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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re:	Chapter 11 Proceedings
DUNLAP OIL COMPANY, INC.,	Case No. 4:12-bk-23252-BMW
QUAIL HOLLOW INN, LLC,	Case No. 4:12-bk-23256-BMW
Debtors.	(Jointly Administered)
Filing applies to:	**MEMORANDUM IN SUPPORT OF CONFIRMATION AND RESPONSE TO CONFIRMATION OBJECTIONS**
DUNLAP OIL COMPANY, INC. ☐	
QUAIL HOLLOW INN, LLC ☐	**Confirmation Hearing: February 7, 2014 at 10:00 a.m.**
BOTH ☒	

Dunlap Oil Company, Inc. ("DOC") and Quail Hollow Inn, LLC ("QHI"), the debtors and debtors-in-possession in the above-captioned jointly administered bankruptcy case (collectively, the "Debtors"), hereby respond to the *Objection to Confirmation of Debtors' Second Amended Joint Plan of Reorganization* [Dkt.#526] (the "Pineda Objection") and the *Notice of Filing Recorded Judgment Against Non-Debtors and Supplemental Objection to Confirmation of Debtor's Plan* [Dkt. #530] (the "Pineda Notice") filed by Pineda Grantor Trust II ("Pineda"); and the *Objection to Confirmation of Debtor's Second Amended Joint Plan of Reorganization and Joinder to Pineda Grantor Trust II's Objection* [Dkt. #528] (the "CCB Objection") filed by Canyon

Community Bank ("CCB").

In keeping with their conduct throughout this Case, Pineda and CCB go to great lengths (some might say any lengths) to defeat a successful reorganization by the Debtors intended to maximize the recovery for all creditors and preserve the going concern of the Debtors' business pursuant to the *Second Amended Joint Plan of Reorganization dated December 27, 2013* [Dkt. #473] (the "Plan"), as amended or modified.[1]

Because the Debtors have previously addressed, through evidence and argument, the feasibility and good faith arguments again proffered by Pineda and CCB, this memorandum will focus on the most recent assertions by Pineda and CCB relating to the sale of QHI, the alleged effect of Pineda's judgment lien against non-debtor entities, and the lack of any collateral estoppel effect relating to the Court's denial of confirmation of the first plan.

I. INTRODUCTION.

CCB and Pineda continue to ignore the considerable support for confirmation from a substantial number of creditors and interested parties, and it is once again only Pineda and CCB that fervently wish to see these Debtors liquidated. In addition to the loss of more than 100 jobs in rural communities throughout Arizona, the result sought by Pineda and CCB will also eliminate more than $40 million in annual revenues in these same small communities. Vendors, suppliers, customers, and employees will suffer the result – while only CCB and Pineda seek to gain. Based on the record in this Case, confirmation of the Plan is warranted and best serves the interests of all creditors and parties in this Case. Accordingly, the Debtors respectfully request that the Court provide the Debtors the opportunity to rehabilitate through confirmation of the Plan rather than liquidate through foreclosures of assets and conversion of these cases as requested by Pineda and CCB.

[1] Unless otherwise indicated, capitalized terms used in this Response will correspond to defined terms used in the Plan.

II. ANALYSIS.

A. Law of the case does not preclude this Court's consideration of the Second Amended Plan.

Without citing any authority to support its position, Pineda argues that the "law of the case" doctrine somehow precludes this Court from evaluating the Second Amended Plan on the merits. In reaching this conclusion, Pineda apparently rewrites the Bankruptcy Code, specifically Code Section 1127 and 1129, which provide for modification of a Plan and consideration by the Court of all relevant factors relating to the Plan that is currently pending before this Court. Furthermore, Pineda cites to prior comments of the Court that have been directly addressed by the Debtors through the amendments set forth in the Plan. *See, e.g.,* quote on Pineda Objection page 4 – which concern has been addressed by increasing to $350,000 the cash funding available for Effective Date and Plan payments. For all of these reasons, and based on the Court's explicit authority to examine the Plan currently pending before it (including any modifications or amendments), the Plan should be confirmed.

B. Pineda's arguments regarding alleged credit bid rights is unsupported, and cause exists to define the scope of Pineda's alleged credit bid.

Relying on the *Radlax* decision, Pineda asserts the unremarkable position that it should be entitled to credit bid at the proposed auction of the QHI Hotel. The Debtors do not disagree with this limited portion of Pineda's assertion, and have built in an express provision into the Sale Procedures that allows for Pineda to credit bid up to its secured interest in the amount of the Stipulated Value of the Hotel ($1.9 million). However, the Debtors strongly disagree with Pineda's unsupported and erroneous conclusion that it is entitled to bid the entire amount of its secured and unsecured claims in this Case.[2]

While Pineda relies generally on the holding of *Radlax* to support its right to credit

[2] Pineda's assertion that it should be entitled to bid its entire alleged claim amount is yet another attempt to end run around its failure to make a Section 1111(b) election in this Case, despite numerous opportunities to do so.

bid as part of the sale of the QHI Hotel, it conveniently fails to recognize that the Supreme Court in *Radlax* also expressly recognized that its decision was limited to allowing a secured creditor to credit bid "up to the amount of its security interest," rather than the full amount of its allowed claim, seemingly acknowledging the possibility that the "amount of [the] security interest" is not necessarily established by (and may be set independent of) the sale itself. *See* 32 No. 7 Bankruptcy Law Letter (2012) (citing *RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* 132 S. Ct. 2065, 2070, 182 L. Ed. 2d 967 (2012)). Here, the amount of Pineda's secured claim was set by the Stipulated Value proposed by Pineda itself, and Pineda's citations to distinguishable, off-point, pre-*Radlax* case law to argue otherwise are unavailing. *See* Pineda Objection at 6.

In addition, as the Supreme Court also pointed out in *Radlax*, the right to credit bid can be limited for "cause." The Bankruptcy Code does not define what constitutes "cause," and a cause determination is left to discretion of the courts to decide on a case-by-case basis. Generally, "cause" has been found to exist in three circumstances: (i) where there is evidence of misconduct by the secured creditor, such as where the secured creditor engages in conduct to specifically undermine the reorganization efforts of the debtor, (ii) where there is a bona fide dispute as to the collateral or the lien secured by the collateral, or (iii) where granting the right to credit bid would chill the bidding process. In instances where any of the foregoing exists, courts have often found "cause" to deny a secured creditor's right to credit bid. *See* Commercial Bankruptcy Litigation § 17:9 (2014) (citing *In re Aloha Airlines, Inc.,* 2009 WL 1371950 (Bankr. D. Haw. 2009) (finding of misconduct on the part of the party seeking to credit bid sufficient to deny the right to credit bid); *In re Antaeus Technical Services, Inc.,* 345 B.R. 556 (Bankr. W.D. Va. 2005) (denying the right to credit bid to a secured creditor where the creditor's conduct was not in the nature of merely protecting its collateral but rather evidenced an intent to enhance its positions); *In re Theroux*, 169 B.R. 498, 25 Bankr. Ct. Dec. (CRR)

1406, 74 A.F.T.R.2d 94-5592 (Bankr. D. R.I. 1994) (disallowing the right to credit bid where a secured creditor bid a low amount to obtain the assets so that it could subsequently immediately resell at a higher price to the detriment of all creditors); *In re McMullan*, 196 B.R. 818, 29 U.C.C. Rep. Serv. 2d 1063 (Bankr. W.D. Ark. 1996), subsequently aff'd, 162 F.3d 1164 (8th Cir. 1998) (denying the right to credit bid to a secured creditor where the validity of its liens were unresolved); and *In re River Road Hotel Partners, LLC,* 2010 WL 6634603 (Bankr. N.D. Ill. 2010), aff'd, 651 F.3d 642, 55 Bankr. Ct. Dec. (CRR) 13, 65 Collier Bankr. Cas. 2d (MB) 1900, Bankr. L. Rep. (CCH) P 82031 (7th Cir. 2011), cert. granted, 132 S. Ct. 845, 181 L. Ed. 2d 547 (2011) and aff'd, 132 S. Ct. 2065, 182 L. Ed. 2d 967, 56 Bankr. Ct. Dec. (CRR) 144, 67 Collier Bankr. Cas. 2d (MB) 483, Bankr. L. Rep. (CCH) P 82218 (2012) (recognizing that the right to credit bid can be denied where it would chill the bidding process)).

Under the circumstances of this Case, all three bases for "cause" are present: Pineda has consistently attempted to undermine the Debtors' reorganization efforts, Pineda itself appears to be disputing the amount or value of its lien against the Hotel, and Pineda's request to allow the total amount of its secured and unsecured claims would drastically chill the bidding process. Accordingly, cause exists to limit Pineda's credit bid rights to the Stipulated Value of its claim against the QHI Hotel.

As recognized by post-Radlax commentators,

> The "loan to own" phenomenon has caused some to question the advisability of credit bidding. The basic concern seems to be that a "loan to own" lender's primary incentive is, unlike a traditional lender, acquiring the debtor's assets as cheaply as possible, rather than maximizing the recovery on its secured loan. A traditional lender has every incentive to maximize the sale price of its collateral through vigorous competitive bidding, sincerely hoping that bid prices will exceed the amount it could credit bid with its existing secured loan, as this would mean a full recovery on that loan. A "loan to own" lender, though, has every incentive to inhibit competitive bidding in order to ensure that bid prices will not exceed the amount it can credit bid with its existing secured loan, as this would mean that the "loan to own" lender can acquire the debtor's assets solely through

a credit bid of its existing secured loan and with no additional investment. 32 No. 7 Bankruptcy Law Letter (2012). In fact, a recent decision by the Delaware Bankruptcy Court found cause for denial of credit bid rights where a "loan to own" distressed debt purchaser sought to credit bid the entirety of its secured claim. *See In re Fisker,* Case No. 13-13087 (Bankr. D. Del. Jan. 17, 2014) at Dkt. #483 (copy of decision attached as Exhibit "A"). The bankruptcy court in *Fisker* capped the amount of the secured claim at the price the distressed debt purchaser had paid when it purchased the debt – finding that the excessive credit bidding rights sought by the loan to own creditor would otherwise chill bidding.[3] *Id.* at fn. 14 ("A court may deny a lender the right to credit bid in the interest of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment.") (citing 3 Collier on Bankruptcy 363.09[1] ("the Court might [deny credit bidding] if permitting the lienholder to bid would chill the bidding process.")).

Here, despite repeat requests, Pineda has refused to disclose the amount that it paid to purchase the debt in this Case (and further refused to disclose its servicing agreement upon direct request). Pineda's alleged right to credit bid an unspecified, but ostensibly significantly higher amount than the Stipulated Value of its claim against QHI, would chill bidding. For all of these reasons, and even assuming that Pineda could properly bid the entire amount of its alleged secured and unsecured claims on all of the Debtors' assets, cause exists to limit its credit bid rights to the interest of Pineda in the Stipulated Value of $1.9 million for the QHI Hotel.[4]

Finally, courts have recognized that even where a secured creditor asserts a cross-

[3] It is also worth noting that the parties in *Fisker*, like Pineda, had stipulated to some portions of its secured claim. *Id.* at 10 ("In their Stipulated Agreements, the Debtors and the Committee agree that Hybrid's claim is partially secured, partially unsecured and of uncertain status for the remainder.")

[4] Pineda's secured interest in the Hotel is junior to approximately $300,000 of secured real estate taxes.

collateralization interest in numerous pieces of collateral, a debtor is not prohibited from removing a lien on some of the collateral by compensating the creditor for its secured claim. *See In re Bryant*, 439 B.R. 724, 747-48 (Bankr. E.D. Ark. 2010) ("Additionally, despite the cross-collateralization of FSA's loans, the Debtors are not prohibited from removing FSA's lien on some of its collateral provided the Debtors adequately compensate the FSA for the entirety of its secured claim.) (citing *Matter of May*, 174 B.R. 832, 838 (Bankr.S.D.Ga.1994) (quoting *Matter of James Wilson Assoc.*, 965 F.2d 160, 171 (7th Cir.1992)) ("[T]he principle that liens pass through bankruptcy unaffected cannot be taken literally, ... and it is the law that, provided the plan of reorganization gives the secured creditor the 'indubitable equivalent' of its secured interest, the bankruptcy judge can force the creditor to accept the exchange.")). Pineda's request that it be allowed to credit bid the entirety of its claims against both Debtors, whether secured or unsecured and regardless of Stipulated Values, should be denied.

C. The Debtors' Plan is the epitome of good faith, and Pineda's conduct throughout this Case demonstrates its unrelenting bad faith efforts to crater a Plan that will result in substantial recoveries for all interested parties.

The Plan proposes to pay all Allowed Secured Claim in full (based on values presented by the secured creditors themselves and stipulated to by the Debtors), pay taxing authorities pursuant to agreed terms, pay a substantial seven figure distribution to unsecured creditors, and preserve the livelihoods of approximately 100 employees. The Plan is the epitome of good faith, and reflects a diligent effort by the Debtors to effectuate the core purposes of the Bankruptcy Code.

Again trying to have its cake and eat it too by refusing to make an 1111(b) election despite multiple opportunities to do so, Pineda now asks this Court to disregard Pineda's own Stipulated Values, deny the Debtors an opportunity to reorganize, and simply turn

the keys over the Pineda to do as it wishes.[5] If there is any bad faith in this Case, it is Pineda's loan to own strategy (Pineda succeeded to Compass, a creditor that sat on the sidelines for almost three years pre-petition and refused to approve prior sales of collateral intended to generate significant paydown of the Compass debt) which has been to crater the Debtors' reorganization efforts at any cost.[6]

Pineda's most recent ploy is set forth in the Pineda Notice – which asserts that the land underlying the Benson Chevron cannot be contributed as part of the Real Property New Value Contribution because Pineda has purportedly obtained a judgment lien against certain non-debtor parties. However, Pineda fails to recognize that the non-debtors against whom it rushed to obtain and record a judgment are not the owners of the fee simple interest in Benson Chevron. Rather, as reflected on the attached title records and Lease Agreement, the Irrevocable Kenneth and Carol Dunlap Trust dated December 19, 1989 is the owner of the fee simple interest, and leases the real property to the Debtors. *See* Exhibit "B". Pineda does not hold any judgment against the Irrevocable Trust. *See* Dkt. #530. The Pineda Notice and arguments contained therein do not affect the Plan whatsoever.

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[5] As demonstrated by Pineda's conduct after obtaining stay relief with regard to the Sierra Vista Chevron and Benson Little General, this apparently means that Pineda will do nothing with the assets upon return. *See* Pineda Notice at fn. 2. Pineda has refused to complete any foreclosure or sale, and instead has put a Receiver in place that refuses to pay for property expenses, refuses to obtain insurance, has demanded that the Debtors continue to cover and pay for property and liability insurance, and has basically done nothing to complete the return to Pineda of its collateral.

[6] One of Pineda's consistently erroneous and improper arguments is that Pineda somehow holds an interest in all of the Debtors' personal property. As set forth at length in prior filings, the Debtors dispute Pineda's alleged "secured interest" in personal property based on numerous grounds including, but not limited to, deficient security instruments and filings by Pineda and/or its predecessor, lack of perfection, and superior and prior liens of Jackson Oil and the IRS that consume any value in the personal property in which Pineda asserts a lien interest. *See* 26 U.S.C. § 6323. Pineda has utterly failed to respond to these arguments, and instead ignores the fact that Pineda simply does not have any enforceable interest in the Debtors' personal property by repeating its same arguments over and over again.

D. CCB and Pineda's arguments regarding alleged diminution in cash and inventory levels are contrary to the actual facts, as testified to at length by the Debtors' representatives.

Finally, in their ongoing apples to oranges comparisons, Pineda and CCB consistently pull numbers from various accounting documents and different time periods to purportedly demonstrate an alleged drop in inventory levels and cash during this Case. However, both Pineda and CCB (along with CCB's only witness, Mark Farr) ignore the substantial testimony provided by the Debtors during this Case explaining at length the actual physical inventory amounts, and further intentionally distort the financial statements and figures beyond the pale.[7] At this point in the Case, and after deposing James Martin (Debtors' controller) three separate times and being provided with extensive explanations upon direct questioning regarding inventory adjustments and levels, Pineda and CCB should know better.

As testified to at length by Jim Martin (Debtors'controller) during his deposition, the physical inventory taken at year-end in December 2012 resulted in a downward adjustment of approximately $100,000 to inventory numbers. *See* Transcript of

[7] CCB's distorted view of alleged cash fluctuations is a perfect example of the lengths that Pineda and CCB will go to inaccurately portray the Debtors' financial performance. Mark Farr's most recent declaration [Dkt. #533] takes a snapshot of cash levels but fails to take into account timing issues or expense payment schedules of the Debtors. Farr's table on page 4 reflecting alleged cash fluctuations starts with October 25, 2012 (the filing date), rather than the month end. Farr's distorted view fails to take into account the substantial payroll of approximately $70,500 that was paid just a few days after the 25th (pursuant to Court order approving payment of pre-petition wages – *see* Dkt. #38). Taking into account this significant cash expense, the cash figures are nearly identical on the Petition Date and the December 31, 2013 date selected by Mr. Farr for comparison.

Moreover, QHI started this case with approximately $7,000 in the bank, and that amount has grown to over $160,000 as of December 31, 2013. *See* Dkt. #509 at p. 18 of 23. Apparently somebody is doing something right to increase QHI's cash position so significantly, and operating QHI in such a manner that multiple buyers are lining up to pay significant value for the QHI Hotel for the benefit of all interested parties in this Case. It is not as though Benson, Arizona was selected as the site for the Early Spring 2014 Olympics that would have driven tourism up by more than 2000% - rather, the increase in QHI's cash position and value is attributable to the hard work of the Debtors' management.

Deposition of Jim Martin dated May 28, 2013 at pp. 12-20 (Tr. Ex. 45), Dkt. #465-1:

A: During one time at the end of the -- at the end of the fiscal year, an actual inventory is made and inventories are adjusted accordingly to actual costs to estimating --to a more sophisticated estimated cost.

Q: Have you completed the physical hand count inventory for 2012 for Dunlap Oil?

A: Yes, we have.

Q: How much of a difference between.

A: There was -- there was a drop in I don't remember exactly, but there was a downward adjustment in the inventory of about $100,000. That sounds like a lot, but remember we're talking about $4 million worth of sales.

…

Q: So that hundred thousand dollar difference between -- the figures that you came up with at the end of the year and the figures that are listed on the Schedule B, are you saying that difference is attributable to nominal errors in estimation as opposed to the debtor actually purchasing less inventory?

A: In large part, yes. Yeah. It was -- it was a correction of a year's worth of transactions. Unfortunately, unfortunately, those inventory adjustments have to be made in the final month of the year, but it relates to all the inventory purchases that were made all year long.

Q: Okay. So the figure that's listed on Schedule B for the non-fuel merchandise of $586,436.47, that's not really accurate?

A: I would say it's probably 90 percent accurate.

J. Martin Transcript at pp. 13-14. Pineda and CCB continually ignore this fact when asserting that there has been an unexplained and precipitous drop in inventory levels during the pendency of this Case.

Pineda's counsel further questioned Mr. Martin regarding the fuel inventory levels, and was informed that fluctuations in price can drastically affect overall fuel inventory figures:

Q. And Dunlap Oil had about $195,000 in fuel inventory at the outset of the bankruptcy case. Correct?

A. Yes.

Q. And have they maintained approximately that same amount of fuel inventory through the end of March of 2013?

A. The inventory will vary with sales and will vary with price. As far as quantity of inventory, we've maintained about the same amount. You have to remember a 50 cent increase in the gallons or a 50 percent -- a 50 percent decrease in price is going to hit that number.

Id. at p. 21. This clarification regarding price fluctuations and inventory levels is further

supported by Mr. Dunlap's *Declaration in Support of the Motion to Reconsider*, explaining that DOC's fuel levels were within 500 gallons (a very small amount considering the overall fuel volume of DOC) of the Petition Date, but that the pricing had changed during that time. *See* Dkt. #445-1 at Exh. A ¶21.

In addition, Pineda's counsel asked for an explanation regarding the alleged drop in inventory listed on the operating reports and Mr. Martin explained that it was due to reconciliations of the physical inventory, as well as a conservative adjustment to the gross profit percentages utilized throughout the remainder of the year. *See id.* at pp. 19-20 (Q: "So the difference is not attributable to the debtor purchasing less inventory. It's simply to reflect the nominal error in gross profit percentage?" A: "If I'm going to err, I'm going to err on the conservative side. I'd rather state this too low than too high.")

Considering that the Debtors have returned six properties (consisting of five stations and one office location) since the Petition Date, and now hold and operate only 67% of their original properties, a corresponding drop in inventory is hardly a surprise or "diminution" to the estate. After taking into account the adjustment for the year-end physical inventory that was made post-petition (which was explained at length during deposition), Debtors have far more inventory on hand than one would expect after a return of six out of eighteen properties.

Mr. Martin has been listed as a trial witness for the Debtors, and it is anticipated that Mr. Martin will be offered as a rebuttal witness to respond to the erroneous and misplaced assertions in the Farr Declaration (Dkt. #533).[8]

[8] Mr. Martin's testimony will primarily focus on rebutting Mr. Farr's assertions that the Debtors have lost $800,000 in cash and inventory during the pendency of this Case. It is unlikely that Mr. Martin will be able to respond to Mr. Farr's testimony relating to the NHTSA greenhouse gas emissions and the "sales-weighted harmonic average of the targets"; however, the Debtors are unaware of on what basis Mr. Farr is qualified to testify regarding the hearsay reports and other unauthenticated materials that he chose to include with his declaration. *See* Dkt. #533-2. Likewise, Mr. Farr is not an economist, is not a CPA, is not an agent or ambassador of the NHTSA, and is not qualified to testify

III. CONCLUSION.

At the end of the day, and despite Pineda's and CCB's concerted efforts to derail this Case, the Debtors have garnered wide support from a variety of constituents (including unsecured creditors, secured creditors, taxing authorities, vendors, and suppliers), and the Debtors are positioned to emerge as a reorganized going concern. For all of the reasons set forth above and supported by the record in this Case, and for the benefit of all interested parties, the Debtors respectfully request an opportunity to perform pursuant to the Plan.

RESPECTFULLY SUBMITTED this 6th day of February, 2014.

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regarding the effects of economic forecasts or greenhouse gasses on the Debtors' sale of fuel and merchandise throughout rural Arizona.