UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT

In re:
Lilo Properties, LLC,
Debtor-in-Possession.

Chapter 11 Case
 # 10-11303

ORDER
CONDITIONALLY GRANTING FANNIE MAE'S MOTION FOR RELIEF FROM STAY

Fannie Mae filed a motion (doc. ## 119, 120) seeking relief from the automatic stay with respect to the Debtor's real property located at 157 State Street, Montpelier, Vermont (the "Property"). Section 362 of the Bankruptcy Code provides, in relevant part:

> (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—
> . . .
> (2) with respect to a stay of an act against property under subsection (a) of this section, if—
> (A) the debtor does not have an equity in such property; and
> (B) such property is not necessary to an effective reorganization . . ..

11 U.S.C. § 362(d)(2). Whether to grant relief from the automatic stay is a matter of the Court's discretion. See Sonnax Indus., Inc. v. Tri Component Products Corp. (In re Sonnax Indus., Inc.), 907 F.2d 1280, 1286 (2d Cir. 1990).

The Debtor Has No Equity in the State Street Property

The parties have stipulated that the Property has a value of $575,000, and, although there is a dispute with respect to Fannie Mae's right to certain interest and costs, there is no dispute the principal balance due Fannie Mae is $598,212.07 – a sum in excess of the value of the Property.[1] Therefore, the first prong of § 362(d)(2) is satisfied.

The Debtor Has Not Yet Demonstrated the Property is Necessary to an Effective Reorganization

With regard to the second prong of this statute, Fannie Mae's motion (doc. ## 119, 120) alleges that the Debtor's plan is not confirmable, and hence an effective reorganization is not possible (doc. #

[1] The computation of Fannie Mae's total claim is complex, as it must take into account the date on which Fannie Mae became oversecured, the deduction of some disallowed fees and expenses, the application of the cash collateral Fannie Mae is holding, and the recalculation of interest due; the Court need not determine the exact amount of Fannie Mae's claim based upon the finding and conclusions set out below.

119). The gravamen of Fannie Mae's argument is twofold: first, the amended plan's treatment of the Debtor principal, Robert Falker, violates the absolute priority rule set forth in § 1129(b)(2)(B), and, second, the plan is not feasible.

With respect to the former point, the Court has ruled that the treatment proposed in the plan filed on April 15, 2011 (doc. # 76) violated the absolute priority rule, and the plan was not confirmable on that basis. See Order dated August 3, 2011 (doc. # 136). However, on September 12, 2011, the Debtor filed an amended plan and a new disclosure statement to accompany it (doc. ## 149, 150), in which the Debtor proposes to allow Mr. Falker to retain his interest in the limited liability company in consideration of a promise to provide future services (as proposed in the prior plan), plus an investment of cash:

> 5.3 ***Class Four:*** Equity Interests. Class Four shall consist of the Membership Interest Holder. Robert L. Falker is the only Equity Interest Holder of the Debtor. Mr. Falker will surrender his current membership interest and will receive new membership interests in the Reorganized Debtor in exchange for a capital investment of $10,000.00 within five (5) business days of the Effective Date. This amount will be distributed to Class Two on a pro rata basis as set forth above.

(doc. # 149, p. 10) (emphasis in original). Mr. Falker's infusion of $10,000 (hereafter "Mr. Falker's contribution") will fund one-half of the distribution to unsecured creditors under the amended plan. The question presented is whether this infusion of cash, in addition to the services he will render to the reorganized Debtor, satisfies the new value exception to the absolute priority rule. The United States Bankruptcy Court for the Southern District of New York addressed the requirements of the "new value" exception to the absolute priority rule as follows:

> The new value exception was first announced in Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939) (Los Angeles Lumber). In Los Angeles Lumber the Supreme Court, citing Northern Pacific Railway Co. v. Boyd, 228 U.S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913), and Kansas City Terminal Railway Co. v. Central Union Trust Co., 271 U.S. 445, 46 S. Ct. 549, 70 L. Ed. 1028 (1926), said that where the need for new money essential to the success of the reorganized debtor arises and the old equity holders make a fresh contribution and receive in return a participation 'reasonably equivalent to their contribution' no objection can be made. 308 U.S. at 121, 60 S. Ct. at 10.
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> Although neither the Supreme Court, nor the Second Circuit, has specifically ruled upon the issue of the continued existence of the new value exception, the Supreme Court has referred to it. In Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 108 S. Ct. 963, 99 L. Ed. 2d 169 (1988) (Ahlers), the Court indicated that there would be no expansion of the new value exception beyond that recognized in the case law at the time the Code was enacted. Id., at 968. In footnote 3, however, the Court specifically stated that it was not ruling on the continued existence of the new value exception.[15] Thus, there has been disagreement as to whether the new value exception has survived the enactment of the Code.

[15] 'Our decision today should not be taken as any comment on the continuing vitality of the Los Angeles Lumber [new value] exception . . .' Ahlers, 485 U.S. 197, 108 S. Ct. 963, 99 L. Ed. 2d 169, n.3.

. . .

> In consideration of above findings, it therefore follows that the Debtor's new value contribution must be evaluated in light of the criteria announced in Los Angeles Lumber. **For old equity to retain its interests pursuant to the exception, the capital contribution must be (1) new, (2) substantial, (3) money or money's worth, (4) necessary for a successful reorganization and (5) reasonably equivalent to the value or interest received. (Citations omitted.)** In re Bonner Mall Partnership, 2 F.3d 899, 1993 WL 288507 at 8.

In re One Times Square Assocs. Ltd. P'ship, 159 B.R. 695, 706–08 (Bankr. S.D.N.Y. 1993), aff'd on other grounds, 165 B.R. 773 (S.D.N.Y. 1994), aff'd without opinion, 41 F.3d 1502 (2d Cir. 1994), cert. denied, 513 U.S. 1153 (1995) (emphasis added).

Following the ruling in that case, the Court measures the adequacy of Mr. Falker's contribution against its 5-part "new value exception" test. Mr. Falker's contribution is certainly new, and is "money or money's worth." It is also necessary for a successful reorganization because without this contribution, Mr. Falker would not be able to retain his interest in the LLC under the absolute priority rule, see 11 U.S.C. § 1129(b)(2)(B)(ii), and without that there would be no LLC and hence no reorganization of the Debtor LLC would be possible. The final two criteria, whether the contribution is "substantial" and is "reasonably equivalent to the value or interest received," are integrally connected and present a close call. Fannie Mae is correct that the Debtor has not taken steps to market test whether his contribution accurately or reasonably reflects the value of his interest. However, the record is clear that it is Mr. Falker who is responsible for all oversight and operation of the Debtor, and without his involvement there would be no operating entity. Therefore, the Court finds that without his involvement the LLC would have no value. Based upon this finding, the Court concludes that $10,000 approximates or exceeds the market value of the Debtor's LLC membership interest. The amount of Mr. Falker's contribution equals one-half of the funds to be distributed to the unsecured creditors in this case. There have been seven proofs of claim filed in this case, and the Debtor has sought to allow one other unsecured creditor to file a claim. However, as the case has moved forward, the pool of unsecured creditors has shrunk to just one: Union Bank's claim in the approximate amount of $300,000. Notably, the Union Bank claim arises from Mr. Falker's individual debt, on which the Debtor has only contingent, guarantor liability. Under these facts, the Court gives least weight to the fifth criteria and concludes that by doubling the dividend to the unsecured creditor, the contribution, while small, is sufficiently substantial to meet the final requirement of the new value exception.

Fannie Mae also objects to the sufficiency of Mr. Falker's contribution on procedural grounds, pointing out that the new value must be something of value to the creditors at the time the plan is confirmed, citing Norwest Bank Worthington v. Ahlers, 485 U.S. at 204, and here, the amended plan calls for Mr. Falker to make his contribution within five business days of the effective date of the plan (see doc. #

174, p. 11). The Court finds this argument unpersuasive. The creditors will have something of value on the date of confirmation in the form of a confirmation order compelling Mr. Falker to make that contribution almost immediately. This is not speculative or negotiable. Moreover, to prove feasibility, the Court will expect the Debtor to present evidence at the confirmation hearing that, as of the date of the confirmation hearing, Mr. Falker has the $10,000 cash available and ready to deliver to the unsecured creditors by the due date set forth in the amended plan.

Lastly, and perhaps most significantly, based upon the Court's recent rulings with respect to the value of Fannie Mae's collateral and debt, the Court concludes that as of early 2011, Fannie Mae was oversecured and thus would hold no unsecured claim in this case. Therefore, if the one holder of an unsecured claim votes in favor of the amended plan, the issue of the absolute priority rule would be moot.

For all of these reasons, Fannie Mae's argument based upon the absolute priority rule, under the likelihood of reorganization prong of § 362(d), fails.

Fannie Mae's final argument in support of relief from stay is that the amended plan is not feasible. The Debtor has the burden of proof on this issue. See 11 U.S.C. § 362(g)(2). While the Debtor is correct that this is not the time for a full blown confirmation analysis, and the Debtor need not demonstrate a guarantee that the plan will succeed (see doc # 181, p. 5), to defeat this motion for relief from stay, the Debtor must demonstrate that the proposed plan has a realistic chance of being confirmed and is not patently unconfirmable. See In re State Street Assocs., L.P., 342 B.R. 32, 44 (Bankr. N.D.N.Y. 2005) (citing In re 266 Washington Assocs., 141 B.R. 275, 281 (Bankr. E.D.N.Y. 1992)). The Debtor has failed to meet that burden of proof. Despite the passage of nearly six months since the Debtor's other parcel of real estate was sold, the Debtor has presented no financial data or operating success to support its projection that it will have sufficient net operating income to make the monthly payment to Fannie Mae during the five year term of the plan.

As this Court has previously ruled with respect to the feasibility prong of § 362(d):

> the court should not be left to speculate about important elements and key issues relating to the likelihood of an effective reorganization . . .. The debtors' hopes and aspirations for reorganization, although well-intended, have not been supplemented by any showing that reorganization is possible, let alone reasonably likely within a reasonable period of time.

In re R&G Props., Inc., 2009 Bankr. LEXIS 1320, *28–29, 2009 WL 1076703, *9 (Bankr. D. Vt. Apr. 16, 2009) (citing In re Diplomat Electronics Corp., 82 B.R. 688, 693 (Bankr. S.D.N.Y. 1988)). That observation is equally apt here.

Even under its computation of a lower interest rate than this Court would permit (5% rather than 5.75%), and without the required replacement reserve allocation, the record does not support the premise that the Debtor will have enough net operating income to fund the plan. The Debtor's amended plan pro-

vides for a monthly payment to Fannie Mae in the amount of $4,684.42 with a refinance of the remaining balance at the end of five years (see doc. # 169, p. 5). The Debtor's three most recently filed operating reports (doc. ## 145, 156, 185), covering the periods of July through September 2011, show net operating income of negative $5,272, negative $1,996, and negative $919, respectively. The Debtor has argued that the monthly payment is excessive in that it fails to reflect the reduced annual real property tax obligation; however, it also understates the required replacement reserve contribution by $500 per month. If the Debtor's reorganization effort were to go forward, the monthly payment due Fannie Mae would be reduced because Fannie Mae would be required to apply the cash collateral it is holding to reduce the principal balance, to deduct from its claim the disallowed costs and expenses, to back out all post-petition interest included prior to the date Fannie Mae became oversecured, and to accept the Till interest rate post-confirmation. However, the Debtor's own operating reports demonstrate that the Debtor has not been able to meet its monthly operating expenses over the last quarter, and the reports acknowledge that the situation will become more difficult when winter begins and the Debtor will need to purchase heating fuel.

The Debtor mentions in a recent filing that it has "successfully procured financing for the paydown [of the Fannie Mae debt] with the assistance of its principal who has graciously offered personal assets as collateral" (doc. # 181, p. 6). However, there is nothing in the record to substantiate the reality or timing of this possible refinancing, so this does not change the otherwise bleak financial picture painted by the operating reports.

Relief from Stay is Conditionally Warranted

Since the Debtor has no equity in the Property and the Debtor has not yet demonstrated that the Property is necessary to an effective reorganization, the Court finds that cause exists for granting Fannie Mae conditional relief from stay against the Debtor's State Street property. However, the record leaves one essential fact undefined that makes the granting of absolute relief from stay premature at this time.

The Court entered an order on November 4, 2011, finding Fannie Mae's computation of the value of its collateral to be correct and to total collateral value to be $634,950.26, allocated among the following assets:

State Street real property	$575,000.00
Net adequate protection payments	$ 41,680.64
Funds on retainer	$ 10,000.00
Replacement reserve account	$ 8,269.62

(doc. # 186, p. 8).

Neither party has presented the Court with a final computation of Fannie Mae's claim or the monthly payment that would be due to Fannie Mae under the amended plan since these determinations.

The burden is on the Debtor to demonstrate that it can pay the allowed claim and fund the amended plan. Accordingly, the Court will allow the Debtor one week from the entry of this order to file a statement:

(A) showing the computation of Fannie Mae's allowed secured claim that is consistent with this Court's November 4th order and with the principles articulated herein, and in particular

(i) deducts the disallowed costs and expenses from the most recent statement of claim;

(ii) determines the date on which Fannie Mae became oversecured;

(iii) backs out all post-petition interest included prior to the date Fannie Mae became oversecured;

(iv) adds in monthly post-petition interest, up to the value of the collateral;

(v) applies the net adequate protection payments, the reserve replacement account, and the $10,000 retainer (the cash collateral) against the principal balance, as of the date of the Court's determination that the cash collateral is an addition to Fannie Mae's collateral, i.e., as of November 4, 2011;

(vi) labels the resulting figure as the allowed amount of Fannie Mae's claim for purposes of the plan; and

(vii) computes plan payments on the allowed secured claim with the Till interest rate of 5.75%; and

(B) demonstrates that based solely on the average net operating income (as shown on the Debtor's monthly operating reports) since the sale of the Loomis Street property, the Debtor has funds to make the payments that would be required under the amended plan.

If the Debtor fails to timely file this statement or the statement fails to demonstrate that the Debtor can make these payments, upon an affidavit by Fannie Mae to that effect, the Court will enter an order granting relief from stay.

The Court is cognizant of the fact that granting relief from stay to Fannie Mae will be fatal to the Debtor's chapter 11 case and does not grant conditional relief without considering that consequence. This Court strongly supports giving chapter11 debtors every reasonable opportunity to reorganize, see e.g., In re R&G Props., Inc., 2009 Bankr. LEXIS 1320, 2009 WL 1076703; however the bounds of reasonableness are determined by facts that reflect the Debtor's financial viability. The Debtor's operating history and records are the best proof of its future financial vitality. Here, the imminent, certain, and significant increase in operating expenses, coupled with the current lack of adequate operating income to fund operating expenses, lead to the conclusion that the Debtor will not be able to generate the operating income it needs to fund a successful plan of reorganization.

Accordingly, IT IS HEREBY ORDERED that Fannie Mae's motion for relief from stay as to the Debtor's real property located at 157 State Street, Montpelier, Vermont, is conditionally granted.

IT IS FURTHER ORDERED that the Debtor may file a statement regarding Fannie Mae's claim that is consistent with this order by November 17, 2011.

IT IS FURTHER ORDERED that Fannie Mae shall be entitled to an order granting the motion for relief from stay upon the filing of an affidavit indicating that the Debtor did not file a statement consistent with this order.

SO ORDERED.

November 10, 2011
Burlington, Vermont

Colleen A. Brown
United States Bankruptcy Judge