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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

FRESNO DIVISION

In re: SOUTH LAKES DAIRY FARM, Debtor and Debtor-in-Possession.	Case No.: 12-17458-B-11 Chapter 11 DCN: KDG-17 **OPPOSITION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTOR'S PLAN OF REORGANIZATION** Hearing Date and Place Date: July 18, 2013 Time: 9:00 a.m. Place: 2500 Tulare Street Fresno, CA 93721 Courtroom 11 Judge: Honorable W. Richard Lee

1 The Official Committee of Unsecured Creditors (the "Committee") of South Lakes Dairy Farm
2 (the "Debtor"), by and through its undersigned counsel, hereby files its objection to Debtor's Plan of
3 Reorganization (the "Plan"), stating as follows:

4 **ARGUMENT**

5 **A. The Plan Violates the Absolute Priority Rule**

6 1. Courts have held that unsecured creditors must be paid in full prior to any junior class
7 receiving or retaining any property under a plan of reorganization. *See In re Tucson Self-Storage, Inc.*,
8 166 B.R. 892, 900 (9th Cir. BAP 1994); *Norwest Bank Worthington*, 485 U.S. 197, 2002 (1988). This
9 concept is termed the absolute priority rule. It is important to take note of the timing of the triggering
10 of the absolute priority rule. The general nonpriority unsecured creditors must be provided for in full
11 *before* any junior class can receive or retain any property under a plan. *Norwest*, 485 U.S. at 202.

12 2. Courts in the "Ninth Circuit now recognize the new value exception to the absolute
13 priority rule." *In re Tucson Self-Storage, Inc.* at 899. In short, "[t]he new value exception allows the
14 equity owners of a debtor in bankruptcy to obtain an interest in the reorganized debtor in exchange for
15 new capital contributions over the objections of a class of creditors that have not received full payment
16 on [their] claims." *Id.*

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3. The Plan provides that class fourteen (14) shall be comprised of the partnership interests in the Debtor, and that the partners (the "Partners") are to retain those partnership interests in the Debtor post-confirmation. S*ee* Plan, p. 10, lines 6-7. The Plan, however, does not provide that the Partners are to pay any value for the partnership interests. Those interests are retained by the Partners without their providing any new value. In fact, over the life of the Plan, the Partners are to receive more payments from the Debtor in the form of partner draws than the total of payments to unsecured creditors.[1] The Partners are retaining interests in a business that will shed $8.8 million in unsecured debt, and substantially pay down its secured debt, without paying a single cent from their pockets over the life of the Plan. What is more, the Debtor is to pay the carrying costs of the real property it operates on, which is owned by a majority of the Partners, and so the Partners will also enjoy the increase in equity in the underlying real property that the Debtor will be required to pay for without any value added by the Partners as well.

4. The Bankruptcy Code and case law is clear that the Partners may not retain their interests in the Debtor, which interests are subordinate to those of unsecured creditors' claims, until unsecured creditors are first repaid in full. The Plan cannot be confirmed as drafted in that it violates the Absolute Priority Rule.

B. The Plan Improperly Vests Unanticipated Profits In The Debtor

5. The Plan and Disclosure Statement provide that "[i]f unanticipated profits are generated during the term of the Plan, they will remain with Debtor as capital to ensure Debtor remains viable." Disclosure Statement Dated May 9, 2013, p. 22, lines 4-6. To the extent these "unanticipated profits" exceed $1.5 million, those funds are to be paid to Wells Fargo under the terms of the Plan. *Id.* at lines 9-14.

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[1] The Plan provides distributions to general unsecured non-priority claims over five (5) years of $1.2 million. Partner draws over the same five (5) years totals $1.856 million.

1 6. The Committee believes that the Plan is attempting to improperly funnel assets to the
2 Partners through this term. Wells Fargo is to be paid in full by the third anniversary of the effective
3 date of the Plan. Ergo, to the extent there are “unanticipated profits” after year three (3), the sweep by
4 Wells Fargo does not apply. What is more, the Debtor’s justification for retention of the “unanticipated
5 profits” is, at best, confusing. On the one hand the Debtor presents the Plan as being feasible,
6 specifically stating that it “believes that the capital shown in the Budgets is thin, but sufficient.” *Id.* at
7 lines 9-10. On the other hand the Debtor states that the “unanticipated profits” must be retained to
8 “ensure the Debtor remains viable.” *Id.* Either the Debtor’s Plan is feasible, or it is not. If it is
9 feasible, which the Debtor claims to be the case, then these profits should flow to unsecured creditors.
10 The failure to provide unsecured creditors with these profits is merely a further ploy to shift loss to the
11 unsecured creditors for the benefit of the Partners. After year three (3) post-confirmation, there is no
12 reason that these profits should not be paid to unsecured creditors.

13 **C. The Plan Does Not Meet The Best Interest Of Creditors Test**

14 **7**. Where the general partners of a partnership debtor are solvent and are personally liable
15 for the partnership's debts under state law, partnership creditors would receive 100% of their claims in
16 a Chapter 7 liquidation. Consequently, any Chapter 11 plan proposed for the partnership debtor would
17 have to pay 100% to the nonconsenting creditors to satisfy the "best interests of creditors" test. *See In*
18 *re Monetary Group*, 55 B.R. 297, 299 (Bankr. MD FL 1985); *see also In re Diversified Investors Fund*
19 *XVII*, (BC CD CA 1988) 91 B.R. 559, 561-562 (Bankr. CD CA 1988). In such cases, the plan
20 proponent must provide evidence of the general partners' net worth. This may be done by declaration
21 or live testimony; or the court may require general partners to file a FRBP 1007(g) statement listing
22 their assets and liabilities. *See In re Monetary Group*, 55 B.R. at 299; *see also In re Diversified*
23 *Investors Fund XVII*, 91 B.R. at 562; *see also In re Union Meeting Partners*, 165 B.R. 553, 575
24 (Bankr. ED PA 1994).
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8. The Debtor is a California general partnership. Partners in a general partnership under California law are personally liable, jointly and severally, for partnership debts, obligations, and liabilities. Corp. Code §§ 16305 and 16306(a). A general partner's liability is not limited to that partner's percentage interest in the partnership, but extends to his or her other assets as well. *Id.*

9. The Debtor must provide, through admissible evidence, evidence of the general partners' net worth. The only evidence provided thus far is a statement in Exhibit A, page 24 of the Disclosure Statement that, in a completely conclusory fashion, claims that there are "non-exempt partner assets ($1,368,000) with a reduction for the 2012 income tax liability ($159,627) and estimated capital gains and taxes resulting from the liquidation of the above property ($925,624)." This Court, nor the creditors of the Debtor, have any idea of what the net worth of the Partners are. The Plan cannot be confirmed unless the Debtor provides clear evidence of the net worth of the Partners showing them to be unable to fund debts of the Debtor.

D. The Plan Does Not Disclose The Timing And Identification Of Targets Of Avoidance Actions That Are To Be Filed By The Debtor

10. The Plan and Disclosure Statement provide that the Debtor is retaining causes of action against third parties, and particularly parties that received payments from the Debtor within the ninety (90) days prior to the petition date under § 547 of the Bankruptcy Code. *See* Disclosure Statement, p. 13, lines 4-10. The Plan does not provide the identity of potential targets of preference actions or the amounts of those actions, much less an estimate of recoveries. Ergo, parties-in-interest that are targets of an avoidance action are unsure of what amount their distributions under the Plan may be decreased by. Further, parties-in-interest are unsure of the amounts that their claims may increase by due to any potential avoidance actions recoveries. The Plan cannot be confirmed without this information. Parties-in-interest have a right to know whether the forecasted payout to them under the Plan may be lower than forecasted due to potential preference liability.

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E. There Are A Number Of Inconsistencies And Instances Of Non-Disclosure Regarding The Real Property Lease

11 The Debtor operates on a parcel of real property owned by a majority of the Partners. The Disclosure Statement and Plan provide that "Debtor believes that the Landlord and Debtor will agree to a modification of the lease that will allow Debtor to continue to lease the real property." Disclosure Statement, p. 17, lines 1-5. On July 3, 2013, the Debtor filed that Declaration of Ryan Schakel in Support of Motion (the "Motion") to Assume Unexpired Nonresidential Real Property Lease with Lessor, Schakel Family Partnership, L.P. as Modified (the "Schakel Declaration"). Docket No. 372. The Schakel Declaration and the underlying Motion it supports act as that modification of the real property lease referred to in the Disclosure Statement and Plan.

12. The Schakel Declaration asserts that the "Debtor is **not** in default or in arrears on its lease, except that Debtor and Lessor agreed to reduce the monthly rental rate to $105,500 per month after the commencement of the case and after negotiation with Wells Fargo Bank as a part of obtaining use of cash collateral. (emphasis added) Schakel Declaration ¶ 9. From this statement, it is clear that the Debtor owes no amounts under its lease with the lessor other than the amounts on a going forward basis. However, the Motion requires that the Debtor pay Lessor $90,000 as a "partial cure of the rent payment default under the Lease…" (emphasis added) *Id.* at ¶ 13. The estate should not be responsible for any cure in assuming the lease when the landlord has agreed that the post-petition modification was not a breach of the lease, meaning the lease is not in default, and further meaning that there are no arrears. Even if there are amounts owing, the Debtor leaves the cure amount open ended. The $90,000 is only a partial cure, according to the Motion, of the landlord's breach with its lender, Farm Credit West. In fact, the Schakel Declaration asserts that the $90,000 is only 1/5 of the amount outstanding under the note with the landlord's lender. Whether the Debtor will be responsible for any further amounts is never made clear. There is potentially $450,000 in amounts owing to the landlord's lender that the landlord may in the future be requesting that the Debtor to pay as a cure to assume the lease.

1 13. The Disclosure Statement and Plan never mention a cure payment being made to the
2 landlord, and the Motion appears to suggest that the cure payment may be more than the $90,000. The
3 Debtor never explains how this cure payment(s) will affect the Plan, or even disclose the ultimate cure
4 amount.

5 14. What is more, the amount of rent moving forward is uncertain. The Debtor's Plan
6 projections show $140,000 per month being paid in rent through the entirety of the Plan. However, the
7 Schakel Declaration provides that the "Debtor estimates that the rent will be about $140,000 per month
8 until and unless the interest rates on Lessor's loans vary." *Id.* at ¶ 10. To test feasibility, the Court and
9 parties-in-interest need to know the extent that the rent under the lease could vary.

10 15. The Debtor has stated that the Plan is thin. The Debtor must flesh out the issues related
11 to the lease of the real property for the Committee to properly analyze the feasibility of the Plan.

12 **F. The Plan Is Not Feasible On Its Face**

13 16. The Disclosure Statement provides that the full amounts owed to Wells Fargo "will be
14 all due and payable three years from the Effective Date of the Plan." Disclosure Statement, p. 16, lines
15 11-12. The Disclosure Statement's income and expense projections show the Debtor owing roughly
16 $10 million on a date that is thirty-six months from the effective date of the Plan. What is also clear
17 from the income and expense projections of the Disclosure Statement is that the Debtor is projected to
18 run cash balances between $374,000 and $670,000 in the years 2015 and 2016. Thus, the Debtor will
19 not have the cash to pay the Wells Fargo liens in full. This means there will need to be a refinancing
20 of the debt to Wells Fargo. The Disclosure Statement also does not establish that a refinance would be
21 feasible at that point. Creditors are left to guess what the state of the Debtor will be three (3) years
22 from the effective date, which, if history tells a story, would not be good.

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WHEREFORE, the Committee respectfully requests that this Court not confirm the Plan, and for such other relief as the Court deems just and appropriate.

Dated: July 5, 2013

By: __/s/Ronald A. Clifford______________
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Ronald A. Clifford
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