UNITED STATES BANKRUPTCY COURT
Eastern District of California

Honorable Michael S. McManus
Bankruptcy Judge
Sacramento, California

May 31, 2016 at 10:00 a.m.

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1. 15-29600-A-11 ANTIGUA CANTINA & GRILL, INC. — MOTION FOR RELIEF FROM AUTOMATIC STAY
RCO-1 — 4-28-16 [41]
CHARLES TRAVERS VS.

Final Ruling: The hearing on this motion has been continued to June 13, 2016 at 10:00 a.m. Docket 52.

2. 15-25213-A-11 BLU COMPANIES, INCORPORATED — MOTION TO SELL FREE AND CLEAR OF LIENS
ET-4 — 4-18-16 [31]

Tentative Ruling: The motion will be denied without prejudice.

The court continued the hearing on this motion from May 16 for the debtor to file supplemental papers in support of the motion. The debtor has filed such papers. The court's amended ruling follows below.

The debtor in possession requests authority to sell 430,200 share units it owns in Bluon Energy, L.L.C., to Strathspey Crown Holdings, L.L.C., in exchange for 322.65 share units in Strathspey. The debtor asserts that the 322.65 units in Strathspey have a value of over $3 million.

The debtor requests that the sale be approved free and clear of the $1,691,235.79 lien of Debra Fletter, Harry Duncan, Philip Duncan and Harry Duncan, as trustee of the Louis M. and Jacqueline G. Duncan Trust, under 11 U.S.C. § 363(f)(4). The $1,691,235.79 lien is based on a stock pledge agreement, giving the lien creditors security interest in the debtor's 430,200 share units in Bluon Energy.

The debtor also asks for waiver of the 14-day period of Fed. R. Bankr. P. 6004(h).

11 U.S.C. § 1107(a) provides that a debtor-in-possession shall have all rights, powers, and shall perform all functions and duties, subject to certain exceptions, of a trustee, "[s]ubject to any limitations on [that] trustee." This includes the trustee's right to sell property of the estate pursuant to section 363. Section 363(b) allows, then, a debtor-in-possession to sell property of the estate, other than in the ordinary course of business. The sale must be fair, equitable, and in the best interest of the estate. Mozer v. Goldman (In re Mozer), 302 B.R. 892, 897 (C.D. Cal. 2003). Sale of property outside the ordinary course of business requires the estate to show good faith and valid business justification for the sale. 240 N. Brand Partners, Ltd. v. Colony GFP Partners, LP (In re 240 N. Brand Partners, Ltd.), 200 B.R. 653, 659 (B.A.P. 9th Cir. 1996). Good faith "encompasses fair value, and further speaks to the integrity of the transaction." Id.

Pursuant to 11 U.S.C. § 363(f), the debtor in possession may sell the personal property free and clear of liens only if: 1) applicable nonbankruptcy law permits sale of such property free and clear of such liens; 2) the entity holding the lien consents; 3) the proposed purchase price exceeds the aggregate value of the liens encumbering the property; 4) the lien is in bona fide dispute; or 5) the entity could be compelled to accept a money satisfaction of the lien.

The court agrees with the debtor that the $1,691,235.79 lien is in bona fide dispute. The lien is unperfected. According to the debtor, there is nothing filed with the California Secretary of State to perfect the lien creditors' interest in the 430,200 share units in Bluon Energy. Nor is there evidence that the putative secured creditors took possession of the certificates.

"*(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by--*

"*(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;*

"*(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or*

"*(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.*"

11 U.S.C. § 544(a).

"Upon the filing of the bankruptcy petition, therefore, [the debtor] obtained the right to avoid [the creditor's] interest under 11 U.S.C. 544(a)(1), leaving [the creditor] with an unsecured claim for the amounts due it for the Original Equipment."

Pac. Exp., Inc. v. Teknekron Infoswitch Corp. (In re Pac. Exp., Inc.), 780 F.2d 1482, 1486 (9th Cir. 1986).

Given that the $1,691,235.79 lien is unperfected and given the debtor's powers to avoid such unperfected liens under section 544(a)(1), the lien is in bona fide dispute for purposes of section 363(f)(4). Accordingly, the court can approve the sale free and clear of the $1,691,235.79 lien.

Nevertheless, the motion will be denied.

When selling substantially all of its assets, a debtor in possession must establish a sound business reason for the sale, especially given that the plan confirmation process is being short circuited. The line of cases discussing such pre-confirmation sales identifies the tension between the proposed sale

and the chapter 11 confirmation process. See In re On-Site Sourcing, Inc., 412 B.R. 817, 823-24 (Bankr. E.D. Va. 2009).

"A § 363(b) sale is generally viewed as quicker. Only a motion and a hearing are required, and most courts apply a 'business judgment test' to determine whether to approve the sale. By contrast, confirmation of a chapter 11 plan usually involves (i) preparation, court approval, and distribution of a disclosure statement, (ii) voting by creditors to accept or to reject the plan, and (iii) determination by the Court of whether the plan meets statutory confirmation standards."

In re Gulf Coast Oil Corp., 404 B.R. 407, 415 (Bankr. S.D. Tex. 2009) (footnotes omitted).

An early and still relevant authority on the circumstances under which pre-confirmation sales are proper is Committee of Equity Security Holders v. The Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063 (2nd Cir. 1983).

"*The history surrounding the enactment in 1978 of current Chapter 11 and the logic underlying it buttress our conclusion that there must be some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under section 363(b).*

"*. . . .*

"*Resolving the apparent conflict between Chapter 11 and § 363(b) does not require an all or nothing approach. Every sale under § 363(b) does not automatically short-circuit or side-step Chapter 11; nor are these two statutory provisions to be read as mutually exclusive. Instead, if a bankruptcy judge is to administer a business reorganization successfully under the Code, then—like the related yet independent tasks performed in modern production techniques to ensure good results—some play for the operation of both § 363(b) and Chapter 11 must be allowed for.*

"*The rule we adopt requires that a judge determining a § 363(b) application expressly find from the evidence presented before him at the hearing a good business reason to grant such an application. In this case the only reason advanced for granting the request to sell Lionel's 82 percent stock interest in Dale was the Creditors' Committee's insistence on it. Such is insufficient as a matter of fact because it is not a sound business reason and insufficient as a matter of law because it ignores the equity interests required to be weighed and considered under Chapter 11. The court also expressed its concern that a present failure to approve the sale would result in a long delay. As the Supreme Court has noted, it is easy to sympathize with the desire of a bankruptcy court to expedite bankruptcy reorganization proceedings for they are frequently protracted. 'The need for expedition, however, is not a justification for abandoning proper standards.' Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 450, 88 S.Ct. 1157, 1176, 20 L.Ed.2d 1 (1968). Thus, the approval of the sale of Lionel's 82 percent interest in Dale was an abuse of the trial court's discretion.*

"*In fashioning its findings, a bankruptcy judge must not blindly follow the hue and cry of the most vocal special interest groups; rather, he should consider all salient factors pertaining to the proceeding and, accordingly, act to*

further the diverse interests of the debtor, creditors and equity holders, alike. He might, for example, look to such relevant factors as the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value. This list is not intended to be exclusive, but merely to provide guidance to the bankruptcy judge."

Lionel Corp. at 1070–71.

Here are the considerations recognized by Gulf Coast Oil Corp. for the approval of a chapter 11 pre-confirmation sale:

"*• The debtor in possession or trustee in a chapter 11 case must consider its fiduciary duties to all creditors and interest holders before seeking approval of a transaction under § 363(b).*

"*• The movant must establish a business justification for the transaction and the bankruptcy court must conclude, from the evidence, that the movant satisfied its fiduciary obligations and established a valid business justification.*

"*• A sale, use, or lease of property under § 363(b) is not per se prohibited even though it purports to sell all, or virtually all, of the property of the estate, but such sales (or proposed sales of the crown jewel assets of the estate) are subject to special scrutiny.*

"*• Parties that oppose § 363(b) transactions on the basis that they constitute a sub rosa chapter 11 plan must articulate the specific rights that they contend are denied by the transaction.*

"*• Although the bankruptcy court need not turn every § 363(b) hearing into a mini-confirmation hearing, the bankruptcy court must not authorize a § 363(b) transaction if the transaction would effectively evade the 'carefully crafted scheme' of the chapter 11 plan confirmation process, such as by denying §§ 1125, 1126, 1129(a)(7), and 1129(b)(2) rights.*

"*• If the bankruptcy court concludes that such rights are denied, then the bankruptcy court can only approve the transaction if it fashions an appropriate protective measure modeled on those which would attend a reorganization plan.*

"*• Transactions that explicitly release all (or virtually all) claims against the estate, predetermine the structure of a plan of reorganization, and explicitly obligate parties to vote for or against a plan are not authorized under § 363(b).*"

Gulf Coast Oil Corp. then identifies nine specific areas of concern, phrased as questions:

1. Is there evidence of a need for speed?
2. What is the business justification?
3. Is the case sufficiently mature to assure due process?

4. Is the proposed purchase agreement sufficiently straightforward to facilitate competitive bids or is the purchaser the only potential interested party?
5. Have the assets been aggressively marketed in an active market?
6. Are the fiduciaries that control the debtor truly disinterested?
7. Does the proposed sale include all of a debtor's assets and does it include the "crown jewel?"
8. What extraordinary protections does the purchaser want?
9. How burdensome would it be to propose the sale as part of confirmation of a chapter 11 plan?

Gulf Coast Oil Corp. at 423-24.

Here, the subject stock proposed to be sold is "the crown jewel" of the estate's assets. The debtor does not own real property and its personal property assets have a scheduled value of approximately $5.359 million. $4.5 million of this figure is represented by 450,000 units of Bluon Energy, L.L.C. By this motion, the debtor is seeking to sell 430,200 or 95.6% of the total Bluon Energy stock. The next most valuable asset of the estate is a $478,334 note receivable owed by Bluon Energy. Docket 1, Schedules A & B.

Although in its supplemental papers the debtor has represented that the value of the Bluon Energy stock is actually $2,151,000 ($5/unit), the debtor has not amended its Schedule B to correct the purported error in valuation.

In any event, the stock proposed to be sold is the estate's principal asset.

Further, the record before the court says nothing about why this sale must be approved under section 363(b) as opposed under a plan of liquidation, which will secure both the creditors' and equity security holders' chapter 11 plan confirmation rights.

The debtor has had sufficient opportunity to propose a plan implementing the subject sale within the confines of the plan confirmation process. The court infers from the record that the debtor has known about this sale since approximately early April, with approximately 40 to 50 days having elapsed since that time. This would have been a sufficient period for the debtor to propose a disclosure statement and set a hearing on plan confirmation. See Fed. R. Bankr. P. 2002 & Local Bankruptcy Rule 9014-1(f)(3). Yet, the debtor has not done so. It has elected to pursue a sale under section 363(b).

The court is also concerned with the way the debtor has solicited support for the sale of the estate's main asset. The debtor has solicited support from creditors without the court having had approved a disclosure statement. This violates the essence of 11 U.S.C. § 1125(b) because a liquidation plan would have proposed the same sale.

Moreover, while the debtor has solicited support from creditors, it has not solicited support from all creditors. An entire block of unsecured creditors, representing $215,366.71 in claims, was admittedly not contacted. Docket 49 at 7.

With Strathspey being the only potential purchaser in this sale, the court is concerned with due process and the solicitation for support of what would be a plan confirmation otherwise.

In addition to the creditors, the court is concerned for the equity holders of

the debtor as well. The court sees nothing in the record about the position of all the debtor's equity holders on the sale.

Importantly, the court notes that the debtor's statement of financial affairs (Question 21) lists only 76.5% of the debtor's equity holders. The court would like to know who are the remaining 23.5% of the debtor's shareholders.

Furthermore, the debtor has not articulated a coherent business purpose for the sale. The debtor seems in a hurry to avert the granting of the U.S. Trustee's dismissal or conversion motion. And, a large block of the debtor's unsecured creditors seem to be against dismissal or conversion to chapter 7.

However, merely seeking to avert dismissal or conversion is not a sufficient business purpose to authorize a sale without requiring the confirmation of a plan. And, the court also has the option of appointing a chapter 11 trustee.

In general, the court has not been satisfied that the sale, which is an exchange of Bluon Energy shares for Strathspey shares, is a sufficient business purpose to evade the requirements of section 1129 or is in the best interests of the estate. The debtor's receipt of cash on account of the Strathspey shares it will receive in the exchange depends on multiple contingencies.

To receive cash on account of Strathspey shares a host of contingencies must occur: Strathspey's subsidiary - Alpheaon - must go public within the next several months, it must raise sufficient funds, Strathspey must agree to sell a portion of its stake in Alpheaon, Strathspey must decide that it will pay a dividend to its own shareholders, and Strathspey must decide that it will pay a sufficient dividend on account of the debtor's stake in Strathspey for the debtor to pay its creditors.

These contingencies do not depend on the debtor or its management; they depend wholly on the management of Strathspey, the management of Alpheaon, stock market forces and the overcoming of regulatory hurdles (which are not discussed in any particular in this record). In short, the court views the proposed sale merely as a swap of one speculative investment for another speculative investment. The swap is not a proper business justification for the sale nor is it in the best interest of the estate.

Additionally, the court has seen no evidence of whether and to what extent the debtor has marketed the Bluon Energy shares.

Finally, the debtor states nothing about securities regulatory compliance. The court cannot tell whether the proposed sale satisfies securities laws and regulations. The court is also concerned about the propriety of the debtor's seemingly inside knowledge about the value of Strathspey's stock, in connection with the initial public offering of Alpheaon. The motion does not discuss these issues.

The motion will be denied.

3.	15-25213-A-11 UST-1	BLU COMPANIES, INCORPORATED	MOTION TO CONVERT OR TO DISMISS CASE 4-18-16 [35]

Tentative Ruling: The motion will be granted and the case will be converted to chapter 7.

The U.S. Trustee moves for conversion to chapter 7, pursuant to 11 U.S.C. § 1112(b), arguing: (1) unexcused failure to timely file form B26 (report as to value, operations, and profitability of a non-debtor in which the estate owns substantial or controlling share); (2) failure to comply with court order requiring plan and disclosure statement to be filed by February 22, 2016; (3) failure to prosecute the case causing a delay that is prejudicial to creditors; and (4) absence of reasonable likelihood of rehabilitation.

The debtor - a holding company for various investments in other businesses - responds, contending it has been unable to formulate a plan due to uncertainty of when its investments will start producing income. The debtor argues that the motion should be denied because it has negotiated a sale of the debtor's equity interest in Bluon Energy, L.L.C., which would allow the debtor to formulate a plan within 45 days.

11 U.S.C. § 1112(b)(1) provides that "on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate."

For purposes of this subsection, "'cause' includes- (A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation; . . . ; (E) failure to comply with an order of the court; (F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter . . . ." 11 U.S.C. § 1112(b)(4)(A), (E), (F).

The above instances of cause are not exhaustive. Pioneer Liquidating Corp. v. United States Trustee (In re Consolidated Pioneer Mortgage Entities), 248 B.R. 368, 375 (B.A.P. 9th Cir. 2000). For instance, unreasonable delay that is prejudicial to creditors is also cause for purposes of 11 U.S.C. § 1112(b)(1). Consolidated Pioneer at 375, 378; In re Colon Martinez, 472 B.R. 137, 144 (B.A.P. 1st Cir. 2012).

The debtor filed this case on June 29, 2015 but has not yet filed a plan and disclosure statement. The deadline the court set in its August 24, 2015 status conference order was February 22, 2016. Docket 22.

Further, from the debtor's failure to file Form B26 for Bluon Energy (the company representing the debtor's principal investment) in January 2016, the court infers that the debtor either does not know or does not want to disclose the *present* value of its interest in Bluon. As mentioned in the court's ruling on the debtor's sale motion, also being heard on this calendar, the debtor has proffered no evidence in that motion as to the present value of its investment in Bluon either.

And, the debtor's response to this motion does not even attempt to explain its failure to file Form B26 for Bluon.

The delay in filing a plan and disclosure statement, when taken into account with the denial of the debtor's sale motion and its failure to file Form B26 for Bluon Energy, constitutes unreasonable delay that is prejudicial to creditors. Although the one-year anniversary of the petition date is fast approaching, the filing of a plan and disclosure statement is nowhere in sight for the debtor.

The totality of the foregoing also indicates to the court an absence of reasonable likelihood of reorganization, within reasonable time.

The above is cause for dismissal or conversion to chapter 7 under section 1112(b).

As the debtor lists in its schedules approximately $5.36 million in unencumbered personal property assets and it has substantial unsecured debt, totaling approximately $7.253 million, conversion to chapter 7 would be in the best interest of the estate and the unsecured creditors. Docket 1, Schedules B, D, F.

4. 14-30833-A-11 SHASTA ENTERPRISES — STATUS CONFERENCE 10-31-14 [1]

Tentative Ruling: None.

5. 14-30833-A-11 SHASTA ENTERPRISES — MOTION TO APPROVE DISCLOSURE STATEMENT 4-28-16 [481]
FWP-25

Tentative Ruling: The motion will be denied without prejudice.

The chapter 11 trustee is asking the court to approve the disclosure statement filed on April 28, 2016. Docket 481.

The motion will be denied for the following reasons:

(1) The disclosure statement has been amended once again and parties in interest have been given only a seven-day notice of the amended disclosure statement. Dockets 509 & 510. This violates Fed. R. Bankr. P. 2002(b), which requires that at least 28 days' notice be given to parties in interest of the deadline for objections.

While the amended disclosure statement addresses some informal objections to the original disclosure statement, any changes to the disclosure statement have the potential to trigger further objections from previously non-objecting parties.

(2) The court will not allow the trustee to intertwine the plan confirmation process with the claims allowance process. The plan and disclosure statement both seem to contemplate that unsecured creditors be required to enter into an Unsecured Creditor Release and Claim Allowance Stipulation (Docket 481, Ex. 3), establishing their claim amounts, as part of the plan confirmation process. Docket 509 at 14.

"As of the Effective Date, and *conditioned on* each executing and delivering an Unsecured Creditor Release, the filed claim of Class 4 claimant Juanita Sage shall be Allowed in the amount of $508,287.20, the scheduled claim of Class 4 claimant Greg Camastra shall be Allowed in the amount of $240,000, the scheduled claim of Class 4 claimant Rod III shall be Allowed . . . ." Docket 509 at 19.

The court notes that the plan defines "Disallowed Claims" to include claims "specifically designated as a Disallowed Claim *in this Plan or* by Court Order." Docket 509 at 37.

The court will not allow the trustee to unilaterally designate in the plan or disclosure statement any claim as "disallowed," in the absence of a claim objection.

(3) The disclosure statement does not state what would happen if a creditor does not enter into the Unsecured Creditor Release and Claim Allowance Stipulation.

(4) The disclosure statement does not set a bar date for the trustee's filing of objections to proofs of claim.

(5) The disclosure statement does not identify what dividend, if any, general unsecured creditors will receive under the plan. While the trustee may not know the exact dividend percentage at this time, the disclosure statement should at the least contain an estimated range.

Future amendments of the disclosure statement should be accompanied by a red/black-lined version.

6. 14-30833-A-11 SHASTA ENTERPRISES — MOTION TO SELL
FWP-26 — 5-3-16 [485]

Tentative Ruling: The motion will be granted in part.

The chapter 11 trustee requests authority to sell "as is" and "where is" for $1,100,000 in cash the estate's interest in 400 Redcliff Drive, Redding, California, to J.W. Family Trust.

The trustee also seeks:

(1) authority to pay outstanding (approximately $32,526) and prorated prospective property taxes out of escrow, along with the estate's escrow and closing costs and expenses;

(2) authority to pay the current two mortgages on the property, both held by the Curto Trust, in the aggregate amount of approximately $843,348;

(3) the approval of a breakup fee of $25,000 to J.W. Family Trust, in the event a third-party overbidder purchases the property;

(4) authority to pay a real estate commission to the estate's broker, Kennedy Wilson and Properties by Merit, Inc. (per an approved sharing agreement); the commission is 5%, and will be shared with a buyer's broker, if any;

(5) authority to pay an incentive bonus under a court-approved incentive agreement to Mr. Cretaro in the amount of approximately $8,174.82, subject to an increase in the event of an overbid;

(6) a waiver of the 14-day period of Fed. R. Bankr. P. 6004(h);

(7) a good faith finding under section 363(m); and

(8) a determination that the sale does not violate section 363(n).

While the property is not subject to any other monetary encumbrances, it is nonetheless subject to non-monetary encumbrances, such as easements,

dedications, notices and redevelopments. The sale is subject to such non-monetary encumbrances.

The trustee estimates that the net sales proceeds to the estate will be approximately $155,000.

11 U.S.C. § 363(b) allows the trustee to sell property of the estate, other than in the ordinary course of business. The sale will generate some proceeds for the estate, while foreclosure of the property.

Hence, the sale will be approved pursuant to 11 U.S.C. § 363(b), as it is in the best interests of the creditors and the estate.

The court will approve the $25,000 break-up fee to J.W., in the event it does not purchase the property due to an over-bidding, to compensate J.W. for its due diligence and investigation efforts with respect to the property.

The court will authorize payment of the real estate commission to the estate's broker and incentive bonus to Mr. Cretaro, consistent with their employment terms approved by the court.

The court will waive the 14-day period of Rule 6004(h) and it will make a good faith determination under section 363(m), subject to receiving and reviewing a declaration from J.W.'s trustee concerning its good faith in purchasing the property. As of the time the motion papers were filed, there was no such declaration from J.W., attesting to its good faith in this transaction.

7. 14-31890-A-11 SHAINA LISNAWATI — STATUS CONFERENCE 12-6-14 [1]

Tentative Ruling: None.

8. 14-31890-A-11 SHAINA LISNAWATI — MOTION TO APPROVE DISCLOSURE STATEMENT 4-17-16 [260]
JHH-12

Tentative Ruling: The motion will be denied without prejudice.

The debtor is asking the court to approve the amended disclosure statement filed on April 17, 2016. Docket 260.

The motion will be denied for the following reasons:

(1) The claim of PennyMac Holdings, L.L.C., secured by the Silkwood property, is classified as an unimpaired claim, even though the terms of that pre-petition claim are being altered by a loan modification agreement, which the plan incorporates.

(2) The disclosure statement does not state what the debtor will do with her Rose Avenue property and how the property's encumbrances will be treated under the plan in the event the property does not sell.

(3) The disclosure statement does not state what the debtor will do with her Silkwood Drive property and how the property's encumbrances will be treated under the plan in the event there is no *permanent* loan modification with PennyMac.

(4) The disclosure statement does not identify a bar date for the filing of objections to proofs of claim.

(5) The disclosure statement is not accompanied by a red/black-lined version as required by the court's February 22, 2016 ruling denying approval of the debtor's prior disclosure statement. Docket 249.

9. 16-21585-A-11 AIAD/HODA SAMUEL — MOTION TO USE CASH COLLATERAL AND TO PAY O.S.T. 5-26-16 [98]
FWP-2

Tentative Ruling: The motion will be granted in part and denied in part.

The chapter 11 trustee seeks approval to use the cash collateral of several creditors secured by four shopping centers and six residential rental properties.

The estate owns four shopping centers, including:

- on Stockton Boulevard in Sacramento, California (no voluntary liens, encumbered solely by the United States' $3,029,412.64 criminal restitution judgment lien);

- in Rio Linda, California (no voluntary liens, encumbered solely by the United States' $3,029,412.64 criminal restitution judgment lien);

- in West Sacramento, California (valued at $4.3 million and subject to an approximately $2.925 million first priority claim held by Fairview Holdings II, L.L.C. and United States' second priority criminal restitution judgment);

- on Power Inn Road in Sacramento, California (valued at $1.2 million and subject to an approximately $650,000 first priority claim held by JP Morgan Chase Bank and United States' second priority criminal restitution judgment).

All of the estate's residential properties are in Sacramento, California and they include:

- 130 Prairie Circle,
- 180 Prairie Circle,
- 186 Prairie Circle,
- 209 Prairie Circle,
- 5924 Pony Trial Way, and
- 148 Estes Way.

11 U.S.C. § 363(c)(2)(B), (c)(3), (e) provides that, when the secured claimants with interest in the cash collateral do not consent, after notice and a hearing, "the court . . . shall prohibit or condition such use [of cash collateral] . . . as is necessary to provide adequate protection of such interest."

The motion will be denied as to the Stockton Boulevard and Rio Linda shopping centers. The court has no evidence that the rental income from those properties is encumbered. Hence, the rental income is not cash collateral and the trustee does not need the court's authorization to use it in the ordinary course of business.

There is no evidence that the exception to 11 U.S.C. § 552(a) applies. Section 552 provides:

"*(a) Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.*

"*(b)*

. . .

"*(2) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, and notwithstanding section 546(b) of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.*"

The Stockton Boulevard and Rio Linda shopping centers are not subject to voluntary liens, meaning that the security agreement exception of section 552(a) does not apply. The only creditor with a claim secured by those properties, the United States, acquired a pre-petition involuntary lien against the properties. The United States does not have a "security agreement" giving rise to a lien on post-petition rents from those properties.

While the United States holds a criminal restitution judgment lien on the Stockton Boulevard and Rio Linda shopping centers, whereby an abstract of the judgment was recorded with each respective county recorder, the court has seen no legal authority for a judgment creditor to acquire a lien on post-petition rental proceeds simply by recording an abstract of the judgment against the property.

Next, as to the West Sacramento and Power Inn shopping centers, the first priority creditors secured by those properties are adequately protected by the value of each property. The West Sacramento property is worth approximately $4.3 million, whereas Fairview's claim is less than $3 million. The court specifically notes that Fairview has admitted to the $4.3 value in its proof of claim.

The Power Inn property is worth in excess of $1 million, whereas JPMorgan Chase Bank's claim is only approximately $650,000.

The court will approve interim cash collateral use – and set a final hearing on this part of the motion – as to the rental income from the West Sacramento and Power Inn properties, subject to the following restrictions or questions (all figures below are from the combined shopping center budget):

(1) The motion's reference to a carve-out is unclear. The administrative-expense carve-out seems to be based on stipulations with secured creditor(s). Those agreements have not been presented to the court.

(2) Even if the court approves a carve-out for the estate's administrative expenses, the court will not approve professional fees in connection with a cash collateral motion budget. The fees of the trustee and his counsel, for example, will not be approved in connection with this motion.

(3) The budget item for $1,700 a month in legal expenses should be explained. The court will not approve professional fees outside the notice and hearing requirements of 11 U.S.C. § 330. Also, the court has seen nothing about the estate's employment of an attorney for the estate besides attorney Jason Rios' law firm.

(4) The $2,844.64 a month property management fee should be explained. The motion does not say whether, why, and when the estate intends to employ a property management company.

(5) The $2,800 a month HVAC repair/maintenance fee should be explained, as it appears to be an unusually high recurring fee.

(6) The $4,100 a month exterior repair/maintenance fee should be explained, as it appears to be an unusually high recurring fee.

(7) The $4,000 a month parking lot repair fee should be explained, as the necessity for this fee is not obvious and it appears to be an unusually high recurring fee.

(8) The court questions the necessity of the granting of replacement liens to the first priority creditors, given the large equity cushions protecting the claims of those creditors.

(9) The same is true with respect to the proposed $5,000 a month in adequate protection payments. Such payments would be warranted only if the creditors' interest in the cash collateral is not protected otherwise.

(10) Although the motion mentions the debtors' limited liability company, St. Marcorious, L.L.C., it does not say whether any of the subject real properties are owned by St. Marcorious. This is important because St. Marcorious is a separate legal entity.

Finally, the motion will be denied as to the residential properties. The trustee is seeking to use rental income from those properties to pay for their maintenance.

But, the motion does not give sufficient information for an adequate protection determination. The motion does not identify the creditor(s) secured by each residential property, the amount and priority for each lien on each property, or even the value of each property. The motion says only that the residential properties are encumbered by mortgages held by The Bank of New York Mellon, Bank of America, and JPMorgan Chase Bank.

The motion seems to assert that there are no creditors secured by the rental income from the residential properties because no creditor has yet asserted an interest in such rental income. If true, this means that the rental income from the residential properties is unencumbered and authorization to use cash collateral is unnecessary.