



*Eileen W. Hollowell*

Eileen W. Hollowell, Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF ARIZONA

In re:	)	Chapter 11
	)	
REID PARK PROPERTIES, LLC,	)	Case No. 4:11-bk-15267-EWH
	)	
Debtor.	)	<b>MEMORANDUM DECISION</b>

**I. INTRODUCTION**

Reid Park Properties, LLC (“Debtor”) seeks confirmation of its plan of reorganization, which provides for the infusion of new capital by a third party in return for a controlling equity interest in the resulting reorganized entity. The plan cannot be confirmed because it provides significantly more favorable treatment to the investor than to Debtor’s creditors, thereby failing to satisfy the fair and equitable requirement for confirmation.

**II. FACTUAL AND PROCEDURAL HISTORY**

A. Debtor’s Chapter 11 Case

On May 26, 2011 (“the Petition Date”), Debtor filed for Chapter 11 relief.<sup>1</sup> Debtor owns the Doubletree Hotel Tucson at Reid Park, Tucson, Arizona (“the Hotel”), which it

<sup>1</sup> Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532. All “Rule” references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

1 purchased in 2007 for \$31.8 million. Debtor’s majority owner is Transwest Partners,  
2 LLC, which, in turn, is owned by Michael Hanson (“Hanson”) and Randal Dix (“Dix”).  
3 The Hotel is managed by Transwest Properties, Inc., which is also owned primarily by  
4 Hanson (45%) and Dix (35%). (Unless otherwise noted, Partners and Properties will  
5 be collectively referred to as “Transwest”). To finance the purchase of the Hotel, the  
6 predecessor of WBCMT 2007-C31 (“Lender”) loaned Debtor \$31,238,300.00 (“the  
7 Loan”). Repayment of the Loan was provided for by Note A in the original principal  
8 amount of \$27,500,000 and Note B in the original principal amount of \$3,738,300.  
9 (Note A and Note B will be collectively referred to as “the Notes”). The Notes were  
10 secured by a single deed of trust (“the DOT”) on the Hotel and a single “Assignment of  
11 Leases and Rents” (collectively “the Loan Documents”).  
12

13  
14 Through a series of assignments, Lender became the holder of Note A and Arbor  
15 Realty Funding, LLC (“Arbor”) the holder of Note B. Pursuant to an intercreditor  
16 agreement (“the Intercreditor Agreement”), Lender was authorized to exercise all rights  
17 with respect to the Notes in bankruptcy proceedings. Debtor was not a party to the  
18 Intercreditor Agreement.  
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20 On the Petition Date, Debtor filed a Chapter 11 plan of reorganization and  
21 disclosure statement. That plan was amended three times before February 20, 2012,  
22 the date when debtor filed the Fourth Amended Plan. The Fourth Amended Plan was  
23 amended on March 29, 2012. On August 8, 2012, Debtor filed “non-adverse”  
24 modifications (“the Modifications”) (the Fourth Amended Plan and the Modifications will  
25 be collectively referred to as “the Plan”).<sup>2</sup>  
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28 <sup>2</sup> The Modifications were filed to conform with rulings made by the Court at or after the  
conclusion of the confirmation hearing.

1 On August 10, 2011, after an evidentiary hearing, an order was entered valuing  
2 the Hotel at \$17 million. Subsequently, Lender filed a proof of claim and an amended  
3 proof of claim for Note A in the approximate amount of \$33.7 million (Claim No. 15-2,  
4 “the Note A Claim”). Lender also filed a proof of claim for Arbor’s Note B claim in the  
5 approximate amount of \$5.5 million (Claim No. 16-1, “the Note B Claim”). On March 19,  
6 2012, Debtor objected to the Note A Claim and filed a supplementary objection on  
7 May 24, 2012 (“the Claim Objection”).  
8

9 On October 20, 2011, Lender filed a Motion for Relief from the Automatic Stay  
10 (“MRS”), which thereafter “rode” the calendar with evidentiary hearings on confirmation.  
11

#### 12 B. Plan Summary

13 Before the Modifications, the Plan provided for HSL Properties, Inc. (“HSL”) to  
14 make a \$2.1 million cash infusion (“the New Equity”) into the post-confirmation debtor  
15 (“the Reorganized Debtor”) in exchange for a 70% ownership interest in it. Lloyd  
16 Construction (“Lloyd”) would have received the remaining 30% equity interest in  
17 satisfaction of its \$1.4 million claim. The Note A and B Claims were bifurcated into two  
18 classes. One class was treated as secured and scheduled to be paid \$17 million over  
19 23 years at 5% interest based on a 30-year amortization schedule, with the first three  
20 years consisting of interest-only payments. The other was treated as unsecured, a  
21 deficiency claim scheduled to be paid 5% of the Reorganized Debtor’s net cash flow  
22 over 10 years, plus a pro-rata share of any preference recoveries. The Plan separately  
23 classified and impaired all other secured claims and proposed paying 100% of their  
24 value over extended terms, generally at 5% interest. Remaining general unsecured  
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1 creditors were going to receive the lesser of 25% of their claims or a pro-rata share of  
2 \$46,468.44. Finally, the Plan provided for canceling Transwest Partners' equity.

3         The pre-Modifications Plan also provided for HSL to receive a 12% return on the  
4 New Equity ("the Preferred Return")<sup>3</sup> and reimbursement of all attorneys' fees incurred  
5 prior to confirmation.  
6

### 7         C. Plan Confirmation

8         Lender filed ballots for the Note Claims rejecting the Plan. It also objected to Plan  
9 confirmation. All other voting creditors voted in favor of the Plan. Continued evidentiary  
10 hearings on Plan confirmation were held on April 3 and 4, 2012 and May 29 and 30,  
11 2012. At the conclusion of the evidentiary hearings, the interest rate on Lender's  
12 secured claim was set at 6%. The Court requested post-trial briefs on all remaining  
13 confirmation issues. Before addressing other Plan issues, the parties elected to first  
14 address whether the Plan's classification of the Notes was proper.  
15

16         On July 18, 2012, an order was entered finding that: (a) the Note A Claim and  
17 Note B Claim were two separate claims; (b) the Note A Claim and Note B Claim could  
18 not be placed in the same class; and (c) any undersecured portion of the Note A Claim  
19 and the unsecured Note B Claim could not be classified separately from other general  
20 unsecured claims. The Court gave Lender until July 31, 2012 to make an § 1111(b)(2)  
21 election for its Note A Claim and gave Debtor until August 8, 2012 to make the  
22  
23 Modifications.  
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27 <sup>3</sup> The Preferred Return is to be paid from the Reorganized Debtor's surplus cash flow defined as  
28 calendar year net operating revenues, less operating expenses, debt service, taxes,  
management fees (Section 5.19 of the Plan), less funding for a working capital reserve of  
\$500,000.00 and any other required reserves.

1 On July 20, 2012, Lender filed its notice of § 1111(b)(2) election to treat the  
2 Note A Claim as fully secured. As a result, there is no unsecured portion of the Note A  
3 Claim. On August 8, 2012, Debtor filed the Modifications, which: (a) adjusted the  
4 interest rate for the repayment of the secured portion of the § 1111(b)(2) claim to 6%;  
5 (b) classified the Note B Claim with other general unsecured claims in Class 16 and  
6 changed the treatment of the Class 16 creditors to include, along with a pro-rata  
7 distribution of approximately \$45,000, the right to receive a pro-rata share of preference  
8 recoveries and 5% of the Reorganized Debtor's net cash flow over 10 years; and  
9 (c) changed HSL's proposed ownership of the Reorganized Debtor from 70% to 100% if  
10 the Court determined that Lloyd's claim was improperly classified. The Court then took  
11 Plan confirmation under submission.  
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### 14 **III. ISSUES**

15 Does the Plan meet the confirmation requirements of 11 U.S.C. § 1129?  
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### 17 **IV. STATEMENT OF JURISDICTION**

18 Jurisdiction is proper under 28 U.S.C. §§ 1334(b) and 157(b)(2)(L).  
19

### 20 **V. DISCUSSION**

21 The requirements for Chapter 11 plan confirmation are set out in 11 U.S.C.  
22 § 1129(a), and if, as here, a plan fails to satisfy § 1129(a)(8), then a plan also must  
23 satisfy § 1129(b). Debtor argues that it has met all of the requirements of § 1129(a) and  
24 (b). Lender disagrees. Rather than addressing each of the subsections of 1129(a) and  
25 (b), this memorandum will focus on §§ 1122, 1125, 1127 and 1129, all of which Lender  
26 asserts bar confirmation of the Plan.  
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1           A. The Modifications' Reclassification of Note B Does Not Require Re-Solicitation  
2                   of Votes on the Plan (§§ 1122 and 1125 Objections)

3           Lender argues that because the Modifications include Note B in the general  
4 unsecured creditor class (Class 16), the Plan must be re-balloted because the  
5 Modifications are adverse to the general unsecured creditors. However, it is not clear  
6 that the general unsecured creditors have been adversely affected by the Modifications.  
7 While their pro-rata share of the \$46,000 "pot" has been diluted by the inclusion of  
8 Note B, unsecured creditors now participate in a 5% distribution from the Reorganized  
9 Debtor's net cash flow for ten years and a pro-rata share of any net preference  
10 recoveries. As a result, it is at least possible that general unsecured creditors will realize  
11 a greater payout.  
12

13           But even if the Modifications result in a smaller distribution to unsecured creditors  
14 who previously accepted the Plan, re-solicitation of their votes will not affect Plan  
15 confirmation. Once Note B was added to the general unsecured creditor class, its claim  
16 swamped the class, and the class has now rejected the Plan. That outcome will not  
17 change if the creditors, who previously accepted the Plan, are re-balloted. To require re-  
18 solicitation in these circumstances is the type of result bemoaned by Mr. Bumble in  
19 Oliver Twist, who complained because English law made him responsible for the  
20 actions of his wife that "the law is an ass." THE YALE BOOK OF QUOTATIONS 197-198  
21 (Fred A. Shapiro, ed. 2006).  
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25           B. The Plan Improperly Classifies Certain Claims (§§ 1122 and 1129)

26           Section 1129(a)(1) requires that a Chapter 11 plan comply with all applicable  
27 provisions of the Code, including § 1122(a), a section which governs claims  
28

1 classification. Classification of the Note B Claim with the Note A Claim has already been  
2 found to be improper. Lender further asserts that the Plan improperly classifies the  
3 claims held by Lloyd and another creditor, EZ Trading, because both creditors are  
4 receiving more for their unsecured claims than general unsecured creditors, thereby  
5 violating § 1129(b)(1)'s prohibition against unfair discrimination.  
6

7           1. Lloyd

8           The Plan separately classifies Lloyd's claim because Lloyd threatened to  
9 bring an adversary proceeding asserting a right to a mechanic's lien or a claim for unjust  
10 enrichment for work done at the Hotel. Any mechanic's lien Lloyd might assert is based  
11 on work performed after Lender recorded the DOT. Given the Hotel's \$17 million value,  
12 even if Lloyd has a right to a mechanic's lien, it would be junior in time and subordinate  
13 to Lender's claim, therefore completely unsecured. Any unjust enrichment claim is also  
14 a general unsecured claim because Lloyd did not obtain or record a judgment prior to  
15 the Petition Date.<sup>4</sup> Accordingly, Lloyd's claim must be treated the same as those of  
16 other general unsecured creditors. However, for the reasons previously explained,  
17 Debtor will not be required to re-ballot the Plan based on the reclassification of Lloyd's  
18 claim.<sup>5</sup>  
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21           2. EZ Trading

22           EZ Trading LLC ("EZ") holds a lien on some of Debtor's kitchen  
23 equipment. Debtor estimates the claim at \$8,455.00. Debtor also estimates that the  
24 claim is undersecured. Nevertheless, the Plan treats EZ's claim as fully secured and  
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27 <sup>4</sup> The result might have been different if all unsecured creditors had been offered a chance to  
exchange their claims for the Reorganized Debtor's equity and only Lloyd had elected to do so.

28 <sup>5</sup> The Modification provides that if Lloyd's treatment is disallowed, HSL will receive 100% of the  
equity in the Reorganized Debtor.

1 impaired. Because the Plan provides for EZ's claim to be paid in full, its unsecured  
2 deficiency claim will be treated more favorably than the claims of general unsecured  
3 creditors.

4  
5 Different treatment of claims with the same priority is permitted if it is  
6 supported by a rational basis. Steelecase, Inc. v. Johnston (In re Johnston), 21 F.3d  
7 323, 328 (9th Cir. 1994). But the Debtor failed to provide any reason for the disparate  
8 treatment of EZ's claim. Accordingly, the treatment of EZ's claim is improper, and its  
9 deficiency claim must be treated the same as the claims of general unsecured creditors.

10  
11 Assuming, without deciding, that EZ has now rejected the Plan because it  
12 is not receiving the treatment it voted for, the Plan may still be confirmed if there are  
13 other accepting impaired classes. Therefore, the legitimacy of the classification of the  
14 remaining accepting impaired classes must be reviewed.

### 15 3. Classes 8 through 15

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17 Classes 8 through 15 consist of claims secured by Debtor's personal  
18 property, including vehicles. The Plan impairs all of these classes by paying them in full  
19 over an extended term either at the contract interest rate or 5%. Because each of the  
20 claims is secured by separate collateral, placing the claims in separate classes is  
21 permitted. In re Commercial W. Fin. Corp., 761 F.2d 1329, 1338 (9th Cir. 1985) ("Both  
22 Collier and case law establish that creditors with claims against different [collateral] are  
23 entitled to separate classification...").

24  
25 Notwithstanding this general rule, Lender argues that Debtor has  
26 "artificially impaired" Classes 8 through 15 in order to obtain a consenting impaired  
27 class, actions which demonstrate a lack of good faith under § 1129(a)(3). In support of  
28



1 this argument, Lender relies on evidence presented at the confirmation hearing which  
2 demonstrated that all of the classes could be paid in full at confirmation from Debtor's  
3 accumulated cash.<sup>6</sup>

4  
5 However, Lender's artificial impairment argument is not supported by  
6 Ninth Circuit case law. The Ninth Circuit BAP has concluded that even though artificial  
7 impairment might sometimes indicate bad faith, Conn. Gen. Life Ins. Co. v. Hotel  
8 Assocs. of Tucson (In re Hotel Assocs. of Tucson), 165 B.R. 470, 475 (9th Cir. BAP  
9 1994), the gravamen of a bad-faith inquiry is whether a "plan achieves a result  
10 consistent with the objectives and purposes of the Bankruptcy Code." Beal Bank v.  
11 Windmill Durango Office, LLC (In re Windmill Durango Office, LLC), 473 B.R. 762, 778-  
12 79 (9th Cir. BAP 2012). When the totality of the circumstances indicates that a debtor  
13 has not acted in bad faith, artificial impairment is not fatal or controlling. Id. at 779  
14 (finding that a debtor proposing to impair the claims of unsecured nonpriority creditors  
15 despite holding enough operating cash to pay the claims in full had not acted in bad  
16 faith). See also In re Sylmar Plaza, L.P., 314 F.3d 1070, 1074-75 (9th Cir. 2002) (a plan  
17 which achieves a result consistent with the objectives and purposes of bankruptcy is  
18 considered filed in good faith, even when a plan allows a debtor to remain solvent while  
19 impeding contractual rights).

20  
21 Lender additionally argues that the creation of the claims in Classes 8-15  
22 demonstrates bad faith because the debts were incurred shortly before the Petition  
23 Date, after Debtor defaulted on the Loan. But Debtor presented credible evidence that  
24 the Class 8-15 debts were incurred for legitimate business reasons, such as acquiring a  
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28 <sup>6</sup> Debtor's evidence (Exhibit J) indicates it would have more than \$750,000 in its operating  
account at confirmation.

1 van in order to provide a shuttle service for airline personnel and retain contracts with  
2 airlines. Accordingly, the Plan's classification and treatment of Classes 8-15 is proper.

3 C. Good Faith (§ 1129(a)(3))

4 Section 1129(a)(3) requires that a plan be proposed in good faith and not be  
5 forbidden by law in any way. The good-faith inquiry requires a totality-of-the-  
6 circumstances analysis. In re Seasons Partners, LLC, 439 B.R. 505, 513 (Bankr. D.  
7 Ariz. 2010) ("In order to determine good faith, a court must inquire into the totality of  
8 circumstances surrounding the plan, the application of the principles of fundamental  
9 fairness in dealing with creditors, and then decide whether the plan will fairly achieve a  
10 result consistent with the objectives and purposes of the Code"). Lender relies on two  
11 arguments to support its good-faith objection. Its first argument is that the Plan's claims  
12 classifications are improper. This argument has already been discussed and rejected.

13 Lender's second argument focuses on Debtor's prepetition "bad acts." According  
14 to Lender, it was improper for Debtor to increase Transwest's management fees after  
15 Debtor defaulted on the Loan. Increasing the management fees without Lender's  
16 consent violated the Loan Documents' covenants. Lender also asserts that because the  
17 payment of the past-due management fees occurred within one year of the Petition  
18 Date, it is an avoidable preference which Debtor has refused to pursue.

19 The latter argument is unpersuasive because the Plan provides for the  
20 appointment of an estate agent to pursue any avoidance actions. Nor are Debtor's other  
21 alleged prepetition bad acts fatal to confirmation. The totality-of-the-circumstances test  
22 is primarily forward-looking—does the Plan attempt to achieve "a result consistent with  
23 the objective and purposes of the Code?" Sylmar Plaza, 314 F.3d at 1074. The Plan  
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1 seeks to restructure Debtor's obligations by acquiring new capital through a new equity  
2 owner. That goal is consistent with the purpose of Chapter 11. Furthermore, prepetition  
3 violation of loan covenants is not the equivalent of committing waste on the Hotel or  
4 otherwise endangering the Lender's collateral. All parties in this case agree that the  
5 Hotel has been well-managed and maintained during the Chapter 11. Considering the  
6 entire record, Debtor has passed the totality-of-the-circumstances test, and accordingly,  
7 the Plan has been proposed in good faith.<sup>7</sup>

9 D. Post-Confirmation Ownership and Management (§ 1129(a)(5)(A))

10 Lender asserts that the Plan does not pass muster under § 1129(a)(5)(A)  
11 because the transfer of the equity in the Hotel to HSL, and its continued management  
12 by Transwest, is inconsistent with the best interests of creditors. According to Lender,  
13 both HSL and Transwest have poor track records in owning and managing hotels, and  
14 both entities lack adequate hotel-management experience.

15  
16 At the core of Lender's argument is the assertion that because a number of other  
17 Transwest-owned and -managed hotels have filed for bankruptcy, it is not competent to  
18 manage the Hotel. The evidence demonstrated that Transwest bought all of its hotels at  
19 or near the peak of the real estate bubble. The effects of the "Great Recession" have  
20 not been kind to hotel owners in Tucson.<sup>8</sup> But the purpose of Chapter 11 is to permit  
21 businesses, when they encounter the vagaries of a volatile market, to reorganize and  
22 restructure their debt. Furthermore, the evidence demonstrated that the Hotel has done  
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27 <sup>7</sup> To the extent that the good-faith requirement overlaps with the fair and equitable test, those  
28 issues are addressed *infra*.

<sup>8</sup> According to local news reports, a number of hotels in Tucson are either in receivership or face  
foreclosure.

1 well under Transwest's management, outperforming other hotels in its competitive set  
2 ("Competitive Set")<sup>9</sup> during the pendency of its Chapter 11 case.

3 Lender also complains that HSL's record in maintaining franchises for other  
4 hotels it owns is poor. However, HSL's principal testified that he has never defaulted on  
5 any secured hotel obligation (or any other secured obligation), including instances  
6 where the hotel that secures the debt is not generating sufficient cash flow to pay debt  
7 service. Debtor has, therefore, satisfied the requirements of § 1129(a)(5)(A).  
8

9 E. Legitimate Accepting Impaired Class (§ 1129(a)(10))

10 Lender, relying upon its improper-classification and artificial-impairment  
11 arguments, asserts that Debtor has no legitimate accepting impaired class and,  
12 therefore, is unable to meet the requirements of § 1129(a)(10). However, for the  
13 reasons already explained, Classes 8-15 are legitimate accepting impaired classes.  
14 Accordingly, the Debtor has complied with the requirements of § 1129(a)(10).  
15

16 F. Feasibility (§ 1129(a)(11))

17 Section 1129(a)(11) requires that a reorganization plan escape a determination  
18 that it is likely to be followed by a liquidation. In other words, a plan must be feasible to  
19 be confirmed. The parties strongly disagree on this point. Both sides submitted  
20 evidence, including expert testimony, on feasibility. According to Lender's experts, the  
21 Plan is not feasible because: (1) the New Equity is insufficient to make improvements  
22 required to keep the Hotel competitive, including implementing the franchisor's required  
23 Property Improvement Plan ("PIP"); (2) Debtor's projections do not demonstrate that the  
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27 <sup>9</sup> The Travel Industry Dictionary found at [www.travel-industry-dictionary-com/comp-set](http://www.travel-industry-dictionary-com/comp-set) defines  
28 "competitive set" as a selection of other competing hotels against which a property measures its  
own performance. The Lender challenged Debtor's choice of hotels for its competitive set, but  
Debtor's franchisor agreed with Debtor's definition.

1 balloon payment can be made at the end of the 23-year term; (3) the cash-flow  
2 projections do not account for the full amount of Lender's § 1111(b)(2) claim if the Claim  
3 Objection is not sustained; (4) Debtor's evidence in support of confirmation was based  
4 solely on a 5% interest rate and did not consider the Modifications' 6% interest rate; and  
5  
6 (5) HSL, the new investor, has a poor track record when maintaining hotel franchises.

7 Debtor's evidence in support of feasibility was that: (1) the Hotel has consistently  
8 outperformed its Competitive Set and has performed well during the pendency of its  
9 bankruptcy case; (2) using the New Equity and cash on hand, Debtor will have enough  
10 capital following confirmation to undertake all needed capital improvements, including  
11 the PIP, and Lender's assertions that more improvements are necessary is inconsistent  
12 with the Franchisor-approved PIP; (3) Debtor's cash-flow projections are conservative  
13 and attainable; (4) HSL has never defaulted on any secured obligation; and  
14  
15 (5) the balloon payment at the end of 23 years does not make the Plan infeasible.

16  
17 Having considered all of the evidence with an understanding that in order to  
18 satisfy feasibility, a debtor must show a reasonable assurance, but not a guarantee, that  
19 a plan will be successful, the Court is inclined to find that Debtor has satisfied the  
20 requirements of § 1129(a)(11). However, Lender correctly points out that there is  
21 nothing in the record which demonstrates that the Reorganized Debtor will be able to  
22 satisfy the Lender's § 1111(b)(2) claim at 6% interest if the Claim Objection is not  
23 sustained. Were the Plan otherwise confirmable, the Court would reopen the evidence  
24 for the limited purpose of permitting the parties to address that issue. But as explained  
25 infra, the Plan cannot be confirmed, so there is no reason to take additional evidence  
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1 regarding feasibility. Similarly, there is no reason for the Court to rule on the Claim  
2 Objection.

3           G. Lender's § 1129(b) Objections

4           Where, as here, all impaired classes do not accept a plan, confirmation can only  
5 occur if the requirements of § 1129(b) are met.  
6

7           Lender has raised three § 1129(b) objections. Lender's § 1129(b)(1) unfair-  
8 discrimination objection was previously addressed in the classification discussion. The  
9 remaining § 1129(b) objections are: (1) HSL's plan to enter into a post-confirmation  
10 management agreement ("the Management Agreement") with Transwest and HSL's  
11 exclusive right to acquire the New Equity in the Reorganized Debtor violate the absolute  
12 priority rule of § 1129(b)(2)(B); and (2) the Plan does not satisfy the fair and equitable  
13 requirement of §§ 1129(b)(2)(A) and (B).  
14

15                     1. Absolute Priority Rule

16           The absolute priority rule provides that "if a rejecting class of unsecured  
17 claims is not paid in full, then the holder of any claim or interest that is junior to the  
18 claims of such class will not receive or retain...any property..." In re Red Mountain  
19 Mach. Co., 448 B.R. 1, 13-14 (Bankr. D. Ariz. 2011) (internal quotation omitted). But,  
20 the Ninth Circuit permits old equity to acquire new equity if it contributes "new value."  
21 Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. P'ship. (In re Ambanc La Mesa Ltd.  
22 P'ship), 115 F.3d 650, 654 (9th Cir. 1997).  
23  
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25           Lender contends that the Management Agreement violates the absolute  
26 priority rule because it permits Transwest to receive valuable property—a management  
27 fee—in exchange for its pre-confirmation equity interest without contributing any "new  
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1 value.” In support of that argument, Lender cites In re Haskell Dawes, Inc., 199 B.R.  
2 867 (Bankr. E.D. Pa. 1996). The Haskell Dawes court found that “retention and control  
3 over the management and profits” of a reorganized company is clearly of value and  
4 important to consider when assessing if a plan violates absolute priority. Id. at 880. In  
5 that case, a business debtor’s equity holders proposed contributing \$25,600 worth of  
6 new capital in exchange for continued control over debtor’s profits, assured employment  
7 for at least one of the equity holders, health benefits, and the opportunity to generate  
8 additional revenue by leasing commercial real property from a different company also  
9 controlled by the equity holders. Id. at 869, 880-81.

12           The terms of the Management Agreement make clear that Transwest will  
13 not enjoy that sort of power or benefit. The Management Agreement provides  
14 Transwest Properties with the right to manage the Hotel for one year (“Initial Term”).<sup>10</sup>  
15 After the expiration of the Initial Term, Transwest must satisfy stringent performance  
16 requirements to continue managing the Hotel, including assuring that the Hotel’s net  
17 operating income is 95% or more of projected budgets, and that the Hotel achieves  
18 average revenue per room that is 15% higher than that of other hotels in the  
19 Competitive Set.<sup>11</sup> These facts distinguish the Plan from those in Haskell Dawes.  
20 Furthermore, Transwest Partners is receiving compensation for post-petition services,  
21 not for Transwest Properties’ extinguished equity interest in the Debtor. Therefore, the  
22 Management Agreement does not violate § 1129(a)(2)(B)(ii).

25           Lender’s second absolute-priority objection contends that HSL was offered  
26 the exclusive right to obtain the new equity in the Reorganized Debtor, a result

27 <sup>10</sup> See Lender’s Exhibits 29, Article IV.

28 <sup>11</sup> See Lender’s Exhibits 29, Articles III and IV.

1 forbidden by the Supreme Court in Bank of Am. Nat'l Trust & Sav., Assoc. v. 203 N.  
2 LaSalle St. P'ship, 526 U.S. 434, 119 S. Ct. 1411, 143 L. Ed. 2d 607 (1998) ("LaSalle").  
3 LaSalle involved a situation where the debtor proposed a plan during the exclusivity  
4 period which permitted only old equity to acquire new equity without making that  
5 opportunity available to creditors or to the public. Id. at 440-41. However, the Plan does  
6 not run afoul of LaSalle because exclusivity expired in February 2012,<sup>12</sup> and therefore,  
7 the holding of LaSalle is inapplicable. See In re Red Mountain Mach. Co., 448 B.R. at  
8 19.  
9

## 10 2. Fair and Equitable

### 11 a. Unsecured Creditors

12 The fact that the Plan does not violate the absolute priority rule  
13 arguably means that its treatment of unsecured creditors satisfies the fair and equitable  
14 requirement of § 1129(b)(2)(B). However, if Congress had wanted to limit § 1129(b)(2)  
15 solely to the treatment described in its subsections, Congress could have simply  
16 *required* a plan to provide for the treatment set out in those subsections. Instead, the  
17 prefatory language of § 1129(b)(2) provides that "the condition that a plan be fair and  
18 equitable with respect to a class *includes*" the treatment set out in its subsections  
19 (emphasis added). The use of the word "includes," a non-limiting word, as opposed to  
20 "requires" indicates that a plan must do more than satisfy the absolute priority rule in  
21 order to be "fair and equitable" to unsecured creditors. See also In re Dollar Assocs.,  
22 172 B.R. 945, 949 (Bankr. N.D. Cal. 1994)  
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27 \_\_\_\_\_  
28 <sup>12</sup> Debtor acknowledged in its post-hearing brief that exclusivity had lapsed. In light of that acknowledgment, Lender has indicated that it will file a creditor's plan rather than pursue stay relief. As a result, no ruling will be made on the MRS.



1 Here, the Plan's projections indicate that HSL will receive \$5 million  
2 as the Preferred Return over ten years, almost double the amount of the New Equity, as  
3 well as a 100% interest in the Reorganized Debtor. Meanwhile, the Plan projects that  
4 unsecured creditors will receive \$89,000 in the first five years of the Plan along with the  
5 "possibility" of more during the next five years (including any recovery from avoidance  
6 actions), after which all payments to unsecured creditors ends. While parties who invest  
7 in Chapter 11 debtors are entitled to a reasonable rate of return on their investment, the  
8 return promised to HSL compared to the rate of return for the unsecured creditors is so  
9 disproportionate that the Plan cannot satisfy § 1129(b)(2)(B).  
10

11  
12 b. Lender's § 1111(b)(2) Claim

13 The remaining issue is whether the Plan satisfies § 1129(b)(2)(A)  
14 with respect to Lender's § 1111(b)(2) claim. The fair and equitable requirement for  
15 secured creditors begins with a simple mathematical calculation: Does the Plan's  
16 proposed stream of payments pay Lender the present value of its secured claim  
17 (\$17million) and equal the full amount of the Note A claim? Debtor argues it can pass  
18 that test, both at a 5% or 6% interest rate. Yet, even if Debtor is correct and can satisfy  
19 the mathematical test, that by itself does not demonstrate that the Plan passes the fair  
20 and equitable test.  
21

22 According to Lender, the way to assure that it is treated fairly and  
23 equitably is to require that its § 1111(b)(2) claim be paid according to market terms.  
24 Lender submitted expert testimony estimating what such terms would be. However, as  
25 those experts conceded, there *is no* extant market from which the terms for a 100%  
26  
27  
28

1 loan to a property like the Hotel can be determined.<sup>13</sup> Therefore, evidence of the market  
2 terms available for borrowers in situations far better than Debtor's, while informative and  
3 the basis for the expert testimony, is not dispositive in deciding if the Plan is fair and  
4 equitable. Such evidence is, however, helpful in analyzing how much risk the Plan  
5 imposes on Lender. If the Plan shifts too much risk to the Lender, it cannot satisfy the  
6 Code's fair and equitable requirement. In re DeTienne Asocs. L.P., 2005 Bankr. LEXIS  
7 3122, 19-21 (Bankr. D. Mont. July 29, 2005); Aetna Realty Investors v. Monarch Beach  
8 Venture (In re Monarch Beach Venture), 166 B.R. 428, 436 (C.D. Cal. 1993).

9  
10 Additionally, as noted above, use of "includes" in § 1129(b)(2) allows for additional  
11 considerations in analyzing whether a plan is fair and equitable. See, e.g., Red  
12 Mountain Mach. Co., 448 B.R. at 13; see also In re Bjolmes Realty Trust, 134 B.R. 1000  
13 (Bankr. D. Mass. 1991); In re Jones, 32 B.R. 951 (Bankr. D. Utah 1983)

14  
15                   Ultimately, the final determination of whether a plan is fair and  
16 equitable requires a context-specific analysis based on the facts of each case. Using  
17 that analysis, the Plan fails the test.<sup>14</sup> In particular, the following provisions of the Plan  
18 place undue risk on Lender:

19  
20                                   (i) the 23-year Plan term is twice as long as a typical 10-year  
21 hotel franchise agreement. As a result, after 10 years, the Hotel may not have a  
22 franchise "flag," a condition which both Debtor's and Lender's experts agree would  
23

24  
25 <sup>13</sup> This case, like many others in this district, is simply too small to be of any interest to potential  
26 sources of financing which are available in larger Chapter 11 cases filed in districts like the  
27 Southern District of New York. Accordingly, there is no "bankruptcy" loan which can be used as  
28 a comparison for the Plan's loan.

<sup>14</sup> Many of the Plan's terms regarding the treatment of Lender's § 1111(b)(2) claim were  
approved in another case where Transwest Partners owned the Debtor. However, in that case,  
all but one of the modifications was agreed to by the lender. Here, the Lender has not  
consented to any part of the treatment of its 1111(b)(2) claim.

1 negatively impact the value of the Hotel. Debtor argues that it would make no sense for  
2 the Hotel's owner not to renew the Hotel's franchise and, therefore, the risk to Lender is  
3 minimal. Furthermore, Section 4.1 of the DOT, which the Plan indicates will be retained  
4 post-confirmation, makes termination of a franchise agreement an event of default. But  
5 if a franchise agreement is terminated, the Hotel will suffer a loss in value before the  
6 Lender can exercise its foreclosure rights;

8 (ii) the "due on sale provisions" of the DOT are suspended  
9 between Year Five and Year Fifteen of the Plan. The only protection provided to Lender  
10 is the right to consent to the new owner, which consent shall not be "unreasonably"  
11 withheld—a standard so broad that it is a recipe for future litigation about what terms of  
12 the DOT will have to be met by the transferee;

14 (iii) the abolition of the Plan's interest reserve account after  
15 three years, when fully amortized payments of interest and principal first become due to  
16 the Lender;<sup>15</sup>

18 (iv) the absence of a requirement that post-confirmation  
19 accounts (interest reserve, capital, etc.) be deposited with Lender; and

20 (v) the failure to require any guarantees, including limited  
21 "bad boy" guarantees of the PIP.<sup>16</sup>

23 \_\_\_\_\_  
24 <sup>15</sup> There are debt-service-ratio and cash-on-hand restrictions which must be met before the  
25 interest reserve account can be abolished, but the Plan's cash-flow projection indicated that  
those restrictions can be easily met in Year Three of the Plan.

26 <sup>16</sup> Upon cross examination by HSL's counsel, Lender's representative acknowledged that even  
27 if guarantees were given or various accounts were deposited with Lender, Lender would still  
28 reject the Plan. But a plan may be fair and equitable even when a creditor rejects it. The fact  
that Lender would reject any version of the Plan is largely irrelevant to the fair and equitable  
determination.

1                   While any one of the above-listed modifications of Lender’s rights  
2 might be acceptable—especially were more protections for Lender added—taken as a  
3 whole, these terms shift too much of the burden of reorganization to Lender for the Plan  
4 to pass the fair and equitable test.

5  
6                   In addition to shifting too much of the risk, the Plan unfairly favors  
7 the new equity holder. As noted earlier, the Plan permits HSL to realize substantial  
8 benefits of the reorganization fairly quickly by returning to HSL twice the New Capital in  
9 10 years. HSL also assumes immediate ownership and a right to any net profits.  
10 According to the Plan’s projections, those profits could be several million dollars at the  
11 end of Year Ten. During those same 10 years, Lender receives a payment stream  
12 which does not fully amortize its debt and leaves it with the risk of a balloon payment  
13 14 years later.

## 15                                           **VI. CONCLUSION**

16                   Chapter 11 provides a business debtor with the opportunity to restructure its debt  
17 and hopefully maintain employment opportunities for its workers.<sup>17</sup> The Code provides  
18 powerful tools to assist a debtor’s reorganization efforts, including the right to extend  
19 loan terms, change interest rates, and rewrite or eliminate loan covenants. But to  
20 successfully exercise those rights, a debtor must assure that the risk of reorganization is  
21 borne fairly by all of the parties in the case. Debtor has failed to do so, and therefore,  
22  
23  
24  
25

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26 <sup>17</sup> Restructuring businesses so they can remain taxpaying members of a community and a  
27 source for employment is an important policy goal of Chapter 11. However, when a business is  
28 a service business, such as a hotel, there is little risk of jobs leaving the community. The real  
risk to employment in this case is to upper-level management and for the employees of  
Transwest as the manager of the Hotel who will not be retained if the Plan is not confirmed.

1 the Plan cannot be confirmed. A separate order denying confirmation of the Plan will be  
2 entered on this date.<sup>18</sup>

3 Dated and signed above.

4 Notice to be sent through the  
5 Bankruptcy Noticing Center  
6 to the following:

7 Reid Park Properties LLC  
8 2850 E. Skyline Dr., Ste. 200  
9 Tucson, AZ 85718

10 Eric Slocum Sparks  
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22 Chicago, IL 60603

23 Office of the U.S. Trustee  
24 230 North First Avenue, Suite 204  
25 Phoenix, AZ 85003  
26  
27  
28

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<sup>18</sup> The foregoing constitutes the court's findings of fact pursuant to Rule 7054.