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UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re: HORIZON VILLAGE SQUARE LLC, Debtor.	In Proceedings Under Chapter 11 Case No. 11-21034-mkn **WELLS FARGO BANK, N.A.'S POST-TRIAL BRIEF IN OPPOSITION TO CONFIRMATION OF DEBTOR'S PLAN AND IN SUPPORT OF STAY RELIEF OR DISMISSAL** Hearing Date: April 28, 2015

Wells Fargo Bank, N.A. ("Wells Fargo") hereby submits its post-trial brief in opposition to confirmation of *Debtor's Amended Plan of Reorganization* [Docket No. 403] (the "Plan") and in support of *Wells Fargo Bank, N.A.'s (i) Renewed Motion for Relief from the Automatic Stay With Respect to Debtor's Property Located In Henderson, Nevada, or, In the Alternative, (ii) Motion to Dismiss* [Docket No. 371] (the "Stay Relief/Dismissal Motion"). The Court held an evidentiary hearing regarding the Plan and the Stay Relief/Dismissal Motion on April 28, 2015 (the "Hearing"). This brief supplements Wells Fargo's objection to confirmation of the Plan [Docket No. 409] and the Stay Relief/Dismissal Motion, which are incorporated herein by reference.

I. INTRODUCTION.

This chapter 11 case has been pending for nearly four years. The Debtor has already failed to confirm one plan in that time, and the current Plan is an over-reaching attempt to saddle Wells

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Fargo with inordinate risk, deprive it of standard loan protections, benefit insiders, and improperly shield non-debtor third parties from their guaranty obligations to the bank. Like the prior plan, this Plan cannot be confirmed. Yet, neither should the Debtor be permitted to languish in chapter 11 indefinitely. Accordingly, as it indicated it likely would do, the Court should grant the Stay Relief/Dismissal Motion and finally resolve this case through stay relief or dismissal.

II. <u>BACKGROUND</u>.

On July 31, 2011, the Debtor filed its voluntary chapter 11 petition. The Debtor owns and operates a retail shopping center located at 25 through 75 East Horizon Ridge Parkway in Henderson, Nevada (the "<u>Property</u>"). [Ex. 8 at 12][1]

<u>The Three-Year Term Loan</u>

On February 13, 2008, Wells Fargo, as successor-by-merger to Wachovia Bank, National Association, made a short-term "bridge" loan to the Debtor in the principal amount of $11.35 million (the "<u>Loan</u>"). [Ex. 3 ¶¶ 5-7; Exs. 25-32] The Loan is secured by a first-position lien on the Property and all rents and other personal property related to the Property [Ex. 21 at 3-4; Ex. 25 at 1; Ex. 27 at 1-3; Ex. 29], and is guaranteed by Todd, Ryanne, Michael, and Margaret Nigro (collectively, the "<u>Guarantors</u>") [Ex. 2 ¶ 30; Ex. 31]. The Loan had a three-year term with two extension options. [Ex. 26 at 2-3]

The Debtor's ability to obtain the Loan was subject to certain conditions, including that the Property have an appraised value of at least $14,187,500 and that the Debtor contribute at least 20% of the appraised value (totaling at least $2,837,500) through its own funds or existing equity in the Property. [Ex. 3 ¶ 19; Ex. 25 §§ 2.1, 2.2(b)] The Loan requires the Debtor to maintain its 20% equity contribution at all times (the "<u>Equity Covenant</u>"). [Ex. 3 ¶ 19; Ex. 25 § 2.1] The Loan also requires the Debtor to comply with certain other covenants, including:

(i) that the Debtor comply with the terms of its leases of the Property and enter into new leases on pre-approved terms or with Wells Fargo's consent (which consent expressly cannot unreasonably be withheld) (the "<u>Lease Covenant</u>") [Ex. 25 § 7.4];

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[1] Trial exhibits are cited to as "[Ex.]," and the Hearing transcript is cited to as "[Tr.]." The Court admitted exhibits 1-35. [Tr. at 6:1-10] The Hearing transcript is attached as <u>Appendix A</u>.

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(ii) that neither the Debtor nor its majority owner default on any of their respective obligations owing to Wells Fargo (the "Cross-Default Covenant") [*id.* § 7.7];

(iii) that the unpaid balance of the Loan not exceed 80% of the value of the Property (the "LTV Covenant") [*id.* § 7.13]; and

(iv) that the prospect for repayment or performance of the Debtor's obligations under the Loan not become materially impaired and that no material adverse change occur in the business or prospects of the Debtor (the "MAC Clause") [Ex. 26 § 16(f)].

In May 2010, two years into the Loan term, the Debtor breached the LTV Covenant and failed to make the pay down required by the loan documents to cure the default. [Ex. 8 at 13; Tr. at 28:4-7] Nevertheless, Wells Fargo took no enforcement action due to this default. [Tr. at 42:6-43:12] Rather, Wells Fargo negotiated with the Debtor for more than a year after this default without resolution. [*Id.* at 29:12-23, 42:6-43:12]

On February 13, 2011, the Loan matured. [Ex. 3 ¶ 9; Ex. 26 at 2] The Debtor did not qualify for or seek to exercise the maturity extensions under the Loan. [Ex. 3 ¶ 8; Tr. at 21:12-24] Wells Fargo notified the Debtor and the Guarantors of the maturity default, made demand for payment, and continued to negotiate with the Debtor regarding the Loan. [Ex. 3 ¶¶ 9-10; Tr. at 42:6-43:12] Neither the Debtor nor the Guarantors repaid the Loan. [Ex. 3 ¶ 10] As of the petition date, the Debtor owed not less than $11,225,639.40[2] under the Loan. [Ex. 1 ¶ 2.3]

Insider Management

The Debtor is a limited liability company managed by Nigro Development, LLC ("Nigro Development"). [Ex. 2 ¶ 2] Nigro Development also holds the largest ownership interest (42.97%) in the Debtor. [Ex. 22 at 29; Tr. at 9:7-10:5] As such, Nigro Development has total control over the Debtor. [Tr. at 9:3-6] In turn, Nigro Development was founded by, and is co-managed and co-owned exclusively by, Todd and Michael Nigro. [Ex. 2 ¶ 12; Tr. at 8:19-9:2] Accordingly, Todd and Michael Nigro exclusively control the Debtor.

[2] This amount does not include certain professionals' fees or default interest and other charges claimed by Wells Fargo, and the bank's entitlement to such amounts will be adjudicated in the claims allowance process and not in connection with the Plan. [Ex. 1 ¶¶ 2.3, 2.7]

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The 1990 Nigro Trust holds the second largest ownership interest (39.73%) in the Debtor. [Ex. 22 at 29] An entity known as Omega Industries also holds an ownership interest (3.85%) in the Debtor. [Tr. at 12:7-12] Edward Nigro, the father of Todd and Michael Nigro, set up the 1990 Nigro Trust and also owns Omega Industries. [*Id.* at 10:12-13, 11:18-12:9] And Todd Nigro may ultimately be a beneficiary of the 1990 Nigro Trust. [*Id.* at 12:4-6] Accordingly, more than 86% of the ownership interest in the Debtor is held by entities and trusts in which Todd, Michael, and Edward Nigro hold ownership and/or beneficiary interests.

Furthermore, Nigro Management LLC ("Nigro Management") is an affiliate of the Debtor that was also founded by, and is also co-managed and co-owned by, Todd and Michael Nigro. [Ex. 2 ¶ 12; Tr. at 10:22-11:6] Nigro Management provides property management and leasing services to the Debtor. [Ex. 2 ¶¶ 17, 22; Tr. at 10:22-11:6]

The Bankruptcy Case And Plan

The Debtor filed this chapter 11 case in July 2011. Wells Fargo is the Debtor's only secured creditor, and the bank's lien encumbers all or substantially all of the Debtor's property.[3] [Ex. 8 at 4] General unsecured claims total $16,500 or less in the aggregate. [*Id.* at 4-5] The Debtor has no other creditors. [*Id.*]

In December 2011, the Debtor filed a chapter 11 plan that would allow the Debtor to retain the Property, allow equity holders to retain their interests, extend maturity of the Loan to March 2017, and otherwise treat Wells Fargo's claims in a manner that the bank opposed. [Ex. 20; Docket No. 105] Wells Fargo sought relief from the automatic stay with respect to the Property and its other collateral. [Docket No. 114] In January 2012, the Court held a multi-day evidentiary hearing on the plan and Wells Fargo's stay relief motion. [Docket Nos. 169, 175, 178-79]

On November 13, 2014, the Court entered an order denying confirmation of the initial plan [Ex. 12], entered a corresponding memorandum decision (the "Memorandum Decision") [Ex. 11], and entered an order conditioning the automatic stay on the Debtor filing an amended plan by December 29, 2014 [Ex. 34 at 2]. In the Memorandum Decision, the Court found that the value of

[3] The Debtor disputes that Wells Fargo has a lien on certain of the Debtor's cash assets. This issue is before the Court on a separate motion.

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the Property as of the January 2012 confirmation hearings was $10,845,000 and that an interest rate of at least 4.25% had to be applied to Wells Fargo's secured claim. [Ex. 11 at 16, 23]

On December 24, 2014, the Debtor filed an amended plan that incorporated certain of the Court's findings in the Memorandum Decision. [Ex. 7] The amended plan, however, retained many of the provisions regarding treatment of Wells Fargo's secured claim that Wells Fargo opposed. [*Id.* at 11-13] On December 31, 2014, Wells Fargo filed a chapter 11 plan as an alternative to the Debtor's amended plan. [Docket No. 321]

On February 6, 2015, the Court entered an order (i) permitting the Debtor to move forward with its amended plan, (ii) indicating that the Court would likely grant stay relief or dismiss this case if the Debtor does not confirm its amended plan, and (iii) setting a combined hearing on plan confirmation and any stay relief or dismissal motion that the bank would file. [Ex. 10 at 3-5]

On March 27, 2015, Wells Fargo filed the Stay Relief/Dismissal Motion requesting that the Court grant stay relief with respect to the Property and the bank's other collateral or dismiss this case in the event the Debtor again fails to confirm a plan.

On April 7, 2015, Wells Fargo and the Debtor filed a stipulation (the "<u>Stipulation</u>") agreeing that: (i) Wells Fargo's allowed claim includes the amount of $11,225,639.40, and that the bank's entitlement to certain pre- and post-petition professionals' fees, default interest, and other charges will be deferred and not decided in connection with plan confirmation; and (ii) for purposes of the Hearing only, (a) an interest rate of 4.25% with respect to Wells Fargo's secured claim satisfies section 1129(b)(2)(A)(i) as provided in the Memorandum Decision, (b) the as-is, fair market value of the Property and improvements as of the confirmation date of the Debtor's plan remains no less than $10,845,000 as provided in the Memorandum Decision, (c) Wells Fargo is an oversecured creditor without a deficiency claim, and (d) Wells Fargo will not challenge feasibility (section 1129(a)(11)) or good faith (section 1129(a)(3)) with respect to the plan. [Ex. 1] The Court approved the Stipulation. [Docket No. 417]

On April 15, 2015, the Debtor filed the Plan (intended to amend the December 24, 2014 plan consistent with the Stipulation). With respect to Wells Fargo's secured claim, the Plan proposes to: (i) repay more than $11.2 million in debt based on a 30-year amortization period with

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a five-year term [Ex. 4 §§ 4.1.1(d), (e)]; (ii) make a modest effective date pay down of $585,000 while the Debtor currently holds cash on hand of more than $1.8 million [*Id.* § 4.1.1(d); Ex. 2 ¶ 8; Tr. at 24:13-26:5]; (iii) include no restrictions on the Debtor's ability to use its remaining cash in which the bank holds a lien [Ex. 4; Tr. at 26:23-27:9]; and (iv) eliminate the Lease Covenant, the Cross Default Covenant, the LTV Covenant, and the MAC Clause [Ex. 4 § 4.1.1(h); Ex. 2 ¶ 62].

The Plan also purports to "cure" any defaults under the Loan existing prior to the effective date of the Plan and render the Debtor "current and in good standing" under the Loan. [Ex. 4 § 4.1.3] The Debtor's articulated understanding of this provision with respect to the liability of the Guarantors "is that the [L]oan is in good standing, and so if a loan is in good standing, I would assume that the guarantees are in good standing, as well, and there's no default . . . and there would be no guarantee exposure at that time." [HQ Tr. at 81:17-82:14][4] In other words, the Debtor's intent is to bring the currently-defaulted guaranties into "good standing" and prohibit Wells Fargo from bringing guaranty claims against the Guarantors absent a future default under the Loan.

Finally, equity retains its interests and puts no new cash into the Debtor. [Tr. at 12:19-24]

Wells Fargo voted its claim to reject the Plan [Ex. 5 at 2] and filed an opposition to confirmation of the Plan [Docket No. 409].

The Debtor's Decision Not To Pursue A Sale Of The Property

On or about June 6, 2014, and during the pendency of this case, the Debtor received a letter of intent to purchase the Property for $14.9 million. [Ex. 2 ¶ 56; Ex. 33; Tr. at 35:16-36:8] The $14.9 million purchase price would have been sufficient to repay all amounts then due and owing under the Loan, plus leave a significant return for equity. [Tr. at 40:18-41:19]

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[4] At the Hearing, Wells Fargo's counsel questioned Todd Nigro regarding this "cure" provision. [Tr. at 14:19-17:2] While he tried to parry counsel's questioning, Mr. Nigro ultimately testified that his understanding of this provision is the same as the understanding that he testified to at the hearing held by the Court a day earlier, on April 27, 2015, in the companion case of *In re Nigro HQ LLC*, Case No. 11-21034-mkn, regarding the same "cure" provision set forth in the plan offered in that case. [*Id.* at 16:7-17:2] Thus, Mr. Nigro incorporated his prior testimony, which is relevant and admissible here. *See* Fed. R. Evid. 401, 402, 801(d)(2). Accordingly, Wells Fargo cites herein to Mr. Nigro's testimony at the April 27 hearing regarding this issue. The April 27 hearing transcript is cited to as "[HQ Tr.]," and that transcript is attached as Appendix B.

At the time, however, Todd Nigro, on behalf of the Debtor, informed Wells Fargo that the Debtor had received the purchase offer but refused to share the letter of intent with Wells Fargo, refused to disclose the purchase price to Wells Fargo, and informed Wells Fargo that the Debtor would only pursue the sale of the Property if the bank would take a discounted payoff on the amounts due under the Loan (apparently requiring that Wells Fargo waive all accrued default interest and possibly other accrued amounts).[5] [Ex. 2 ¶ 56 n.6; Tr. at 36:9-40:17] Absent full disclosure from the Debtor regarding the terms of the purchase offer, Wells Fargo declined to accept repayment of less than all amounts due under the Loan and the Debtor therefore refused to pursue the sale of the Property. [Ex. 2 ¶ 56 n.6; Tr. at 41:20-42:5]

III. <u>LEGAL ARGUMENT</u>.

The Plan cannot be confirmed because it fails to satisfy the "cram down" requirement that the treatment of Wells Fargo's claim is fair and equitable, post-confirmation management of the Debtor is not consistent with the best interests of creditors or with public policy, and the Plan's "cure" provision is effectively an impermissible third-party injunction. Because the Plan cannot be confirmed, the Court should grant the Stay Relief/Dismissal Motion.

A. <u>The Plan Fails To Comply With Section 1129 And Cannot Be Confirmed</u>.

A bankruptcy court may only confirm a chapter 11 plan that complies with each of the requirements set out in section 1129(a) of the Bankruptcy Code. 11 U.S.C. § 1129(a). In addition, if all impaired creditor classes do not accept the plan as required by section 1129(a)(8), then the debtor must satisfy the section 1129(b) "cram down" requirements. *Id.* § 1129(b). The debtor bears the burden of proving that its plan meets these requirements, and the failure of proof on any single requirement precludes confirmation. *In re Perez*, 30 F.3d 1209, 1214 n.5 (9th Cir. 1994). The Plan does not satisfy the section 1129(a) and (b) requirements as discussed below.

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[5] In fact, the Debtor refused to disclose the letter of intent or the proposed purchase price to Wells Fargo until compelled to do so in discovery commenced in connection with confirmation of the Plan. [Tr. at 36:9-18]

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1. The Plan Does Not Comply With Section 1129(b)'s "Cram Down" Requirements and Prohibition Against Unfair Discrimination.

Wells Fargo voted to reject the Plan on account of its secured claim, which is impaired. Accordingly, the Debtor must proceed to "cram down" and prove that the Plan does not discriminate unfairly, and is fair and equitable, with respect to Wells Fargo. 11 U.S.C. § 1129(b). The Plan's treatment of the bank's claim is unfairly discriminatory and is not fair and equitable, which precludes confirmation.

Separate and apart from the specific requirements of section 1129(b)(2)(A), the general "fair and equitable" test requires a plan proponent to show that the plan meets the "implicit" fairness standard under section 1129(b)(1). *See, e.g.*, *In re D & F Const., Inc.*, 865 F.2d 673, 675 (5th Cir. 1989); *In re Monarch Beach Venture, Ltd.*, 166 B.R. 428, 436 (C.D. Cal. 1993); *In re Prussia Assoc.*, 322 B.R. 572, 605 (Bankr. E.D. Pa. 2005); *In re Tri Growth Centre City, Ltd.*, 136 B.R. 848, 852 (Bankr. S.D. Cal. 1992). The implicit fairness test focuses on broad notions of fairness and whether a plan unreasonably shifts risk to the party subject to cram down. *See, e.g.*, *Monarch Beach*, 166 B.R. at 436; *see also* Jack Friedman, *What Courts Do to Secured Creditors in Chapter 11 Cram Down*, 14 Cardozo L. Rev. 1495 (1993). The Plan treats Wells Fargo's claim unfairly and shifts virtually all of the risk to the bank for the following reasons:

<u>Repayment Terms</u>: The Plan proposes to repay the Loan based on a five-year term and 30-year amortization period while the Debtor retains approximately $1.1-1.3 million cash after effective date payments. [Ex. 2 ¶ 75; Tr. at 25:21-26:22] Other than an effective date pay down of $585,000, the Plan does not provide for any other payments from excess cash to the bank or any restrictions on the Debtor's ability to use or distribute cash on which the bank holds a lien. [Tr. at 13:16-14:12] And the Debtor projects to accumulate more than $2.7 million cash by the end of the Plan term. [Ex. 2 ¶ 52; Ex. 13]

The only justification offered at the Hearing for the Debtor to accumulate so much cash is to give the Debtor "needed flexibility" for tenant improvements, maintenance, and repairs. [Ex. 2 ¶ 75] But that justification is belied by the facts. The Debtor's projections disclose a total of only $151,000 in anticipated tenant improvements over the Plan term. [Ex. 13] The projections also

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disclose a total of only $22,680 in anticipated leasing commissions over the Plan term. [*Id.*] Event when accounting for these amounts and all projected maintenance and repairs set out in the Debtor's projections, the Debtor still projects accumulated cash by the end of the Plan term of more than $2.7 million. In other words, there is no valid operational or business justification for the Debtor to accumulate more than $2.7 million over the course of the Plan term; it is merely the improper protection of equity interests over those of a secured creditor. Absent restrictions on the use of that cash, the Plan unduly shifts risk to the bank that its collateral may be diminished and unavailable at the end of the Plan term to repay the Loan.

Furthermore, the Debtor's interpretation of its rights under the Plan with respect to its cash is inconsistent with the Equity Covenant, which requires the Debtor's members to maintain no less than $2,837,500 in equity in the Debtor at all times. At the Hearing, Todd Nigro specifically stated that the Plan would ***not*** remove the Equity Covenant. [Tr. at 45:19-24] Yet, Todd Nigro testified that Nigro Development (controlled by Todd and Michael Nigro) can make equity distributions in its sole discretion. [*Id.* at 13:16-14:12] The Plan cannot provide a right that is at odds with a financial covenant expressly retained under the Loan.

Wells Fargo again submits that, to the extent the Plan would otherwise be confirmed, the Debtor's cash in excess of an appropriate reserve for improvements and repairs should be used to increase the effective date pay down on the Loan or, at minimum, to fund a debt service escrow to be used only for the repayment of the Loan. But permitting the Debtor unfettered discretion to use more than $2.7 million of cash during the Plan term shifts too much risk to the bank.

Finally, the proposed five-year cram down Plan term is unfair and inequitable in light of the Debtor's refusal to pursue a sale of the Property for an amount ($14.9 million) that would have exceeded all amounts due under the Loan by more than $1 million, conservatively. [Tr. at 41:10-42:5] Indeed, the Loan could have been repaid in full with a return to equity nearly a year ago. Gluttony, however, led the Debtor's principals to refuse to pursue the sale after Wells Fargo unsurprisingly declined to take a discounted payoff that, it turns out, would have resulted in a significant windfall directly to the Debtor's equity—primarily Todd, Michael, and Edward Nigro. Given that the Debtor could have sold the Property and repaid, and presumably still could sell the

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Property and repay,[6] the Loan in full immediately, it should not now be permitted to term the bank out for another five years simply because the Debtor refuses to pay default interest.

Financial Covenants: The Plan also proposes to eliminate the Lease Covenant, the Cross Default Covenant, the LTV Covenant, and the MAC Clause. [Ex. 4 § 4.1.1(h); Ex. 2 ¶ 62] These covenants provide important, customary, and bargained-for mechanisms that allow the bank to monitor its collateral and protect its rights. [Ex. 3 ¶¶ 15-17] Elimination of these financial covenants further increases the risk unduly shifted to the bank. *See In re P.J. Keating Co.*, 168 B.R. 464, 473 (Bankr. D. Mass. 1994) (stating that stripping of loan covenant was not fair and equitable); *In re Kellogg Square P'ship*, 160 B.R. 343, 368 (Bankr. D. Minn. 1993) ("In exchange for the forced entry into that loan, the creditor is entitled to demand both pecuniary and nonpecuniary terms that are sufficient to shelter it from the risks inherent in the Debtor's proposal."). At the Hearing, Todd Nigro testified that these covenants must be removed "because they will jeopardize Debtor's ability to successfully reorganize." [Ex. 2 ¶ 62] This is meritless.

First, Todd Nigro asserts that the Lease Covenant must be eliminated because it requires Wells Fargo's approval of lease terms "that are not reflective of the current commercial leasing market," the Debtor never previously complied with its obligation to obtain the bank's consent, and the concept of "commercially reasonable terms" is "open to wide interpretation" and "ripe for disagreement." [*Id.* ¶¶ 62(i), 63-66] The Debtor's understanding of this provision is flawed.

As an initial matter, the Lease Covenant requires the Debtor to comply with the terms and conditions of all of its leases. [Ex. 25 § 7.4] Even if the Debtor's other concerns regarding this provision were valid (which they are not), there is no justification for eliminating the requirement that the Debtor comply with its lease obligations. Furthermore, the Lease Covenant only requires Wells Fargo's consent for leases over 5,000 square feet or that do not comply with the pre-approved terms set out in that provision. [*Id.*] While all leases that do not satisfy the pre-approved terms must be approved by Wells Fargo, there is an express limitation that prohibits the bank from unreasonably withholding, conditioning, or delaying its consent to a lease. [*Id.*] The

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[6] Todd Nigro testified at the Hearing that, based on the $14.9 million letter of intent, there may be a 20% equity cushion in the Property today. [Tr. at 33:3-34:16]

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Debtor's suggestion that this provision gives Wells Fargo too much discretion is misplaced, as it places contractual requirements on Wells Fargo to ensure commercial reasonableness. The Debtor offers no valid explanation as to why this provision was acceptable pre-petition but would be problematic post-confirmation.

The Debtor's argument that its prior failure to comply with the Lease Covenant and obtain Wells Fargo's consent also is no justification for eliminating this provision. Nor is the unsurprising fact that terms of art such as "commercially reasonable terms" may become subject to dispute a reason to eliminate this covenant. All contracts are subject to interpretation, but rarely are they litigated. Here, the elimination of "commercially reasonable terms" gives the Debtor carte blanche to enter into new leases without any oversight or approval, which shifts substantial risk to the bank that the cash flow supporting the Debtor's ability to service the Loan may be impaired and that the bank's real property collateral could be leased on terms that impair the overall value of the real estate.

Todd Nigro also asserts that the Lease Covenant must be eliminated, otherwise the current leases for which the Debtor never received the bank's consent would constitute an event of default. [Ex. 2 ¶ 63] Wells Fargo affirms that if the Court confirms the Plan without removal of the Lease Covenant, the Debtor's prior failures to obtain the bank's consent to existing leases will not constitute an event of default. Accordingly, this cannot justify elimination of this covenant.

Second, Todd Nigro asserts that the Cross Default Covenant must be eliminated because it "unduly impairs Debtor's ability to reorganize as it places Debtor at risk of a default even if it is fully performing in accordance with the terms of its Plan." [Ex. 2 ¶ 67] The Cross Default Covenant simply requires the Debtor and its majority owner not to default on their respective obligations to Wells Fargo. [Ex. 25 § 7.7] This is a standard covenant that protects the bank from the Debtor and its majority owner defaulting on other debt obligations they may have owing to Wells Fargo, and incentivizes those parties to perform on their obligations to the bank. Furthermore, the Debtor does not propose to eliminate the financial covenant that requires the Debtor not to default on monetary obligations owing to parties other than the bank. [*Id.* § 7.8; Ex. 2 ¶ 71] Eliminating the Cross Default Covenant would have the anomalous effect of allowing the

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Debtor to default on its other obligations to Wells Fargo without triggering a default under the Loan, but a default on the Debtor's obligations to third parties ***would*** trigger a default under the Loan. The justification for eliminating this covenant is unfairly discriminatory and meritless.

Third, Todd Nigro asserts that the LTV Covenant must be eliminated because the "Debtor could arguably be placed in default immediately after the Effective Date." [Ex. 2 ¶ 68] The Debtor has provided no evidence that it would not be in compliance with the LTV Covenant if the Plan is confirmed. In fact, as discussed above, Todd Nigro testified at the Hearing that there may be as much as a 20% equity cushion in the Property based on the June 2014 letter of intent to purchase the Property for $14.9 million. [Tr. at 33:3-34:16] Conjecture on this issue does not satisfy the Debtor's burden of proving that eliminating this covenant is fair and equitable to the bank—particularly in light of the Debtor's assertion of value of the Property based on the $14.9 million letter of intent. Furthermore, the Debtor's gratuitous suggestion that Wells Fargo would seek to locate an appraiser that would be willing to value the Property at an amount that would trip the LTV Covenant is absurd. As the Court may recall from the hearing in the companion *In re Nigro HQ LLC* case, Wells Fargo's representative, Kevin Haley, discussed the process that the bank uses to employ an appraiser in matters such as this. [HQ Tr. at 117:5-118:2][7] Through this process, an appraiser is selected based on a blind quote obtained through an independent arm of the bank. [*Id.* at 117:15-118:1] Accordingly, the Debtor's concocted rationale for eliminating this covenant is without merit.

Fourth, Todd Nigro asserts that the MAC Clause must be eliminated because it allows Wells Fargo to declare a default in its discretion if it believes its prospects for repayment are materially impaired. [Ex. 2 ¶ 69] This too is a standard loan covenant that provides the bank with protection in the event the Debtor should experience a truly material adverse change to its business

[7] After submitting him to cross-examination at the April 27 hearing in the companion case of *In re Nigro HQ LLC*, Debtor's counsel strategically opted not to cross-examine Mr. Haley at the Hearing the next day. [Tr. at 52:7-18] Because all witnesses submitted direct examination simultaneously by declaration, Mr. Haley had no opportunity other than on re-direct to address Todd Nigro's contentions regarding this appraiser issue. And because Debtor's counsel declined to call Mr. Haley, there was no re-direct of Mr. Haley. Had Mr. Haley had an opportunity to discuss this issue on re-direct, he would have provided the same testimony as cited herein.

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or property. Todd Nigro cites to Wells Fargo's opposition to confirmation of the Plan as the only evidence of the bank's purported belief that the Debtor is in violation of the MAC Clause. [*Id.*] This is absurd. The Plan has nothing to do with whether there has been a material adverse change to the Debtor's business or property, nor has Wells Fargo suggested this. Elimination of this covenant, particularly when coupled with the proposed elimination of other covenants, would put the bank in the precarious position of having no ability to declare a "financial" default except in the event the Debtor fails to make payments, because these are the covenants that permit the bank to react to declines in collateral value and other adverse events affecting a borrower. This would literally handicap Wells Fargo's ability to protect itself and its collateral in the event of a calamity.

Elimination of these covenants shifts substantial risk to Wells Fargo, is not fair and equitable to the bank, and should not be permitted.

<u>Debtor's Fair and Equitable Justifications</u>: Finally, Todd Nigro offers a number of irrelevant reasons that the Plan treats Wells Fargo's claim fairly and equitably. [Ex. 2 ¶ 61] One reason proffered is that the Debtor timely tendered every payment due under the Loan prior to maturity. [*Id.*] Without conceding whether that is true, the Debtor's prepetition loan payments have no bearing on whether the terms of the Plan going forward are fair and equitable with respect to the bank's claim. Another reason is the Debtor's revisionist view that it had to file this case solely because the bank refused to extend the maturity of the Loan. [*Id.*] Although the evidence established that Wells Fargo worked with Todd Nigro, exercised patience in negotiations pre-petition, and negotiated for resolution various times thereafter, the asserted reason for filing this case (though incorrect) also has no bearing on the fair and equitable analysis. Furthermore, it fails to take into consideration that the Loan was a short-term bridge loan. Todd Nigro very well knows that the Loan was never intended to be a long-term loan, and it is patently unfair and inequitable for the Debtor to attempt to impose a plan on Wells Fargo that would repay the vast majority of the debt more than ***12 years*** after the making of the three-year Loan. Another proffered reason is that the Debtor has made a number of adequate protection payments to the bank during this case. [*Id.*] Again, the Debtor's compliance with its agreed-upon cash collateral arrangement is to be expected—it is not a rationale to justify cram down. The Debtor has failed to

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cite any legal authority that its proffered justifications are relevant to the fair and equitable standard. What is relevant to this analysis is how the Plan proposes to treat the bank's claim going forward, and that treatment does not comply with the relevant legal standards cited herein.

Todd Nigro's remaining reasons for why the Plan treats Wells Fargo's claim fairly and equitably concern repayment terms and the cash the Debtor projects to accumulate. [*Id.*] Such rationale is circular—the payment terms are fair, *ergo* the payment terms are fair. And although Wells Fargo agreed in the Stipulation not to contest the interest rate to be applied to its secured claim, a plan's feasibility does not also satisfy the fair and equitable requirement.

2. Debtor's Post-Confirmation Management Is Not Consistent With the Best Interests of Creditors and Public Policy Under Section 1129(a)(5).

Section 1129(a)(5) of the Bankruptcy Code requires the plan proponent to disclose the identity and affiliations of any individuals expected to serve (or continue to serve) as a director, officer, or voting trustee of the reorganized debtor. Often taken for granted is the additional requirement that any such appointments (or proposed continuation of service) be "consistent with the interests of creditors and equity security holders and with public policy." 11 U.S.C. § 1129(a)(5)(A)(ii); *see also* 11 U.S.C. § 1123(a)(7) (plan must be consistent with best interest of creditors and public policy with respect to post-confirmation management).

Todd Nigro testified that he and Michael Nigro will continue to manage the Debtor post-effective date as the co-managers and co-owners of Nigro Development, and that Nigro Management will continue to provide administrative and leasing services to the Debtor. [Ex. 2 ¶¶ 22-24] Todd and Michael Nigro's continued management of the Debtor is not in the best interest of creditors or consistent with public policy.

As discussed above, the Debtor's proposed management (Nigro Development) is the single largest equity security holder, refuses to provide any reasonable safeguards for Wells Fargo's cash collateral, and would have unfettered discretion to make distributions to itself under the Plan. Indeed, and notwithstanding the Equity Covenant, Todd Nigro testified that nothing in the Plan would prohibit the Debtor's management from making a distribution of any amount to itself and the other equity security holders after confirmation. [Ex. 2 ¶ 76; Tr. at 13:16-14:12] And the

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holders of the vast majority of the equity interests in the Debtor are entities and trusts owned and controlled by Todd, Michael, and Edward Nigro. All the while, Wells Fargo is "termed out" on a loan that naturally matured four years ago. A plan that permits insider management to reap such undue benefits at the expense of a creditor (and in this case, effectively the sole non-insider creditor) should not be confirmed. *E.g., In re Digerati Technologies, Inc.*, 2014 WL 2203895 (Bankr. S.D. Tex. May 27, 2014) (denying confirmation because insider management could trigger lucrative benefits after confirmation).

Management's inherent conflicts of interest also compromise its ability to pursue avoidance actions against various insiders, all of whom are related to the Debtor's proposed management. *See In re WRN 1301, Inc.*, 2007 WL 1555812 (Bankr. E.D. Tex. May 24, 2007) (continued service of existing president of debtor approved because court found he was "disinterested person" under the Bankruptcy Code). At the Hearing, Todd Nigro confirmed this fact, stating that while he has not undertaken "an exhaustive analysis," he does not anticipate that the Debtor will pursue any avoidance claims. [Ex. 2 ¶ 49] As an example, he confirmed that the Debtor has no intention of seeking the return of a $30,000 retainer that it paid to a law firm to defend the Guarantors from a potential lawsuit by the bank, notwithstanding that no such lawsuit has ever been brought. [Tr. at 19:11-20:18]

Management by an entrenched, self-dealing insider is not in the best interest of the Debtor's only meaningful creditor, Wells Fargo, and is not consistent with public policy. The meaning of the term "public policy" in these provisions of the Bankruptcy Code can be traced to the Senate Report accompanying the Chandler Act. That legislative history indicates that the provision "directs the scrutiny of the court to the methods by which the management of the reorganized corporation is to be chosen, so as to ensure, for example, adequate representation of those whose investments are involved in the reorganization." *In re Machne Menachem, Inc.*, 304 B.R. 140, 142 (Bankr. M.D. Pa. 2003). If the Plan were confirmed, Wells Fargo would have no "representation" with respect to the Debtor's post-confirmation management, no financial covenant protection, and no safeguards against the diminution of the significant cash on hand, on which Wells Fargo asserts a lien. There would also be no restrictions on Todd and Michael

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Nigro's self-dealing. The purpose of chapter 11 is to allow the honest but unfortunate debtor to reorganize and emerge from bankruptcy; it is not to ensure a windfall to equity and insiders by shifting all the risk of reorganization to creditors.

3. The Plan's "Cure" Provision Violates Section 1129(a)(1).

Confirmation also is impermissible because the Plan violates section 524(e) of the Bankruptcy Code, and therefore section 1129(a)(1). It has been the law in this judicial circuit for more than 25 years that a chapter 11 plan cannot discharge or otherwise affect a non-debtor's obligations to a third party. Section 524(e) provides that "the discharge of a debt of the debtor does not affect the liability of any other third entity on, or the property of any other entity for such debt." 11 U.S.C. § 524(e). The Ninth Circuit has interpreted this statute to prohibit the permanent release, discharge, or injunction of non-debtors. *E.g.*, *In re Lowenschuss*, 67 F.3d 1394, 1401 (9th Cir. 1995); *In re Am. Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989).

Section 4.1.3 of the Plan purports to "cure" all pre-effective date defaults and make the Debtor "current and in good standing" under the Loan. [Ex. 4 § 4.1.3] Todd Nigro's testimony on this issue, while evasive, was ultimately clear and damning. Todd Nigro and the other Guarantors guaranteed the Loan. While Todd Nigro testified on leading questions that the Plan does not impose an injunction in favor of the Guarantors, it became clear on further cross-examination that Mr. Nigro intends to invoke section 4.1.3 of the Plan as a disguised, *de facto* injunction against any guaranty action brought against the Guarantors. His testimony was unequivocal:

> Q. Your testimony a moment ago with Ms. Kozlowski is that if a default occurs under the plan, then Wells Fargo would be free to pursue the guarantors, correct?
> A. Yes.
> Q. What if no default occurs under the plan? Is it your position that Wells Fargo cannot pursue the guarantors as long as the plan is performing based on existing defaults?
> . . .
> A. My understanding is that the loan is in good standing, and so if a loan is in good standing, I would assume that the guarantees are in good standing, as well, and there's no default.
> Q. Your understanding is that right now as we sit here, the loan is in good standing?

> A. No. If the plan is confirmed, my understanding is that the loan would be in good standing, and if then the loan is in good standing, then the guarantees would remain in place and there would be no guarantee exposure at that time.

[HQ Tr. at 81:17-82:14] It is clear that the Debtor's decision-makers, who are Guarantors along with their spouses, believe that the carefully-crafted plan language regarding "cure" of defaults provides a preclusive argument in any action on their guarantees as long as the Debtor is performing under the Plan.

Section 524(e) is not limited to *express* attempts to accomplish the proscribed. Courts must look beyond labels and prohibit all forms of discharge or permanent injunction in favor of non-debtors. *See Am. Hardwoods, Inc.*, 885 F.2d at 625 (examining effect of relief sought and rejecting argument that injunction is distinguishable from discharge). The Debtor cannot make an end-run around the law through subterfuge and cleverly drafted plan language. *Id.*

Furthermore, there is no policy justification for the Debtor's attempt to protect insiders and management at Wells Fargo's expense. To the contrary, the rationale for the rule against non-debtor injunctions illustrates the impropriety of the Plan. Pursuant to the Bankruptcy Code, a debtor must disclose all of its assets and submit those assets to the bankruptcy court's control. In exchange, the court can generally require creditors to accept a pro rata distribution and prevent them from taking further action against the debtor through the Bankruptcy Code's discharge provisions. Courts outside of bankruptcy have no power to force creditors to accept monetary settlements. There is then no reason to allow a solvent insider to seize the benefits of bankruptcy merely because of its relationship to the debtor—and force its creditors to accept less than their state-law rights against the insider—when the insider does not have to accept the burdens and duties imposed by the Bankruptcy Code. *See generally* Judith R. Starr, *Bankruptcy Court Jurisdiction to Release Insiders from Creditor Claims in Corporate Reorganizations*, 9 Emory Bankr. Dev. J. 485, 498 (1993). Permitting injunctive relief in favor of non-debtors would create a serious moral hazard, as insiders would be incentivized to bring a company into bankruptcy to avoid personal liability. *See id.*; *In re Cont'l Airlines*, 203 F.3d 203, 217 (3d Cir. 2000) ("[G]ranting permanent injunctions to protect non-debtor parties on the basis of theoretical identity of interest alone would turn bankruptcy principles on their head.").

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Accordingly, confirmation of the Plan must be denied as the impermissible "cure" provision violates section 524(e), which in turn violates section 1129(a)(1). The Debtor's attempt to disguise the effect of this provision also further illustrates the problems with the Debtor's proposed post-confirmation management and how the Plan's treatment of Wells Fargo's claim is not fair and equitable under section 1129(b).

B. Stay Relief Or Dismissal Is Appropriate.

For all of the reasons set forth herein, the Plan should not be confirmed. As such, and for all the reasons set forth in the Stay Relief/Dismissal Motion, cause exists to lift the automatic stay or dismiss this case due to the Debtor's failure to confirm the Plan. This case must be resolved at this juncture, and stay relief or dismissal is appropriate.

IV. CONCLUSION.

Based on the foregoing, Wells Fargo respectfully requests the Court enter an order denying confirmation of the Plan, granting the Stay Relief/Dismissal Motion, and granting Wells Fargo such other and further relief as the Court deems just and proper under the circumstances.

RESPECTFULLY SUBMITTED this 5th day of June, 2015.

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