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UNITED STATES BANKRUPTCY COURT
Southern District of California

In re: Ivanhoe Ranch Partners, LLC, a California limited liability company, Debtor-in-Possession.	Case No. 13-09397-LT11 Chapter 11 **OBJECTION OF ESSEL ENTERPRISES, LLC TO THE DISCLOSURE STATEMENT OF CREDITOR CARLOS TORRES FILED IN CONNECTION WITH HIS PROPOSED PLAN OF REORGANIZATION** Date: July 11, 2014 Time: 11:00 a.m. Dept.: 3 Judge: Hon. Laura S. Taylor

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Essel Enterprises, LLC (the "Secured Lender"), by and through its undersigned counsel, Ballard Spahr LLP, hereby objects (this "Objection") to the Disclosure Statement (the "Disclosure Statement") of creditor Carlos Torres ("Torres") filed in connection with *The Plan of Reorganization Proposed by Creditor Carlos Torres* (the "Plan") and in support thereof states as follows:[1]

I.

PRELIMINARY STATEMENT

This Court should deny approval of the Disclosure Statement because (i) the Plan is unconfirmable on its face and (ii) the Disclosure Statement does not contain "adequate information" as required by Section 1125 of the Bankruptcy Code. It is axiomatic that a court may disapprove a disclosure statement if the accompanying plan could not possibly be confirmed. Here, the Plan is unconfirmable as a matter of law for at least three reasons:[2]

(i) The Plan is not "fair and equitable" because it fails to comply with Section 1129(b)(2)(A) of the Bankruptcy Code. Specifically, the Plan neither provides for the Secured Lender to retain its lien on the Property nor grants it the right to credit bid its secured claim as required by the Supreme Court's decision in RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065 (2012). Distilled to its essence, the Plan provides for a sale of the Property to Torres. Accordingly, Torres must comply with Section 1129(b)(2)(A)(ii) of the Bankruptcy Code, which mandates that the Secured Lender be afforded the right to credit bid its Secured Claim.

(ii) The Plan violates the so-called "absolute priority rule" because Torres, who upon information and belief is an insider or an otherwise close business associate of the Debtor, its insiders or its affiliates, seeks to contribute purported new value to obtain the Debtor's equity, while at the same time, evading a competitive process which would assure the Secured

[1] All capitalized terms not defined herein shall have the meaning ascribed to such terms in the Disclosure Statement or Plan, as applicable.

[2] The Secured Lender has additional objections to the Plan. These objections will be made at Plan confirmation, if necessary. The Secured Lender reserves its rights to oppose the Plan on all grounds until such time.

Lender and all of the Debtor's creditors that the value of the Debtor's assets are being maximized. A debtor's equity holder may not evade a competitive process by arranging for the new value to be contributed by (and the new equity to go to) an "insider." In re Castleton Plaza, LP, 707 F.3d 821, 821 (7th Cir. 2013).

(iii) The Plan (a) manipulates voting by impermissibly gerrymandering a separate impaired class and (b) is not fair and equitable in a non-technical sense.

In addition to the Plan's failure to abide by the provisions of the Bankruptcy Code, making it unconfirmable on its face, the Disclosure Statement fails to provide "adequate information" because, *inter alia*:

- No detail is provided regarding the treatment of the Secured Claim of the Secured Lender should it make an election under Section 1111(b) of the Bankruptcy Code;
- The Disclosure Statement fails to provide any financial or operational information which is necessary to judge the feasibility of the Plan;
- There is no liquidation analysis attached to the Disclosure Statement; and
- The Disclosure Statement does not identify any of the directors, members or officers proposed to serve on the initial board of directors or as an officer or member of the reorganized Debtor and the nature of compensation.

For these reasons alone, this Court should not approve the Disclosure Statement.

II.

BACKGROUND

A. The Secured Loan and the Debtor's Default Thereunder

On or about September 22, 2005, the Debtor executed a written promissory note (the "Original Note") in the original principal amount of $2,715,000, evidencing a loan (the "Secured Loan") made by the Secured Lender to the Debtor.

On or about January 4, 2006, the Debtor executed an Additional Advance and Amendment Number One to Promissory Note (the "Amended Note" and as subsequently amended, modified and/ or supplemented, the "Promissory Note"), amending the Original Note, and increasing the amount of the Debtor's indebtedness to the Secured Lender under the Secured Loan to the principal amount of $8,365,000.

It is undisputed that the Secured Loan is secured primarily by the Debtor's interest in approximately 220 acres of land situated around the Steele Canyon Golf Club near El Cajon. The land consists of what is referred to in the loan documents as the Willow Glen Property (50 acres) and the Ivanhoe Ranch Property (170 acres) (collectively, the "Property"). The Secured Lender's security interest in the Debtor's collateral is evidenced by two Deeds of Trust, Assignment of Leases and Rents, Security Agreements and Fixture Filings (collectively, and as amended, modified and/ or supplemented, the "Deeds of Trust").

The Debtor owns all of the fee title of the Property, and all of the fee title was granted as collateral for the Secured Loan.

To induce the Secured Lender to make the Secured Loan, Henry Gamboa ("Gamboa"), an insider of the Debtor, executed a Repayment Guaranty dated September 22, 2005, in favor of the Secured Lender (the "Guaranty"). Pursuant to the Guaranty, Gamboa guaranteed to the Secured Lender, inter alia, prompt payment of all indebtedness arising under the Promissory Note and other related loan documents.

The Debtor defaulted under the terms of the Promissory Note and the Deeds of Trust due to, among other things, failing to pay the Secured Lender an installment of principal in the amount of $125,000 on or before June 10, 2010. Accordingly, the entire indebtedness under the Secured Loan became due and payable on that date.

Since 2005, the Debtor has paid down the Secured Loan's principal by just over $377,000.00, and paid just over $806,000.00 in interest. In fact, no payments on the Secured Loan have been made since August 16, 2010. The total amount of principal, interest and property taxes due and owing, exclusive of attorneys' fees and court costs, was **$11,029,815.11** as of January 31, 2014 (the "Secured Claim").[3]

On or about March 15, 2012, the Secured Lender instituted a Judicial Foreclosure action (the "Foreclosure Action") against the Debtor and Gamboa, among others, in the Superior Court of California, County of San Diego, Central Division, Case No. 37-2011-00085682-CU-OR-

[3] This amount includes the $231,286.57 the Secured Lender advanced towards unpaid real estate taxes to protect its security interest in June, 2013.

CTL, which was scheduled for trial on September 23, 2013, the day the Debtor filed this bankruptcy case.

In addition to seeking an order of judicial foreclosure in the Foreclosure Action, the Secured Lender asserts causes of action for negligent misrepresentation, intentional misrepresentation, fraudulent concealment and false promise on the grounds that the Debtor and Gamboa intentionally or negligently represented the extent of the Debtor's ownership rights in certain real property (purportedly part of the Property) in order to induce the Secured Lender to extend the Secured Loan.

B. <u>The Debtor's Commencement of this Case</u>

On September 23, 2013, the Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code with this Court.

The Debtor continues to operate its business as a debtor in possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code. To date, no trustee or official committee of unsecured creditors has been appointed in this case.[4]

C. <u>The Lift Stay Motion</u>

On February 10, 2014, the Secured Lender moved this Court for relief from the automatic stay (the "Lift Stay Motion") to continue the Foreclosure Action on the grounds that the Debtor possessed no equity in the Property. Docket No. 34.

On March 13, 2014, this Court heard argument on the Lift Stay Motion and granted the motion with the proviso that if the Debtor (but **<u>not</u>** another person or entity) pays the assessed fair market value of the property of $2,192,600 to the Secured Lender, without condition, then the Debtor (but **<u>not</u>** another person or entity) may return to Court to request the Court stay the Foreclosure Action. In that event, the Secured Lender would still have an opportunity to argue as to why imposition of a stay should not be granted.[5] On April 1, 2014, this Court entered an order to that effect. Docket No. 53.

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[4] At the June 23, 2014 status conference held in this case, the issue of diversion and potential misappropriation of water from the Property was discussed, which if left unabated may form the basis for grounds for dismissal or the appointment of a Trustee in this case.

[5] The Secured Lender submits that there are no grounds to terminate stay relief in that regard, even if that

The Foreclosure Action is currently scheduled for August 22, 2014.

D. The Proposed Disclosure Statement and Plan

On May 28, 2014, Torres filed the Disclosure Statement and Plan. Docket No. 73. The terms of the Plan provide that Torres will pay the Debtor's estate $2,442,600 (the "Purchase Price") in consideration for 85% of the equity/membership interests in the reorganized Debtor. The remaining 15% of the equity/membership interests in the reorganized Debtor will be allocated among the Debtor's impaired unsecured creditors on a pro rata basis as their interests appear, including to the Secured Lender on account of its deficiency claim. Plan at Article 2 and Article 4.

The Purchase Price will be utilized as follows:

- Approximately $2,192,600 (Torres' approximation of the value of the Property) will be paid to the Secured Lender on account of its Secured Claim; and
- $250,000 will be used for the purpose of paying Class II horse depositors, operating needs, administrative expenses, and real estate taxes.

III.

THE DISCLOSURE STATEMENT SHOULD NOT BE APPROVED BECAUSE (I) THE PLAN IS UNCONFIRMABLE ON ITS FACE AND (II) IT CONTAINS INADEQUATE INFORMATION

A court may deny approval of a disclosure statement if the accompanying plan is unconfirmable on its face. See In re Main St. AC Inc., 234 B.R. 771, 775 (Bankr. N.D. Cal. 1996) ("it is now well settled that a court may disapprove a disclosure statement … if the plan could not possibly be confirmed"); In re Arnold, 471 B.R. 578, 585 (Bankr. C.D. Cal. 2012) (appropriate to deny approval of disclosure statement where plan is unconfirmable on its face); In re Main St. AC, Inc., 234 B.R. 771, 775 (Bankr. N.D.Cal. 1999) ("It is now well accepted that a court may disapprove of a disclosure statement, even if it provides adequate information about a proposed plan, if the plan could not possibly be confirmed."); see also In re American Capital Equipment, LLC, 688 F.3d 145, 154 (3d Cir. 2012) ("[i]t appears to be within the discretion of

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unforeseen payment were to be made by the Debtor.

the bankruptcy court to withhold approval of a disclosure statement if the accompanying plan is unconfirmable") (citation omitted). Courts may address confirmation issues at the disclosure statement stage to avoid engaging in a wasteful and fruitless exercise of sending the disclosure statement to creditors and soliciting votes on the proposed plan when the plan is unconfirmable as a matter of law. Such an exercise in futility only serves to further delay a debtor's attempts to reorganize. In re Atlanta West VI, 91 BR. 620, 622 (Bankr. N.D. Ga. 1988); see also In re Beyond.com Corp., 289 B.R. 138, 139 (Bankr. N.D. Cal. 2003) (approval of disclosure statement should be denied if the plan is clearly unconfirmable).

If a proposed plan is not facially unconfirmable, the accompanying disclosure must contain "adequate information." See In re City of Col. Spring Creek Gen. Imp. Dist., 177 B.R. 684, 689 (Bankr. D. Colo. 1995) (finding disclosure statement deficient due to inadequacy of information and that "information to be provided should be comprised of all those factors presently known to the plan proponent that bear upon the success or failure of the proposals contained in the plan") (quoting In re Stanley Hotel, Inc., 13 B.R. 926, 929 (Bankr. D. Colo. 1981)); Huntington Banks of Michigan v. Velcor/LAX Holding LP, 9 Fed. Appx. 669, 670 (9th Cir. 2001) (citations omitted). "Adequate information" is defined by Bankruptcy Code § 1125(a)(1) to mean "information of a kind, and in sufficient detail, … that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan." The disclosure statement must provide information to enable the hypothetical reasonable investor to make an informed judgment about the feasibility of the proposed business plan, and the resulting likelihood that the proposed payment plan will in fact be accomplished without default. **Thus, at the hearing on the Disclosure Statement in this case, two basic issues will be before this Court: Are there valid objections to the confirmability of the Plan on its face? If not, does the Disclosure Statement provide "adequate information?"**

In Part III. A. below, the Secured Lender establishes that the Plan is facially unconfirmable on at least three grounds. Based on this fact alone, this Court should deny the Disclosure Statement. In Part III. B. below, the Secured Lender establishes that the Disclosure

Statement does not contain "adequate information" to enable an informed judgment as to the Plan's feasibility or whether the Plan is in the best interests of creditors. This too is grounds for not approving the Disclosure Statement.

A. <u>The Proposed Plan is Facially Unconfirmable</u>

1. <u>The Debtor's Plan is Not "Fair and Equitable" Because It Fails to Comply with Section 1129(b)(2)(A) of the Bankruptcy Code</u>

Bankruptcy Code Section 1129(b) permits confirmation of a plan over the objection of the Secured Lender if, in addition to other general confirmation requirements, two tests are satisfied: (i) the Plan must not "discriminate unfairly," and (ii) it must be "fair and equitable." Bankruptcy Code § 1129(b)(1). As a starting proposition, those phrases are given their literal meanings. In addition, Bankruptcy Code Section 1129(b)(2) goes on to give a more technical meaning to the phrase "fair and equitable," by setting out certain necessary (though not sufficient) conditions which a plan must satisfy to be found "fair and equitable." Thus, for the Plan to be confirmable over the objection of the Secured Lender, it must meet the technical "fair and equitable" rules of Section 1129(b)(2) and it must also be, in the non-technical sense, both non-discriminatory and fair and equitable under Section 1129(b)(1).

Section 1129(b)(2) requires that the plan proponent meet one of three requirements in order to be deemed "fair and equitable" with respect to a nonconsenting secured creditor's claim.[6] The plan must provide:

> (i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

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[6] When a claim is secured by property with a value less than the amount of the claim, as the Secured Lender's Secured Claim appears to be, it ordinarily is split into a secured claim equal to the property's value and an unsecured claim for the balance. 11 U.S.C. § 506(a). This treatment is subject, however, to the creditor's election under Section 1111(b) to have its entire claim treated as secured, resulting in a different application of Section 1129(b)(2)(A). Here, the Plan classifies the Secured Lender's secured claim in Class I and its unsecured deficiency claim in its own class, Class III. The classification of the Secured Lender's general unsecured deficiency claim in its own class, despite receiving the identical treatment being provided to general unsecured creditors in Class IV, is improper for the reasons set forth below. Moreover, as discussed below, notwithstanding Section 506(a), the Bankruptcy Code does not permit "lien stripping" in a Section 506(a) proceeding that has the effect of eliminating a secured creditor's right to credit bid the entirety of the amount owing on the debt forming the basis of the lien claim.

> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
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> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. §1129(b)(2)(A).

Under clause (i), the secured creditor retains its lien on the property and receives deferred cash payments. Under clause (ii), the property is sold free and clear of the lien, "subject to section 363(k)," and the creditor receives a lien on the proceeds of the sale. Section 363(k), in turn, provides that "unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property"—i.e., the creditor may credit-bid at the sale, up to the amount of its claim. Finally, under clause (iii), the plan provides the secured creditor with the "indubitable equivalent" of its claim.

Torres' Plan plainly fails to provide the Secured Lender with the treatment mandated by Section 1129(b)(2)(A) because the Secured Lender does not retain its lien on the Property but rather, receives a cash payment equal to the value of the Property, which value is to be determined by this Court, and receives its pro rata share of the Debtor's equity on account of its unsecured deficiency claim. Plan at § 2.1. Based on this fact alone, the Plan is unconfirmable and the Disclosure Statement should be denied.

Furthermore, the foundation of the Plan – Torres' payment of the Purchase Price in consideration for the Debtor's equity – is nothing more than a sale of the Debtor's assets in disguise. As such, Section 1129(b)(2)(A)(ii) requires an alternative means of "fair and equitable" treatment by invoking § 363(k) of the Bankruptcy Code. See In re NNN Parkway 400 26, LLC, 505 B.R. 277, 287 (Bankr. C.D. Cal. 2014). Section 363(k) requires that in any sale of property of the estate through a plan, the dissenting secured creditor must be afforded the opportunity to credit bid its claim against the purchase price. This right has been confirmed by the Supreme Court of the United States and courts in this Circuit. RadLAX Gateway Hotel, LLC v. Amalgamated Bank, —— U.S. ——, 132 S.Ct. 2065, 2070, 182 L.Ed.2d 967 (2012) (creditor may credit bid up to the amount of its claim at a sale); In re NNN Parkway 400 26, LLC, 505 B.R. at 287; In re Monarch Beach Venture, Ltd., 166 B.R. 428, 433 (C.D. Cal. 1993) ("[I]n this Circuit, the right to credit bid may not be taken from the creditor.").[7]

In Pacific Lumber, the Fifth Circuit addressed a plan – much like this Plan – providing for the transfer of assets free and clear of secured creditors' liens to new entities owned by the plan sponsor in exchange for payment of a cash infusion and other consideration. In re Pacific Lumber, 585 F.3d 229, 245 (5th Cir. 2009). The Pacific Lumber court ruled that this was indeed a "sale" which might have been controlled by § 1129(b)(2)(A)(ii). But the objection by the creditor that it had been denied its credit bidding rights was not sustained by the trial court, and this ruling was upheld on appeal, because the appellate court ruled that the alternatives means for "fair and equitable" treatment described in § 1129(b)(2)(A) were not exclusive and the "indubitable equivalent" option found at § 1129(b)(2)(A)(iii) alternatively applied in lieu of credit bidding referred to in § 1129(b)(2)(A)(ii). This holding of Pacific Lumber is no longer good law because it was overruled by RadLAX. See In re NNN Parkway 400 26, LLC, 505 B.R. at 287 ("The holding of Pacific Lumber is probably no longer good law (at least in part) as it is likely overruled by RadLAX."). However, Pacific Lumber provides insight as to what is, in fact, a "sale" to which credit bid rights clearly apply versus a mere "transfer," which may not trigger such rights.

The transfer of the Debtor's equity to Torres is a sale of the Debtor's assets, including the Property, free of the Secured Lender's liens. Without the Property, the Debtor's equity has no value whatsoever. Because Torres is essentially purchasing the Property under the Plan, the

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[7] See also In re SunCruz Casinos, LLC, 298 B.R. 833, 839 (Bankr. S.D. Fla. 2003) ("[t]he plain language of the statute makes clear that **the secured creditor may credit bid its entire claim, including any unsecured deficiency portion thereof**.") (emphasis added); Cohen v. KB Mezzanine Fund II, LP (In re SubMicron Sys. Corp.), 432 F.3d 448, 459-60 (3d Cir. 2006) (describing a cap on credit bids based on the economic value of the collateral as "theoretically nonsensical" because "any amount bid for [the collateral] up to the value of lender's full claim becomes the secured portion of lender's claim by definition").

Secured Lender should be entitled to credit bid its secured debt thereby maximizing the value of the Debtor's assets while helping protect the Secured Lender against the risk that its collateral is being sold at a depressed price. See RadLAX Gateway Hotel, LLC, 132 S. Ct. at 2070, fn. 2; see also In re NNN Parkway 400 26, LLC, 505 B.R. at 287 (citing RadLAX Gateway Hotel, LLC, 132 S.Ct. 2070) ("Plans that would effect a sale but short circuit the right of a secured creditor's § 363(k) to offset cannot be confirmed …") (emphasis added).

2. The Debtor's Plan Violates the Absolute Priority Rule Because It Permits Torres to Obtain the Debtor's Equity Interests without Providing the Secured Lender with the Right to Credit Bid its Secured Claim

The absolute priority rule prohibits existing equity from retaining for itself the exclusive right to purchase the equity of the reorganized debtor at an arbitrary price not subject to a market test. Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999).[8] Following lower courts across the country, the Seventh Circuit recently held that under LaSalle, if unsecured creditors are not paid in full and reject the plan, an insider of the equity holder cannot inject new value and obtain ownership; the debtor must expose the new equity to some type of competitive bidding process. In re Castleton Plaza, LP, 707 F.3d 821, 821-22 (7th Cir. 2013) (holding that plans giving insiders preferential access to investment opportunities in the reorganized debtor should be subject to the same opportunity for competition as plans in which existing claim-holders put up the new money); see also In re Global Ocean Carriers Limited, 251 B.R. 31, 37 (Bankr. D.Del.

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[8] The LaSalle mandate is well summarized by then Bankruptcy Judge Bruce A. Markel:

> Thus, the exclusive ability to propose a plan taints the trial court's evaluation, presumably to the point at which it could not be trusted as an index that the debtors old equity holders are paying top dollar. As the [LaSalle] Court saw it, under a plan granting an exclusive right, making no provision for competing bids or competing plans, any determination that the price was top dollar would necessarily be made by a judge in a bankruptcy court, whereas the best way to determine value is exposure to market. In order to give appropriate deference to Congress' statutory scheme, there should be a disfavor for decisions untested by competitive choice … when some form of market valuation may be available to test the adequacy of an old equity holders proposed contribution.

LaSalle and the Little Guy, Some Initial Musings on the Ultimate Impact on the Bank of America, N.T & S.A. vs. 302 N. LaSalle St. Partnership (Bruce A. Markel, 16 Bank. Dev. J. 345 at *4 2000) (internal quotations omitted).

2000) ("we conclude that the Debtors' Modified Plan violates the absolute priority rule by allowing the existing controlling shareholder to determine, without the benefit of a public auction or competing plans, who will own the equity of Global Ocean and how much they will pay for the privilege."); In re GAC Storage El Monte, LLC, 2013 WL 1124074, at *17 (Bankr. N.D.Ill. 2013) (following Castleton by holding that plan has to provide an opportunity for competition if it seeks to provide preferential access to an investment opportunity to an insider); see also In re Graham & Currie Well Drilling Co., Inc., 2011 WL 5909632, at *1 (Bankr. E.D.N.C. 2011) (appropriate value of new equity must be determined by the market); In re RIM Development, LLC, 448 B.R. 280, 292 (Bankr. D.Kan. 2010) (failure to provide for LaSalle-type "competition or market valuation" renders plan "patently unconfirmable").

Torres has not, and cannot, establish that his proposed Plan is fair and equitable because the Plan does not comply with the absolute priority rule embodied in the Bankruptcy Code. Specifically, while general unsecured creditors are not paid in full, the Plan allows an insider or otherwise close affiliate of the Debtor, Torres, to purchase the Debtor's equity while failing to provide a mechanism that adequately exposes the Debtor's assets, including the Property, to the market, due to a lack of competitive bidding.[9] The bidding process is established to "prevent the funneling of value from lenders to insiders …". See In re Castleton Plaza, LP, 707 F.3d at 824 ("Nor does the rationale of 2013 North LaSalle depend on who proposes the plan. Competition helps prevent the funneling of value from lenders to insiders, no matter who proposes the plan or when. An impaired lender who objects to any plan that leaves insiders holding equity is entitled to the benefit of competition"). Based on the forgoing, the Plan must provide for a competitive

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[9] The precise nature of Torres' relationship with the Debtor, its insiders and affiliates is not fully understood as of the date of this Objection. Anecdotally, it appears that Torres' mailing address is the same address previously used by the Debtor as evidenced by its SOFA's filed in this case. The Secured Lender reserves its right to conduct discovery in connection with this Objection and Plan confirmation should this Court hold that defining the precise relationship between the parties is relevant. For purposes of this Objection, however, other grounds exist upon which this Court should deny approval of the Disclosure Statement. In any event, because a secured creditor is entitled to credit bid the entirety of the debt giving rise to the secured lien, there is no principled reason that the Debtor's equity should not be subject to competing transactions, even if the Debtor's proposed buyer was a complete stranger.

auction process so that the value of the Debtor's assets is maximized while assuring the Secured Lender that the Property is being sold for market value.

3. Additional Grounds Support a Finding that the Plan is Unconfirmable on its Face

(a) The Plan Gerrymanders the Secured Lender's Unsecured Deficiency Claim for Voting Purposes

In the event that the Secured Lender does not make the Section 1111(b) election, Torres proposes to classify the Secured Lender's unsecured deficiency claim in Class III of the Plan and the balance of general unsecured claims in Class IV, even though the Plan proposes identical treatment for both classes.[10] The separate classification of the Secured Lender's unsecured deficiency claim is improper.

Torres is clearly seeking to obtain the approval of at least one class of impaired claims in order to attempt cramdown of his Plan under section 1129(b). See 11 U.S.C. § 1129(a)(10) (requiring at least one class of impaired claims to vote in favor of the plan). If the Secured Lender's deficiency claim were included in the general unsecured class, the Secured Lender's vote would determine whether the unsecured class accepts or rejects the Plan pursuant to Section 1126.[11] By separating the Secured Lender's unsecured deficiency claim from the general unsecured claims, Torres is manipulating voting by impermissibly gerrymandering a separate impaired class. As a result, the separate classification of the Secured Lender's deficiency claim constitutes impermissible gerrymandering and violates Sections 1122(a) and 1129(a)(1). See Sections 1122(a); 1126; 1129(a)(1). See In re Barakat, 99 F.3d 1520, 1524-25 (9th Cir. 1996) (holding that debtor's classification of secured creditor's unsecured deficiency claim separately

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[10] Classification of claims is governed by section 1122(a) providing, in part:

> (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

11 U.S.C. § 1122(a).

[11] Torres states in the Plan that it estimates the Secured Lender's unsecured claim equals $8,279,535, and Debtor scheduled other general unsecured claims of approximately $259,142.00. See Debtor's Schedules, Docket No. 15. Accordingly, the Secured Lender's unsecured deficiency claim is more than one-third of the aggregate amount of general unsecured claims, and its vote against the Plan, which should be placed in Class IV, will cause Class IV to reject the Plan. That would leave Torres with no accepting impaired class of claims.

from other general unsecured claims was impermissible because it was done for the purpose of creating an impaired class that would accept the plan); see also Travelers Ins. Co. v. Bryson Properties XVIII (In re Bryson Properties), 961 F.2d 496, 502 (4th Cir.1992) ("[A]though separate classification of similar claims may not be prohibited, it 'may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims.'") (citation omitted); In re Holywell Corp., 913 F.2d 873, 880 (11th Cir. 1990) ("[I]f the classifications are designed to manipulate class voting ..., the plan cannot be confirmed.").

(b) The Plan's Treatment of the Secured Lender is Unfair and Inequitable

This bankruptcy case is essentially a two-party dispute. The Debtor admittedly filed for bankruptcy protection to avoid foreclosure by the Secured Lender and the Debtor holds a de minimis amount of general unsecured debt. Through the Plan, Torres, on his own or very likely in concert with the Debtor's insiders or affiliates, seeks to pay the Secured Lender a fraction of its Secured Claim, pay certain other administrative claims, and in return, receive the Property free and clear of all liens and claims to do with what he chooses. The Secured Lender will be left with nothing but payment of a fraction of its secured debt while the Property it explicitly bargained for to secure such payment is stripped from its hands. This treatment is the very definition of unfair and inequitable and for these reasons, the Plan is unconfirmable. Accordingly, this Court should not approve the Disclosure Statement.

B. The Disclosure Statement Fails to Provide Adequate Information

The purpose of a disclosure statement is to provide "adequate information" to creditors and other parties in interest about the terms of a proposed plan, allowing for both an informed vote and knowledgeable participation in the confirmation process. In re Holm, 1991 U.S. App. LEXIS 8172, at *5 (9th Cir. 1991); In re Comm. W. Fin. Corp., 761 F.2d 1329, 1331 (9th Cir. 1985). Section 1125 of the Bankruptcy Code requires a debtor to provide full and fair disclosure. The disclosure statement must contain information adequate to allow hypothetical reasonable investors typical of members of the relevant class to make an informed judgment about the plan. 11 U.S.C. § 1125(a). The Bankruptcy Code defines "adequate information" in relevant part as:

> information of a kind, and in sufficient detail, as far as reasonable practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of claims or interests in the relevant class to make an informed judgment about the plan ....

11 U.S.C. § 1125(a)(l).

Torres, as plan proponent, bears the burden of establishing that the Disclosure Statement contains adequate information. See In re Machelson, 141 Br. 715, 720 (Bankr. E.D. Calif. 1992). The Disclosure Statement fails to provide adequate information as required by Section 1125 of the Bankruptcy Code in the following areas, among others:

- No detail is provided regarding the treatment of the Secured Claim of the Secured Lender should the Secured Lender make an election under Section 1111(b) of the Bankruptcy Code. The Disclosure Statement and the Plan simply provide no information at all regarding rate on interest, amortization schedule or maturity date, along with other basic economic terms under this option. Absent some meaningful explanation of the proposed economic treatment of the Secured Lender's secured claim under a Section 1111(b) election, the Secured Lender cannot make an informed decision as to how it will respond to the Plan. The Plan and the Disclosure Statement must provide the details of such treatment.

- The Disclosure Statement fails to provide any information necessary to judge the feasibility of the Plan.[12] There are neither historical financial statements nor projected financial statements to assist creditors in analyzing whether the proposed reorganization is feasible. Given that the sole distribution being provided to general unsecured creditors in this case is a share of the Debtor's equity, creditors must be able to ascertain whether that equity will have any value in the future. This requires Torres to provide information regarding his business plan, his ability to develop the Property and risk factors which may impede his ability to do so. On this basis alone,

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[12] Section 1129(a)(11) of the Bankruptcy Code requires that confirmation of the plan not "likely be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan …". 11 U.S.C. §1129(a)(11). Any plan of reorganization must offer "a reasonable assurance of success." Kane v. Johns-Manville Corp., 843 F.2d 636, 649 (2d Cir. 1988).

this Court should deny approval of the Disclosure Statement because without additional information, Torres cannot establish Plan feasibility.[13]

- There is no liquidation analysis attached to the Disclosure Statement comparing what creditors will receive under the proposed Plan to what creditors would receive in a Chapter 7 liquidation.

- The Disclosure Statement makes no mention of Torres' intentions with regard to objections to claims, the pursuit of preference or fraudulence conveyance actions, or other actions or proposed actions that may recover assets for the benefit of the estate.

- The Disclosure Statement should identify those claims to which Torres intends to object. Without identifying such claims, the Plan and Disclosure Statement establish a regime pursuant to which creditors voting for the Plan do not know whether their claims will ultimately be the subject of an objection and/or whether Torres will assert affirmative claims against them. Under this arrangement, creditors cannot know what the projected recovery would be under the Plan regardless of their affirmative vote for the Plan because their claims may be subject to objection and/or they may have offsetting claims asserted against them so that they may receive no payment at all. Accordingly, the Disclosure Statement should identify those claims to which Torres intends to object or those creditors against whom Torres intends to assert affirmative claims.

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[13] "In determining whether a plan meets the requirements of §1129(a)(11), … 'the bankruptcy court has an obligation to scrutinize the plan carefully to determine whether it offers a reasonable prospect of success and is workable.'" Travelers Ins. Co. v. Pikes Peak Water Co. (In re Pikes Peak Water Co.), 779 F.2d 1456, 1460 (10th Cir. 1985) (quoting Pizza of Hawaii. Inc. v. Shakey's, Inc. (In re Pizza of Hawaii, Inc.), 761 F.2d 1374, 1382 (9th Cir. 1985)). Specifically:

> When determining whether a plan is feasible, courts often consider a debtor's cash flow projections, showing its ability to simultaneously make plan payments and fund projected operations. The projections must be based on evidence of financial progress and must not be speculative, conjectural or unrealistic. While courts often do not require projections for the same period over which a long term plan spans, a debtor must still sustain its burden to somehow prove that it will be able to perform all obligations it is assuming under the plan. This is especially true when significant balloon payments are required in years not covered by the projections.

In re Investment Company of the Southwest, Inc., 341 B.R. 298, 311 (10th Cir. 2006).

- The Disclosure Statement fails to indicate that the Secured Lender intends to oppose the Plan and argue before the Bankruptcy Court that the Plan violates the requirements of the Bankruptcy Code, among other confirmation issues.

- The Disclosure Statement does not identify any of the directors, members or officers proposed to serve on the initial board of directors or as an officer or member of the Reorganized Debtor and the nature of compensation. It likewise fails to identify any insiders of the Debtor who will be employed and their compensation. Under the circumstances, these disclosures should be made and included in the Disclosure Statement so that parties in interest can make an informed decision on the Plan and whether an objection is appropriate.

- The Disclosure Statement fails to indicate whether Torres has any relationship or other connection to the Debtor, its insiders, including Gamboa, and/ or its affiliates. Understanding these relationships is vitally important in determining whether the proposed transaction under the Plan is truly at arm's length and fair and equitable to creditors.

- The Disclosure Statement fails to describe the current ownership structure of the Debtor as well as any other individuals or entities holding an ownership interest in the Property.

WHEREFORE, the Secured Lender respectfully requests that this Court enter an order sustaining this Objection, denying approval of the Disclosure Statement, and granting such other relief as this Court deems just and proper.

Dated: July 3, 2014

BALLARD SPAHR LLP

By: /s/ *Christopher Celentino*
Christopher Celentino
Counsel for Counsel for Essel Enterprises, LLC