

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
FRESNO DIVISION

In re Case No. 13-12551-A-11
Wide West Services, LLC, DC No. HWL-3
Debtor.

MEMORANDUM DECISION

Section 1112(b)(4)(A) of the Bankruptcy Code authorizes dismissal of a Chapter 11 bankruptcy where there is continuing loss to the estate and no reasonable likelihood of rehabilitation. The debtor in possession operates a 162-unit apartment complex. It has been consistently losing money before and after the bankruptcy. It has no demonstrated access to working capital and, other than hiring a property manager, no specific plan to become profitable. Should the court dismiss this case?

HISTORY

The debtor in possession Wide West Services, LLC ("Wide West") is owned and operated by Vinod Kaura and Veena Kaura (the "Kauras"). It has two major assets: A 162-unit apartment complex in Bakersfield, California, known as Pacific Pines, and a claim against Wells Fargo Bank ("Wells Fargo"). The apartment complex has an estimated value of \$7.2 million. It is encumbered by a first deed of trust in favor of Wells Fargo and a second deed of trust in favor of LSREF2 Chalk, LLC ("Chalk"). The aggregate amount due to these lenders exceeds \$8.2 million. Wide West's claim against Wells Fargo is estimated at \$14 million, but the claim appears to be unliquidated and contingent.

Wide West or its predecessor, the Kauras, have owned Pacific Pines since 2005. The Kauras were absentee owners, leaving daily management duties to onsite manager Gabriel Ramos and his daughter Faviola. Pacific Pines has also been consistently losing money since 2010, requiring infusions of cash from the Kauras. In the spring of 2012, the complex was collecting approximately \$32,000 in monthly rent. However, expenses were running more than \$82,000 per month, consisting of \$59,000 in secured debt service; \$15,000 in utilities, insurance, and maintenance; and \$8,300 in property taxes.

1 In 2012, of the mind that the loan was in default, Wells Fargo
2 instituted a judicial foreclosure against the property. See *Wells*
3 *Fargo Bank, N.A. v. Kaura*, No. S-1500-CV-276872-NFT (Cal. Sup. Ct.
4 Kern Cnty. 2012). The bank sought the appointment of a receiver to
5 take control of Pacific Pines and collect the rents. The Kern County
6 Superior Court agreed and entered an order appointing Josh M. Hodeda
7 ("Hodeda") to act as receiver. That order also required that the
8 Kauras turn over specified records to Hodeda.

9 When Hodeda took over in June 2012, the affairs of Pacific Pines
10 were not in order. The complex had substantial deferred maintenance,
11 boarded windows, 20 abandoned cars on site, enough debris to fill 14
12 40-yard dumpsters, squatters in some units, and groups of people who
13 were neither tenants, nor their guests, regularly loitering in the
14 parking lot. Similarly, management was lacking. Tenant security
15 deposits were not placed in separate accounts. The roll of tenants
16 was not fully supported by rental agreements. Many tenants were not
17 paying rent or were paying it late. The average monthly rent
18 collected for the entire 162-unit complex in the spring of 2012, was
19 \$32,461 per month, or just over \$200 per unit per month.

20 As the receiver, Hodeda attempted to improve the condition of the
21 property and increase profitability. Under his supervision, extensive
22 cleanup efforts had been undertaken, squatters evicted, the property
23 made more secure, new management installed, and tougher rent policies
24 implemented. Revenues increased, but the complex was not yet
25 profitable. As a result, Wells Fargo had to pay \$100,000 for the
26 property taxes and advanced Hodeda an additional \$260,000 to cover the
27 operating shortfall.

28 Perceiving that the Kauras had not fully complied with the Kern

1 County Superior Court's order to turn over records, Wells Fargo
2 brought an order to show cause for contempt against the Kauras
3 individually. Yet, immediately prior to the hearing on this contempt
4 citation, the Kauras caused Wide West to file for Chapter 11
5 bankruptcy protection on April 11, 2013.

6 After the filing, Wide West stipulated that Hodeda would remain
7 in place as the receiver of Pacific Pines. In the following months,
8 he has increased rent revenues to \$40,000 to \$45,000 per month. Yet,
9 even with these increased revenues and the prior financial assistance
10 from Wells Fargo, Hodeda has been unable to service the secured debt
11 throughout his time as the receiver, both before and after the
12 petition date.

13 Wells Fargo and Chalk have now filed a motion to dismiss the case
14 for cause under 11 U.S.C. § 1112(b). Among other grounds, the movants
15 argue that cause exists based on the continuing loss to the estate and
16 the absence of a reasonable likelihood of rehabilitation.

17 DISCUSSION

18 **I. Cause Includes Continuing Loss to the Estate and the Absence of a** 19 **Reasonable Likelihood of Rehabilitation**

20 On request of a party in interest and after notice and a hearing,
21 the court shall dismiss a Chapter 11 case or convert it to a Chapter 7
22 case, "whichever is in the best interests of creditors and the
23 estate," for cause shown. 11 U.S.C. § 1112(b)(1). In deciding such
24 motions, the court must engage in a two-step analysis. See *Rollex*
25 *Corp. v. Associated Materials, Inc. (In re Superior Siding & Window,*
26 *Inc.)*, 14 F.3d 240, 242 (4th Cir. 1994). First, the court must
27 ascertain whether cause exists. *Id.* Second, if the court finds that
28 cause exists, it must decide whether dismissal or conversion better

1 serves the interests of creditors and the estate. *Shulkin Hutton,*
2 *Inc., P.S. v. Treiger (In re Owens)*, 552 F.3d 958, 960-61 (9th Cir.
3 2009); *Superior Siding & Window*, 14 F.3d at 242.

4 The moving party bears the burden of proving by a preponderance
5 of the evidence that cause exists. *In re Creekside Senior Apartments,*
6 *L.P.*, 489 B.R. 51, 60 (B.A.P. 6th Cir. 2013). Once the moving party
7 has met its burden, it is incumbent on the debtor to show that relief
8 is not warranted. See *In re Woodbrook Assocs.*, 19 F.3d 312, 317 (7th
9 Cir. 1994).

10 Turning back to the first step of the § 1112(b) analysis, the
11 court notes that cause includes the "continuing loss to . . . the
12 estate and the absence of a reasonable likelihood of rehabilitation."
13 11 U.S.C. § 1112(b)(4)(A).

14 **A. Continuing Loss to the Estate**

15 The continuing loss element of § 1112(b)(4)(A) may be satisfied
16 by showing a loss that will "materially negatively impact the
17 bankruptcy estate and the interest of creditors" or "dwindling
18 liquidity, or illiquidity resulting in unpaid postpetition debts which
19 usually constitute administrative expenses that will take priority
20 over prepetition claims." *Hassen Imports P'ship v. City of W. Covina*
21 *(In re Hassen Imports P'ship)*, BAP No. CC-13-1042-KiPaD, 2013 WL
22 4428508, at *13 (B.A.P. 9th Cir. Aug. 19, 2013) (quoting 7 Collier on
23 Bankruptcy ¶ 1112.04[6][a][i] (Alan N. Resnick & Henry J. Sommer eds.,
24 16th ed. 2012)). "This element can be satisfied by demonstrating that
25 the debtor incurred continuing losses or maintained a negative cash
26 flow position after the entry of the order for relief." *Id.* (quoting
27 *In re Schriock Constr., Inc.*, 167 B.R. 569, 575 (Bankr. D.N.D. 1994)).
28 In evaluating the continuing loss prong, the court does not accept the

1 financial statements at face value but must "fully evaluate the
2 present condition of a debtor's estate." *Id.* (citing *In re Motel*
3 *Props., Inc.*, 314 BR. 889, 894 (Bankr. S.D. Ga. 2004)).

4 Since the order for relief, Pacific Pines has been cash flow
5 negative. In the months following the bankruptcy filing, Hodeda has
6 increased monthly revenues to \$40,000 to \$45,000. But postpetition
7 expenses still exceed these increased revenues, and Hodeda has only
8 been able to continue operations (1) by not servicing the secured
9 debts held by Wells Fargo and Chalk, (2) by causing Wells Fargo to pay
10 \$100,000 in annual property taxes, and (3) by obtaining the \$260,000
11 advance from Wells Fargo to pay operating expenses.

12 Wide West's redoubt is two-fold. First, excepting a short and
13 strategic default, Veena Kaura contends that they never missed a
14 payment to Wells Fargo or Chalk and, thus, she reasons, the property
15 can be operated profitably. But this statement is undercut by her own
16 testimony. Specifically, she admitted that Wide West was only able to
17 satisfy its obligations prepetition due to large cash infusions that
18 came in on a monthly basis. The property has been losing money since
19 2010. In spring of 2012, it was losing approximately \$41,000 every
20 month. In May 2012, the Kauras transferred \$83,000 from their
21 personal accounts to pay Wide West's obligations. And even then, Wide
22 West had substantial deferred maintenance costs left unaddressed by
23 the operating budget. Wide West has not introduced any evidence to
24 show that the circumstances have changed after the bankruptcy filing
25 that could show a profitable operation.

26 Alternatively, Wide West argues that the presence of the receiver
27 imposes an unnecessary and sizeable administrative burden on Wide
28 West, which interferes with its ability to become profitable. But

1 this argument lacks momentum. The receiver was appointed only in June
2 2012, but Pacific Pines has not been profitable since 2010. Thus,
3 Pacific Pines's inability to become profitable cannot be directly
4 attributable to the administrative burden of the receiver. Moreover,
5 the \$2,648 monthly management fees actually charged by Hodeda are
6 lower than those proposed by Wide West's expert, Allan Synder
7 ("Synder"), who estimated monthly management fees should be between
8 \$3,000 and \$6,000. Lastly, though Wide West criticizes Hodeda for
9 using companies in which he has an interest to provide vendor services
10 to Pacific Pines, there has been no showing that the fees charged by
11 Hodeda's companies are not actual or reasonable for the tasks
12 performed.

13 As a result, the court finds a continuing loss to the estate.

14 **B. Absence of Reasonable Likelihood of Rehabilitation**

15 For the second prong of § 1112(b)(4)(A), rehabilitation is a
16 different and higher standard than reorganization, which is usually
17 measured by the ability to confirm a plan. *Hassen*, 2013 WL 4428508,
18 at *14 (citing *In re Creekside Senior Apartments*, 489 B.R. at 61).
19 The key inquiry is whether the debtor's business prospects justify
20 continuance of the reorganization effort. *Id.*

21 In this instance, they do not. First, Wide West has no equity in
22 the apartment complex. Pacific Pines has a value of \$7.2 million,
23 while the secured debts against it total \$8.2 million.

24 Second, Wide West has no other significant assets. While
25 Schedule B does reveal an unliquidated, contingent claim of
26 \$14 million against Wells Fargo, there was no evidence offered as to
27 the viability of this claim or the amount of damages. Thus, Wide West
28 cannot reasonably rely on this potential source of capital to fund any

1 plan of reorganization, especially given the possible offsets by Wells
2 Fargo.

3 Third, Wide West has not demonstrated access to working capital.
4 Veena Kaura testified that she and her husband were personally willing
5 to fund Wide West's capital and operational needs. However, her
6 ability to do so is questionable. Synder, Wide West's expert on
7 apartment complexes, testified that he, as the new property manager,
8 would need an immediate \$305,000 capital contribution to renovate
9 apartment units and common areas. After such renovations, it would
10 take an additional eight to nine months to reach the target of 93%
11 occupancy. Until then, based on historical budgets, the complex would
12 have a \$40,000 monthly negative cash flow, requiring significant,
13 additional infusions of cash by the Kauras. But neither Veena Kaura,
14 nor any other witness, provided evidence as to the their ability to
15 withstand these cash flow needs.

16 Fourth, Wide West's plan, suggested by its expert Synder, is not
17 sufficiently concrete to justify further rehabilitation efforts. That
18 plan involves employing Synder as a property manager to create a more
19 profitable complex. But the court does not find Synder's testimony
20 credible on this point. Synder's work in the last 20 years has been
21 predominantly as an expert witness, rather than as an actual apartment
22 manager, and he has no experience with apartment complexes in or
23 around Bakersfield. Similarly, his plan lacks specificity, a fact
24 which he admits. And even were these issues not present, his
25 testimony does not address the primary problem in this case: Wide
26 West's ability to pay off or refinance the secured debts to Wells
27 Fargo and Chalk, its primary creditors.

28 For each of these reasons, the court finds the absence of a

1 reasonable likelihood of rehabilitation. Because the two prongs of
2 § 1112(b)(4)(A) have been established, cause exists in this case.

3 **II. The Best Interests of Creditors and the Estate Favors Dismissal**

4 If the court finds that cause exists, it must then decide whether
5 dismissal or conversion better serves the interests of creditors and
6 the estate. *Shulkin Hutton*, 552 F.3d at 960-61; *Superior Siding &*
7 *Window*, 14 F.3d at 242. The court finds dismissal is the more
8 appropriate relief.

9 Here, there are at least two reasons why dismissal, rather than
10 conversion, better serves creditors and the estate. First, Hodeda is
11 already operating Pacific Pines for the benefit of creditors and would
12 continue to do so after dismissal. Prior to his appointment, the
13 Kauras managed the property but did not do so in a way that is
14 consistent with the interests of creditors. This is evident from a
15 deteriorated condition of the property, poor management, and lacking
16 recordkeeping.

17 Second, creditors do not need the protection of the Chapter 7
18 trustee. The major asset, the complex, is already overencumbered by
19 Wells Fargo and Chalk's liens. Unsecured debts total about \$78,000,
20 which are primarily debts from Hodeda's operation of Pacific Pines and
21 guaranteed by Wells Fargo in the state court's order appointing Hodeda
22 as the receiver. As a result, unsecured creditors have a more
23 reliable source of repayment than the Chapter 7 estate.

24 For these reasons, the case will be dismissed.

25 //

26 //

27 //

28 //

1 **CONCLUSION**

2 Based on the foregoing, the motion will be granted, and the case
3 dismissed. The court will issue a separate order consistent with the
4 findings herein.

5
6 Dated: September 12, 2013

7
8

Fredrick E. Clement
United States Bankruptcy Judge
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28