial Bank of Commerce.

This has been a highly contested, heavily litigated and difficult case for everyone involved. In the joint pretrial statement for the confirmation hearing, the lender listed in 52 paragraphs the contested issues of fact and law, only some of which it identified as falling under nine separate confirmation requirements that it contended are violated, while the Debtor submitted 154 paragraphs describing contested issues of fact and law. This decision is intended to function as findings of fact and conclusions of law as to the actually contested issues of fact and law that the Court heard at the confirmation hearing.

Effect of the Easement

The parties did agree that one key, central issue is the value of the Debtor's property. They also agreed that the valuation dispute largely turns on the legal effect of an easement contained in section two of the Covenants, Conditions and Restrictions (CC&Rs") created when what had been the Debtor's property was subdivided into Kierland I, still owned by the Debtor, and Kierland II, now owned by Bataa/Kierland II, LLC. Bataa/Kierland II currently has the same owners and members as the Debtor.

Although the parties often refer to this issue as being one of the "validity" of the easement, the real issue is not whether the easement is valid, but rather whether it provides the tenants of Kierland I a right to park in up to 75% of the parking spaces in the parking structure on Kierland II's property without having to pay anything for such parking.

The evidence is undisputed that the purpose of the easement was to satisfy the requirements of the City of Phoenix, as a condition to it allowing the split off of the Kierland II property, that Kierland I retain access to 3.5 parking spaces per thousand square foot of tenant leasable space. While the City insisted on evidence of access to such parking, there is no evidence the City had any interest in what Kierland I would have to pay for such parking access.

While the easement does provide such access to parking that was sufficient to satisfy the City's requirements, it does not address what would have to be paid for such parking, particularly in the event the two properties were owned by different owners. This is made absolutely explicit by paragraph 3.4 of the CC&Rs, which provides that "there shall be no material charge for parking ***in the common area*** without the prior written consent of all Owners or unless otherwise required by law" (emphasis added). The CC&Rs define the "common area" expressly to exclude the "Building" on the Kierland II property, and there is no dispute that the parking structure on the Kierland II property is a building. Therefore ¶ 3.4 clearly implies that the only free parking available to Kierland I will be on the relatively few surface sites existing on the Kierland II property, which are not sufficient in number either to satisfy the City of Phoenix' requirement of 3.5 spaces per thousand square feet of tenant leasable area, or the market demand of 4. Therefore while ¶ 2.1.4 may provide Kierland I an easement to the Kierland II parking structure, ¶ 3.4 clearly implies that such parking would have to be paid for and, since no amount or rate was agreed to in the CC&Rs, that implies such amount would have to be agreed to subsequently, although there was really no practical need for such agreement so long as Kierland I and Kierland II were owned by affiliates having common ownership.

Moreover, this conclusion is consistent with the conduct of the parties. The evidence is undisputed that ever since the parking structure was completed, the Debtor has "passed through" to Kierland II its parking revenue derived from its tenants' use of parking in the Kierland II structure. This is not an insubstantial amount, because it is projected by the Lender's appraisal to be approximately $100,000 per year.

To resolve the issue of how much Kierland I would have to pay for parking in Kierland II's structure without litigation, the Debtor and Kierland II negotiated a Parking Agreement that will become effective only upon confirmation of the plan. The Parking Agreement provides for the Debtor to pay Kierland II $5.16 million, representing the Debtor's proportionate share of the cost of constructing the parking structure, plus a monthly payment in excess of $19,000 representing interest on that amount, plus a monthly payment of $1,900 representing the Debtor's share of monthly maintenance of the structure, and semiannual payments of $24,000 for the Debtor's proportionate share of real property taxes on the structure. Significantly, however, the $5.16 million payment need not be made until after payment of the Lender's allowed secured claim and the unsecured creditors' subordinated debenture, which under the plan would be in the seventh year following confirmation.

The Parking Agreement may not be not an arms' length transaction (although it may be, because it has also been agreed to by the lender to Kierland II, Bankers Trust, who has supported the plan and participated in the confirmation hearing), but the Lender presented no fact or expert evidence that the numbers were not correctly calculated on the bases that the Debtor contended, or that it was not a reasonably prudent business transaction for the Debtor to resolve the issue of payment for its parking rights in the Kierland II structure.

The Court therefore finds and concludes that the easement does not provide the

Debtor with free parking in the Kierland II parking structure, nor does it resolve or address what the Debtor would have to pay for that parking. The Court also finds and concludes that in light of the fact that the easement does not resolve what the Debtor would have to pay for parking, supported by the Debtor's historical payment for parking, and the lack of any evidence to the contrary, the Parking Agreement is a reasonable business solution, is the best evidence of how arms' length parties would have resolved the issue without litigation, and is therefore an appropriate part of the Debtor's plan and permitted by Bankruptcy Code § 1123(b)(6).

Valuation

Both the Debtor and the Lender provided appraisals and expert witnesses as to the value of the Debtor's property. Somewhat surprisingly in this hotly contested case, the experts and the appraisals essentially agreed on the value of the property based on the hypothetical assumption that adequate parking exists. The Debtor's appraisal provided by NAI Horizon Valuation Services concluded that the market value of the property, assuming adequate parking, would be $12.5 million. The Lender's appraisal, provided by CBRE, assumed that the easement provided sufficient parking without any necessity for payment, and based on that assumption concluded the value to be $11.7 million.

Unfortunately, however, the Lender's appraisal did not opine as to a value if the Debtor had to pay for the parking provided by the easement. Nor did it opine as to a value on the assumption the Parking Agreement would be binding on the Debtor. Indeed, it did not even take into account the Debtor's historical pass through of parking revenues to Kierland II, which could have a present value effect on valuation in excess of $1 million. Because the Lender's appraisal assumes facts that do not exist, and ignores facts that do exist, it is essentially useless to the valuation the Court must find based upon the existing facts.

The Court therefore finds and concludes, based upon the great preponderance of the evidence, that the as is value of the Debtor's real property is the value concluded by the Debtor's expert witness, $7.7 million. Not only does the Court find the methodology, analysis and conclusions of the Debtor's expert to be credible, but this number also makes sense when the Debtor's proportionate share of the cost of the parking structure, undisputed to be $5.16

million, is subtracted from the Lender's expert's valuation (assuming adequate parking) of $11.7 million.

This conclusion is also supported by the undisputed testimony that when Bankers Trust lent money to Kierland II, it assumed that the Debtor would pay market rent for parking in the Kierland II garage. It is also indirectly supported by the fact that the Lender's appraisal was expressly limited for use by a purchaser of the debt; it *assumed* the same or affiliate ownership of Kierland I and Kierland II, and therefore the appraisal is not appropriate to determine what a purchaser of the Debtor's property would pay, but only what a purchaser would pay for the Lender's note.

Interest Rate

For purposes of determining the present value as required by Bankruptcy Code § 1129(b)(2)(A)(i)(II) and *Till,*[1] the Debtor's interest rate expert concluded that 5% would be an appropriate interest rate, while the Lender's expert concluded 8.7% with adequate parking and 9.4% without adequate parking.

Both interest rate experts purported to apply the *Till* analysis to arrive at their conclusions. Neither of them would have made any changes to the Debtor's projected revenues, projected expenses or projected lease-up period to stabilization. The Lender's expert, however, added 300 basis points on account of the "circumstances of the estate" risk factor, based on his concerns for the Debtor's financial status and experience in operating a building and business such as this, and he added another 300 basis points for the "nature of security risk factor," apparently based solely on his concern for the loan to collateral value ratio. He added another 200 basis points for the "feasibility" risk factor, based upon his concern for the quality of the Debtor's projections.

Based primarily on the cross examination, the Court finds and concludes that the substantial additions for these risk factors lack credibility. Most importantly the risk factors based upon circumstances of the estate and nature of the security were not based upon all of the

[1] *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

highly relevant information, but rather on selective factors seemingly chosen for their tendency to yield a higher rate. The expert did not consider all of the prior ownership and business experience of the principal of the Debtor, David Calvin. Nor did he consider that under essentially the same management, Kierland II had achieved an occupancy rate of approximately 98% in a very short lease-up period during the worst economy since the Great Depression. He relied on opinions that were beyond his scope of expertise. His concern for feasibility failed to consider that the Lender's own appraisal expert agreed that the Debtor's property could be leased-up to stabilization within two years and could then generate cash flow sufficient to service debt.

The Debtor's expert, by contrast, was credible and his ultimate conclusion of 5% was well within the range of reasonableness and within the range suggested by *Till*. It is also strongly supported by the original interest rate on the original lender's loan on the same property but prior to construction. The original interest rate was 5.78% at a time when prime was 8.5%. With prime now significantly less and the construction concluded, and the borrower and the collateral otherwise the same, it would take a lot of very solid and well supported facts, analyses and conclusions to arrive at an interest rate higher than the 5.78% when the loan was originally made.

The Court finds and concludes that the Debtor's expert's analysis is the more credible and therefore finds and concludes that 5% is sufficient to provide present value pursuant to *Till* and to satisfy Code § 1129(b)(2)(A)(i)(II).

Feasibility

The Court finds and concludes that the Debtor's feasibility testimony is credible. Indeed, the Lender's appraisal supported virtually all of the Debtor's projections that bear on feasibility.

The Lender's primary argument about feasibility is that the Debtor will not be able to refinance at the end of seven years to provide full payment of the Lender's allowed secured claim. The Debtor provided testimony, however, as to the value and liabilities at the end of seven years, which support the conclusion there will be sufficient value for the Debtor to refinance. This is particularly true because the distributions to unsecured creditors and the subordinated debenture are contingent and junior to the Lender's lien, and therefore have no effect on the feasibility of the refinancing in seven years. The Court finds and concludes that the Debtor has presented credible testimony to meet the feasibility requirement for purposesw of confirmation of the Plan.

Classification and § 1129(a)(10)

The Lender objects that the plan does not satisfy § 1129(a)(10) because no impaired class accepted the plan.

The Court finds and concludes, however, that both Maricopa County and Annoreno are properly separately classified as secured claims, are impaired and have accepted the plan. The Debtor presented evidence that Annoreno had been granted a security interest in certain computer equipment and that it had perfected that security interest prepetition. The Lender presented no evidence to the contrary. The Court may take judicial notice that Maricopa County's claim for property taxes is secured by the property, and is therefore properly classified as a secured claim even though it might also be a priority claim. Maricopa County's claim is impaired because the plan provides it interest at the statutory rate plus 2%. In *Anaheim*,[2] the Ninth Circuit unequivocally held that any alteration of a claimant's state law rights constitutes impairment, even if the value of those rights is enhanced.

After conclusion of the confirmation hearing, the Lender obtained a hearing on its motion (filed the day of the confirmation hearing) to designate and disqualify Annoreno's vote pursuant to Code § 1126. The Court has taken that motion under advisement and will issue a decision subsequently. Given the impairment and vote of Maricopa County, however, the Court finds and concludes that § 1129(a)(10) is satisfied regardless of the Annoreno's vote. For the same reason, the Court need not address whether the acceptance by the tenants, Kierland II or Bankers Trust also satisfy § 1129(a)(10).

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[2] *In re L & J Anaheim Assocs.*, 995 F.2d 940, 942 (9th Cir. 1993), citing *In re Acequia, Inc.*, 787 F.2d 1352, 1363 (9th Cir. 1986) ("any alteration of the rights constitutes impairment even if the value of the rights is enhanced.") (citations omitted).

Cash Collateral

The Lender objects that the plan does not require the Debtor to turn over all of its cash collateral to the Lender. This objection is without merit because there is no such requirement in the Code.

Cash collateral is a debtor's property, in the form of cash, that secures a lender. Nothing in Code §§ 1123 or 1129 requires that the collateral be surrendered to the lender, any more than they require a surrender of the real property (although surrender of the property is an *alternative* under § 1129(b)(2)(A)(iii), which the Supreme Court recently clarified in its *RadLAX* decision,[3] but which the Debtor's plan does not utilize). Rather, § 1129 can be satisfied if the lender retains its lien while the debtor retains the use of the collateral so long as the lender is paid the present value of its secured claim. Section 506 certainly requires, as made clear by the Ninth Circuit in *Ambanc*,[4] that the value of the cash collateral be added to the value of the real property collateral to determine the *amount* of an undersecured claim. But nothing in *Ambanc* or in §§ 363, 506 or 1129 requires a turnover of the cash collateral.

Best Interests Test

There is similarly no merit to the Lender's objection that the plan does not satisfy the "best interests" test of § 1129(a)(7). When a plan provides a lender with retention of its lien and a payment stream over time along with interest at a rate sufficient to make that payment stream have a present value equal to the value of the collateral (which has already been found above), the plan necessarily provides the undersecured creditor at least what it would receive in a Chapter 7 liquidation. And because this plan also provides the Lender with a *pro rata* share of the $500,000 subordinated debenture, which would not exist in a Chapter 7 liquidation, this plan provides the lender significantly ***more*** than is required by § 1129(a)(7). Moreover, its collateral will be significantly stabilized and enhanced by both the equity owner's $350,000 new value

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[3] *RadLAX Gateway Hotel LLC v. Amalgamated Bank*, ___ U.S. ___, 132 S. Ct. 2065 (2012) (The third alternative under § 1129(b)(2)(A) is to provide a creditor with the "indubitable equivalent" of its secured claim, which might be achieved via a surrender of the property to the secured creditor) .

[4] *In re Ambanc La Mesa Ltd. P'ship*, 115 F.3d 650 (9th Cir. 1997).

contribution and by the Parking Agreement, whereas on foreclosure the lender would inherit a troubled asset subject to serious legal disputes over its rights to park in the adjacent parking structure and over how much must be paid for such parking.

Unfair Discrimination

The Lender objects that the plan unfairly discriminates in favor of the Class 5 claim of Kierland II and the Class 6 claim of Banker's Trust. This objection, however, is either not ripe or moot. No claim of either Kierland II or Banker's Trust has been allowed. And it appears that both claims are resolved by the Parking Agreement, a post-confirmation executory contract that the Court has already found to be reasonable and permitted by Code § 1123(b)(6). The principal purpose of that contract is not solely to resolve a pre-petition claim but more importantly to resolve the Debtor's financial responsibility to pay for parking in the Kierland II parking garage on a going-forward basis, which everyone, including the City of Phoenix and both appraisers, agrees is essential to the Debtor and to the value of its building. The Parking Agreement would be necessary going forward even if there had been a prepetition claim that had been liquidated and allowed, so there is nothing unfair about the fact that Agreement coincidentally eliminates any such claims. The Court finds and concludes there is no unfair discrimination in the Plan.

New Value Corollary

Because the Lender's substantial unsecured deficiency claim will not be paid in full under the plan and its class rejected the plan, the retention of their ownership interests by the equity interest holders would violate the absolute priority rule. The Debtor maintains, however, that the plan satisfies the new value corollary to the absolute priority rule that was recognized by the Ninth Circuit in *Bonner Mall*.[5] The corollary consists of five requirements for the "new value" to be contributed by old equity. Those requirements are that the "new value" is: "(1) new, 2) substantial, 3) money or money's worth, 4) necessary for a successful

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[5] *In re Bonner Mall P'ship)*, 2 F.3d 899 (9th Cir. 1993).

reorganization[,] and 5) reasonably equivalent to the value or interest received" by old equity.[6]

Here, the "market test" required by the Supreme Court's holding in *203* North *LaSalle*[7] is satisfied because exclusivity has been terminated.

The plan requires the equity holders to contribute $350,000 of new value. The Debtor's evidence demonstrated that this new value is necessary to pay for necessary renovations and tenant improvements (which the Lender would not permit to be financed out of its cash collateral), and also to cover any short falls in cash flow while the property is being leased up. There is therefore really no dispute that this new value is necessary and that it consists of money or money's worth.

The amount of $350,000 is certainly "substantial" and far from *de minimis*. It far exceeds any amounts ever found to be insubstantial in any reported case. Neither the origins and purpose of the requirement as explained in *Los Angeles Lumber*,[8] nor do any precedential holdings in the Ninth Circuit or by the Supreme Court, hold that substantiality must be determined by a comparison or percentage of any other number that is relevant in the case, such as total debt, unsecured debt, or debt being discharged. To the contrary, the only mathematical comparison required by the new value corollary is element 5 – that the amount be greater than the value of the interest being retained – and the substantiality requirement exists not to require some other numerical comparison but only to eliminate de minimis contributions (which in reported cases have almost always been less than the debtor's attorneys' fees). If any such comparison were required, the Court would note that the amount is far greater than the amount the Debtor sought to spend to rennovate the building's entrance and common areas, an expenditure the lender refused to permit from its cash collateral, and which amount the Lender must therefore have regarded as very substantial.

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[6] *Id.* at 908.

[7] *Bank of Am. Nat'l Trust and Sav. Ass'n. v. 203 North LaSalle Street P'ship*, 526 U.S. 434 (1999).

[8] *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939).

The Court therefore finds and concludes that the $350,000 new value contribution is substantial.

The Debtor is clearly insolvent on a balance sheet test and will remain insolvent for several years even if the new value is contributed and the plan is confirmed. Because the market test is satisfied by the expiration of exclusivity, the Court finds and concludes that $350,000 exceeds the value of the equity ownership of an insolvent entity.

The principal issue has been whether the money to be contributed by equity owner Bataa Oil is really "new." The issue arises because in 2007 the Debtor distributed approximately $9 million to Bataa Oil, and reflected this on its financial statements as an inter company receivable due from Bataa Oil. In 2009, that distribution was reclassified as a distribution of equity, rather than a loan. Obviously if Bataa's contribution of $350,000 were nothing more than repayment of a loan that it owed the Debtor, it could not be deemed a "new" value contribution.

Aside from the fact of how the 2007 distribution had been reported on the Debtor's and Bataa's balance sheets, no evidence was presented by anyone that there actually had been a loan or a debt. Anne Cline, who acted as the Debtor's bookkeeper when the bookkeeping change was made in 2009, had not been responsible for the books in 2007, and testified she made the change on the recommendation of the Debtor's accountant. She testified it was made only to correct a mistake, not to make a change of any financial significance. Although such testimony may not be highly reliable or credible, the Lender presented no evidence to demonstrate that there ever had been a loan by the Debtor or a debt owed to the Debtor by Bataa Oil. Nor was there any evidence presented by the Lender that it ever relied on a Debtor's balance sheet as showing a significant asset in the form of a receivable from Bataa Oil, which the Lender would have been expected to be able to provide if it had any valid reason to believe that the proposed contribution was not really "new."

Moreover, the evidence is uncontroverted that the original lender agreed in 2007 that the Debtor could distribute to its equity owners $9.6 million of the loan proceeds. Given the significantly deteriorated and deteriorating real estate market in 2007, and the fact that the

Debtor would still have a debt to the lender for the amount of any such distribution for which it received no valuable asset in exchange, there is a significant likelihood that the distribution rendered the Debtor balance sheet insolvent. There is no evidence that the original lender's authorization for that distribution was conditioned upon proof that the Debtor would not thereby be rendered insolvent, or that the "distribution" could only be in the form of a loan (and if the lender had so required, it probably also would have required that the loan be documented, which it was not). In short, it appears that if there were any impropriety in the 2007 distribution such as a fraudulent transfer, the lender aided and abetted that impropriety. Equitable doctrines such as estoppel and unclean hands therefore now bar the creditor standing in the shoes of the original lender -- the only objector to the plan -- from arguing that the money Bataa Oil is now contributing is not new. It would be at least ironic if the Lender could use a transaction that it authorized and facilitated to prevent a debtor from reorganizing for the benefit of both its secured and unsecured creditors, many of whom might have been substantially injured by the very transaction the Lender now seeks to wield as a sword to prevent the reorganization.

Considering all the facts that were established by competent testimony, the fact that the contribution is at least facially "new" as of the confirmation hearing because it is an asset that was not on the Debtor's balance sheet as of the date of the petition, the absolute lack of any evidence that the balance sheet recharacterization in 2009 was a "transfer" of anything, and the failure of the lender to present any evidence (as distinct from lawyer argument) relevant to showing that it was not new money, the Court must find and conclude that the contribution is "new."

The Court therefore finds that the plan satisfies the new value corollary to the absolute priority rule, and therefore is fair and equitable. And based on these findings and conclusions, the Court denies as moot the Debtor's motion to reopen the evidence on the lack of any loan or obligation to Bataa Oil.

Good Faith

The Lender makes several arguments that the plan has not been proposed in good faith as required by § 1129(a)(3). Some of these are directed at the classification and treatment of Annoreno's secured claim and others at the Parking Agreement and the treatment of Kierland II and its lender, Bankers Trust.

Ninth Circuit law is clear that a plan fails to satisfy § 1129(a)(3) when it seeks to "achieve[] a result [in]consistent with the objectives and purposes of the Code."[9] None of the evidence admitted at the confirmation hearing demonstrated any attempt to accomplish a purpose that is inconsistent with the Code. To the contrary, all the evidence demonstrated a a legitimate, honest attempt to reorganize the serious legal and financial problems with the Debtor's asset and business. The Court finds and concludes that the plan was proposed in good faith.

Conclusion

Based on the foregoing findings of fact and conclusions of law, the Court finds and concludes that the Debtor has met the requirements for confirmation under the Bankruptcy Code and that the Plan should be confirmed. Debtor is instructed to upload an appropriate final order confirming the Plan of reorganization that will be subsequently entered by the Court.

DATED AND SIGNED ABOVE

[9] *In re Sylmar Plaza, L.P.*, 314 F.3d 1070, 1074 (9th Cir. 2002).