UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In the Matter of:	Case No. 10-47089-RJK
PFG ASPENWALK, LLC,	Chapter 11
Debtor.	Honorable Robert J. Kressel

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BANK OF AMERICA'S OBJECTION TO
THE DEBTOR'S MOTION FOR ORDER AUTHORIZING
DEBTOR TO OBTAIN DEBTOR-IN-POSSESSION FINANCING

Bank of America, N.A. ("Bank of America"), by its undersigned counsel, Miller, Canfield, Paddock and Stone, PLC, and Gray, Plant, Mooty, Mooty & Bennett, P.A. objects to the debtor's Motion for Order Authorizing Debtor to Obtain Debtor-in-Possession Financing. (Doc. No. 102). In support of this objection, Bank of America respectfully represents as follows:

I. SUMMARY OF ARGUMENT

1. The debtor has proffered no evidence that Bank of America is adequately protected or that the funds requested are necessary to obtain Final Planned Unit Development Approval ("Final PUD Approval"). Even if Final PUD Approval would impart some value to the property, the vast majority of the funds requested in the debtor's motion are not even directly connected to obtaining this approval because they are allocated to pay the debtor's bankruptcy counsel, to fund "Developer Overhead" and for unspecified contingency costs. Furthermore, even though the debtor's plan is entirely contingent upon obtaining $9,000,000 in new financing it has not provided any evidence that it will indeed obtain this financing. The one letter of interest the debtor has produced provides that the lender will make a loan up to 55% of the market value of the property and based upon the debtor's own estimate of the property's value it could not obtain even a $7,000,000 loan. With the confirmation hearing on the debtor's plan set for next month, all of the funds requested by the debtor should be contingent upon the debtor

confirming its plan. Without any assurance of new financing or evidence that Bank of America is adequately protected, allowing further priming borrowing to pay costs wholly unrelated to Final PUD Approval would further impair Bank of America's collateral position pocket and cannot be allowed. The bank cannot be forced to throw good money after bad.

II. BACKGROUND

A. Funding Stipulations and SARE Order

2. Approximately nine months ago, this single asset real estate debtor commenced its chapter 11 bankruptcy case. It valued its real property at $12,000,000.[1] The Debtor did not at the inception of the case, nor at any time thereafter, submit any evidence of value other than affidavits of its principals.

3. On its bankruptcy filing day, the debtor also requested DIP financing which would prime Bank of America's first priority lien on its property because it needed additional funds to obtain Final PUD Approval.[2] Due to the debtor's insistence that additional funding was necessary to obtain Final PUD Approval, Bank of America subsequently entered into three stipulations with the debtor allowing hundreds of thousands of dollars in priming financing. As of May 10, 2011, the debtor owed the priming lender, Rapid Funding, LLC, approximately $820,410.37 (inclusive of principal and interest). By the debtor's own estimate, the amount advanced thus far is far in excess of the necessary third party costs to obtain Final PUD Approval.

[1] *See*, *e.g.*, Notice of Hearing and Motion for (I) Expedited Relief, (II) Interim and Final Orders Authorizing Debtor to Obtain Debtor-in-Possession Financing and Approving the Debtor-in-Possession Loan That Includes the Grant of a Senior Lien Under 11 U.S.C. § 364(D), and Provide Adequate Protection ("Priming Motion"), Doc. No. 6, ¶ 29 ("The Development Property is currently valued at approximately $12,000,000.00.") and the Debtor's Schedules.

[2] *See* Priming Motion, ¶¶ 27-30.

B. Amended Disclosure Statement and Plan

4. One month ago, the debtor filed its amended disclosure statement and plan which provide that the plan will be funded by obtaining $9,000,000 in new financing. Amended Disclosure Statement at 12. (Doc. No. 93). The new financing will be necessary to, among other things, retire the DIP financing and Bank of America's secured claim. Obtaining the new financing is a prerequisite to confirmation of the plan and the deadline for plan confirmation is August 1, 2011. *Id.* at 24; Doc. No. 52.

5. Despite the immanency of the confirmation date, the debtor has provided little evidence of its ability to obtain financing. The one letter of interest the debtor provided to Bank of America, dated February 23, 2011, provides that the new financing is subject to, among other things, a fifty-five percent loan to market value ratio as determined by an appraiser. *Id.; see also* Ex. 1, Kennedy Letter of Interest. Despite these requirements, upon information and belief, neither the Debtor nor its potential lender have engaged an appraiser nor has the debtor provided Bank of America with any evidence that the property is worth more than the $16.3 million which would be required for a $9,000,000 loan under the Kennedy Letter of Interest. Thus, based upon the debtor's own statements of value, it will not be able to obtain sufficient financing to confirm its plan.

C. The Debtor's Motion

6. The debtor now seeks permission to borrow an additional $370,000 which would further prime Bank of America. It does so with no evidence that the additional funds will provide commensurate value or adequate protection to Bank of America.

7. Much of the borrowing sought is to either pay legal counsel or is budgeted as "contingency" with no specific purpose. In its request, the debtor also budgets another $40,000 for its own officers as "Developer Overhead." These items, $290,750 or nearly 80% of the

debtor's request, have no direct relationship to the debtor's stated purpose of obtaining Final PUD Approval and will provide no enhancement in the value of the project.

III. ARGUMENT

8. "Granting post-petition financing on a priming basis is extraordinary and is allowed only as a last resort." *In re YL West 87th Holdings I LLC*, 423 B.R. 421, 441 (Bankr. S.D.N.Y. 2010). "[P]riming is impermissible unless there is adequate protection to existing lien holders." *Id.* The debtor has the burden of proving that adequate protection, the "indubitable equivalent" of the secured lender's original lien, has been provided. *Id.* n.44; 11 U.S.C. § 361(3); *see also Suntrust Bank v. Den-Mark Constr., Inc.*, 406 B.R. 683, 694 (E.D.N.C. 2009). The protection "should as nearly as possible under the circumstances of the case provide the creditor with the value of his bargained for rights." *Resolution Trust Corp. v. Swedeland Dev. Corp. (In re Swedeland Dev. Corp.)*, 16 F.3d 552, 564 (3d Cir. 1994) (en banc) (quoting *In re Martin*, 761 F.2d 472, 476 (8th Cir. 1985)). Protection is adequate if it "provide[s] the pre-petition secured creditor with the same level of protection it would have had if there had not been post-petition superpriority financing." *Id.* The debtor must ground its proof in fact. *In re Mosello*, 195 B.R. 277, 292 (Bankr. S.D.N.Y. 1996) ("[a] finding of adequate protection should be premised on facts, or on projections grounded on a firm evidentiary basis.")

9. Courts recognize that Congress based its requirement for "adequate protection" on both Constitutional and policy grounds. As noted in the House Report on 11 U.S.C. § 364,

> [Adequate protection] is not intended to be confined strictly to the constitutional protection required, however. The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interests. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.

Id. at 288-89; *see also Suntrust Bank*, 406 B.R. at 694.

10. In its first motion for priming financing the debtor cited two cases, *Hubbard Power & Light* and *Aqua Associates*[3] for the proposition that increasing the value of the secured party's collateral suffices as adequate protection. In both cases, the increased value was a virtual certainty. In *Aqua Associates*, the debtor had already lined up a prospective tenant prepared to enter a lease; all that was required was that the debtor complete construction on a building, a process estimated at taking only a few months. 123 B.R. at 194. The construction would enable the debtors to file a plan that paid all creditors in full over time. *Id.* Likewise, in *Hubbard Power & Light*, the land securing a lien needed to be cleaned up to have any significant value. 202 B.R. at 681-682. Only Enron was willing to lend to the debtor. *Id.* The *Hubbard Power & Light* court found that the objecting "secured" lender was adequately protected against loss because the value of its lien was $0 without the cleanup and much higher with it. *Id.* at 685. In both cases, the secured party had virtually nothing to lose by being primed. In such circumstances, priming may be appropriate.

11. These holdings and the prior case law cited suggest that priming is permissible when the benefit to be obtained is a virtual certainty and impermissible if there is a real risk to

[3] *In re Hubbard Power & Light*, 202 B.R. 680 (Bankr. E.D.N.Y. 1996) and *In re Aqua Assocs.*, 123 B.R. 192 (Bankr. E.D. Pa. 1991).

the secured lender's position. Where the "successful rehabilitation of the Subject Property is highly speculative" and "the equity cushion at the debtor level is tenuous at best," priming is inappropriate. *YL W. 87th Holdings I*, 423 B.R. at 442-44 (comparing cases with certainty and where speculation is involved). It takes a lot more than hope to support priming, especially when, as here, the debtor offers no new collateral. *Suntrust Bank*, 406 B.R. at 702 (holding that where the debtor had not lined up necessary further funding and had a thin equity cushion in case of failure, priming was inappropriate); *Swedeland Dev. Corp.*, 16 F.3d at 566 ("Those cases which have considered improvements to be adequate protection have done so only when the improvements were made in conjunction with the debtor's providing additional collateral beyond the contemplated improvements."); *Fayette Bank v. Nesser (In re Nesser)*, 206 B.R. 357, 370-71 (Bankr. W.D. Pa. 1997) (denying request for credit due to speculative nature of venture); 3 COLLIER ON BANKRUPTCY, *supra*, ¶ 364.05[1] ("When the effect of the new borrowing is merely to pass the risk of loss to the holder of the existing lien, the request for authorization should be denied absent the lien holder's consent."). Perhaps the court in *Mosello* summarized it best:

> [The secured lender] is asked to underwrite this risk for the sole benefit of unsecured creditors and the debtors with no offsetting compensation or opportunity to benefit if the project is successful, and with no control whatever over the funding or the work. Not surprisingly, the courts have not endorsed similar requests. . . . "In this case the secured creditor is being made to subordinate so that those with lower priority can potentially make a profit. This is not to be allowed. . . . . The debtor wants the best of all worlds-to use this creditor's money without risk and to keep the profits for itself.

Mosello, 195 B.R. at 293 (quoting *In re Chevy Devco*, 78 B.R. 585 (Bankr. C.D. Cal. 1987)).

12. Thus, maintaining or improving the value of collateral is permissible via priming, *but only if the benefits are nearly certain.* The debtor may not speculate with the secured lien holder's collateral.

13. The debtor has the burden of proving that Bank of America is adequately protected with the indubitable equivalent of its current security interest. *Swedeland Dev. Corp.*, 16 F.3d at 564. It must do so with firm evidence. *Id.* at 292; *YL West 87th Holdings I*, 423 B.R. at 441 n.44; *Suntrust Bank*, 406 B.R. at 694. However, in its motion, the debtor seeks to further prime Bank of America's bargained-for security interest without even attempting to show why this request is necessary for Final PUD Approval.

14. For 80% of its request, the debtor has made no showing that spending on these activities will enhance the value of the estate.

15. For the remaining 20%, the debtor has made no showing that the borrowing is necessary to obtain Final PUD approval. The debtor has not even asserted as such. The most the debtor says on the point is contained in paragraph 45 of its motion:

> Obtaining another advance from the DIP Loan will allow the Debtor to continue operations and work towards a successful reorganization of its operations and the Development Property. Such actions will serve the best interest of the Debtor's estate, Bank of America, and the Debtor's other creditors

Thus, the basis for the request is the vague statement that it will help the estate. No factual basis is put forward to show that the money is needed now or at all. This is not surprising, given that 80% of the borrowing requested appears to activities that do not directly benefit the estate.

16. The information that the debtor has provided to Bank of America makes it clear that the debtor does *not* need this money for Final PUD approval. Instead, it seems that the debtor would like the luxury of a cash cushion in the form of "contingency," as well as additional funding for its officers. That is a luxury a debtor in bankruptcy cannot afford.

17. It is fundamentally unfair to require Bank of America to incur additional risk without proof that the debtor needs the money for a purpose that directly benefits the estate. Furthermore, no proof exists that Bank of America remains adequately protected today and even

based upon the debtor's own estimates it will not be able to confirm its plan. Bank of America agreed to DIP financing at the inception of the case in the belief that the Debtor would obtain Final PUD Approval and confirm a plan of reorganization. Over the course of the case, however, it has become far less likely that the debtor will be able to obtain the necessary exit financing. Until it is able to do so, no further funds are needed or should be allowed. Since essentially all of the current request is for the benefit of the debtor's attorneys and managers, it is not unfair to require them to wait until confirmation and be paid from the exit financing.

IV. CONCLUSION

Accordingly, Bank of America respectfully objects to the debtor's motion and requests that the court DENY the debtor's request to borrow additional funds.

Respectfully submitted,

MILLER, CANFIELD, PADDOCK AND STONE, P.L.C.

By: /s/ Marc N. Swanson

Timothy A. Fusco (P13768)
Marc N. Swanson (P71149)
Ronald A. Spinner (P73198)
Attorneys for Secured Creditor Bank of America, N.A.
150 West Jefferson, Suite 2500
Detroit, MI 48226
(313) 963-6420
swansonm@millercanfield.com

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GRAY, PLANT, MOOTY, MOOTY & BENNETT, P.A.

By /s/ William J. Fisher

William J. Fisher (#167137)
Jessica Mitchell (#0389738)
500 IDS Center
80 South 8th Street
Minneapolis, Minnesota 55402
Telephone: (612) 632-3000
Facsimile: (612) 632-4444
william.fisher@gpmlaw.com
jessica.mitchell@gpmlaw.com

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