(Cite as: 1995 WL 264023 (Bankr.D.Vt.))

In re HICKEY PROPERTIES, LTD., Debtor.

No. 94-10180.

United States Bankruptcy Court,

D. Vermont.

March 23, 1995.

C. O'C. Reis of Obuchowski & Reis, Bethel, VT, for Hickey Properties Ltd. (debtor).

G.C. Gebauer, D. Weiss, and D. Wolinsky of Saxer Anderson Wolinsky & Sunshine, Burlington, VT, for WHBB Real Estate Ltd. Partnership (WHBB).

MEMORANDUM OF DECISION ON DETERMINING VALUE OF DEBTOR'S PROPERTY

FRANCIS G. CONRAD, Bankruptcy Judge.

***1** We are required [FN1] by the motion of WHBB, a secured creditor, to determine the value of its collateral, [FN2] the Brattleboro Inn and Conference Center, which is owned by Debtor, a limited partnership. The value is critical to the ultimate issue of who will end up with control of the Inn. That issue is likely to be determined, at least formally, at the upcoming hearing on Debtor's motion to confirm and WHBB's motion for relief from stay. The parties have agreed that the value we arrive at may be used for purposes of both motions. Transcript of January 31, 1995 Hearing, 5-6 (hereinafter "Tr.").

We hold that the value of the Inn as an operating business is $1.1 million plus whatever an auction of 100% of the equity interest in Debtor brings. In the discussion that follows, we first describe how Debtor proposes to treat WHBB's claim, providing a context for the controversy over value, and then explain how we arrived at our determination.

The task before us is made much easier because the parties agree on significant facts. Although it is not entirely free from ambiguity, we understand the parties to agree that the value of the Inn, as is, is at least $1.1 million. Both parties also agree that the Inn would be worth $3.2 million if the investment of about $855,000 for renovation and rehabilitation resulted in the acquisition of a franchise agreement with a national motel/hotel chain. They disagree, however, on who should bear the risks of that investment and who should retain the rewards.

Debtor proposes to bifurcate WHBB's claim, treating about $1 million as secured. The allowed balance of WHBB's total $2.9 million claim is treated as unsecured. Debtor's Plan puts most of the risk that the investment in renovations won't work out on WHBB, proposing to finance $600,000 of the total required with a superpriority lien that would prime WHBB. [FN3] To raise the balance, Debtors propose, in essence, to sell the reward opportunity for $250,000. [FN4] The Plan calls for current equity holders to get first crack at that opportunity by allowing them 30 days to purchase 100% of the equity in Debtor for $250,000. If current holders of the equity interest do not put up the additional funds, an auction of the equity interest is to follow. Anticipating, perhaps, that this special treatment for existing equity interests might be greeted with some degree of scepticism, the Plan also provides that we may order the equity auctioned off to the highest bidder.

Although they emphasize different points, the parties are not really divided on the issue of the law to be applied. Statutory guidance for valuation is provided by §506(a), which provides:

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

***2** WHBB argues that "the 'proposed use' mandate of section 506(a) requires the court to value the property as though it were being disposed of in a commercially reasonable manner, thereby taking into account its full economic value when put to the most productive use." WHBB's Post-Hearing Memorandum in Support of WHBB's Motion for Valuation and in Support of Objection to Plan of Reorganization, 2 (hereinafter "WHBB Memo"). Accordingly, argues WHBB, the value of the collateral should be "the value that the secured creditor would be likely to realize if the secured creditor were to dispose of the property 'under commercially practical and reasonable circumstances."' Id.

Applying these standards to this case, there are two closely related reasons why $3,200,000, rather than $1,100,000, is the value which must be attributed to the collateral. First, the Debtor's proposed use for the property is not to retain or sell it in its present condition, but to reap the benefit of its full economic value by investing $850,000 in renovations and boosting its value to $3,200,000. Second, if WHBB were to dispose of the property in a commercially practical manner, it could make the improvements itself and recover a much larger portion of its loans than the debtor proposes to pay, (approximately $2,350,000 compared to $1,000,000). In short, $3,200,000 is the going concern value which takes into consideration the use that either party would make of the property, as required by law.

WHBB Memo, 2-3.

WHBB's appeal to fairness raises troubling questions about Debtor's prospects at the hearing on confirmation, when we will have to determine whether Debtor's Plan is fair and equitable to WHBB. §1129(b). We believe that WHBB's legal argument falls short in this context, however, when our only purpose is to determine value. While it is true that Debtor will continue to own the property, Debtor itself will in fact be sold. Article 7 Class 5 of the Plan provides, "The resulting ownership of the Debtor, post-confirmation, shall be held by the persons contributing new equity or purchasing the units at auction in the percentage attributable to their pro rata contribution or auction payments." Thus, the "proposed disposition" of the property, for purposes of § 506(a), is a sale.

Moreover, the $3.2 million value argued for by WHBB is merely a future possibility, not a present reality. It will never become a reality unless a series of far-from-certain contingencies come to pass: if an investment of $855,000 is made, if a national hotel franchise is obtained, if anticipated operational savings are achieved, and if more patrons pay more money for higher-quality renovated rooms, then, at some point in the future, the property may be worth $3.2 million. The Code, however, requires for purposes of confirmation that a secured creditor receive "value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." §1129(b)(2)(A). We are unable, consistent with the Code, to value property today based on a debtor's euphoria about what tomorrow will bring, especially in light of the uncontradicted evidence that the value of the property today, as is, is in the neighborhood of $1.1 million.

***3** WHBB contends that the $1.1 million is a liquidation value, not a going concern value. It attempts to prove this contention through the testimony of its expert, Dale Metz, C.P.A., who did not do an appraisal of his own, but commented on the valuation reports of Debtor's two experts, Mark A. Dayman, CPA, and appraiser Ed Lacroix. Metz' opinion was that the $1.1 million value "basically reflects the operation as it is." Tr. at 12. That value should not be characterized as a "going concern" value, but as a liquidation value, Metz said, because, "if the property would continue as it is, it would further decline in value; therefore $1.1 million is not a going concern but a liquidation value." Tr. at 16. See, also, Tr. at 12. Metz concurred with the conclusion reached by Debtor's expert, Mark Dayman, in his report:

[I]t is clear that in its current market position and with its physical limitations the ... Inn is a wasting asset.

Tr. at 12. Among the factors Metz identified as contributing to the decline of the Inn are the recessionary economy, "the fact that it's an aging property," the lack of a franchise from a national hotel/motel chain, the adverse impact of heavy truck traffic at a neighboring business, "as well as the slippage in the competitive position of the hotel." Tr. at 11. His analysis of Debtor's performance over the last four years, shows, Metz said, a declining downward trend in gross revenues, gross operating profit, and replacement reserves that will continue into the future. Tr. at 21. Accordingly, Metz concluded that the Inn is not an economically viable business, and that "to maximize your value you'd want to liquidate." Tr. at 22. Metz conceded that a willing buyer "may buy the property for [$1.1 million], but they would be looking to do the renovations which would increase the value of the property and make it a going concern." Tr. at 24-25.

Debtor concedes that it cannot continue in business without reducing its debt load, doing the proposed renovations, and obtaining a national hotel/motel franchise. Tr. at 51. Its expert did testify, however that if the Inn was sold for $1.1 million, and the buyer financed 60-70% of the purchase price, the Inn could continue to limp along at its current level of business with no additional capital infusion. Accordingly, Debtor argues, $1.1 million represents the going concern value, not the liquidation value. Tr. at 56-57. That scenario assumes, of course, that the debtload drops from $3 million+- to about $715,000. [FN5]

Whether $1.1 million is a liquidation value or a going concern value is not necessary for us to decide. Clearly, Debtor is not going anywhere but down the proverbial tubes unless dramatic changes are made. Our job is to value Debtor now, not after those changes are accomplished. All of the evidence before us establishes that Debtor is worth at least $1.1 million, given its proposed disposition. Debtor's Plan, however, assumes that 100% of the equity interest in Debtor is worth at least $250,000 more than $1.1 million, because it proposes to sell itself for that amount. How much more than $1.1 million Debtor is worth is a matter that can be easily determined by an auction of 100% of Debtor's equity. Moreover, an auction will eliminate two other issues from the case. First, WHBB contends that it would be unfair to allow the current equity interests to buy the upside potential for a fixed price, without granting WHBB and others an equal opportunity to bid. An auction serves the interests of fairness to all concerned, and also allows market forces to determine the value of the opportunity to transform Debtor into a more valuable property.

***4** An auction of the equity interest in Debtor will also resolve WHBB's confirmation objection that Debtor's Plan violates the absolute priority rule of §1129(b)(2)(B). That section requires as a condition of confirmation that unsecured claims must be paid in full if junior claims or interests receive or retain any property under the Plan. Debtor contends that its Plan can be confirmed notwithstanding §1129(b)(2)(B) under the "new value" exception, which allows a junior class to receive or retain an interest in the debtor in consideration of a new contribution. Whether the "new value" exception, which was recognized under the Bankruptcy Act, survived enactment of the Code, is an open question in this District. See, Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 203 n. 3, 99 L.Ed.2d 169, 177 n. 3, 108 S.

Ct. 963 (1988) (Supreme Court expressly declined to comment on the continuing vitality of the exception). Assuming that the exception is alive, a requirement for its application is that the value of the interest received or retained by members of the junior class must be "reasonably equivalent to their contribution." Case v. Los Angeles Lumber Products, 308 U.S. 106, 21, 84 L.Ed. 110, 123, 60 S.Ct. 1 (1939). By putting 100% of the equity interest in Debtor up for auction, we allow the market to value the right to own Debtor and its future prospects, and avoid altogether the issues raised by the "new value" exception.

In applying the fresh contribution exception, ... there is a transaction in shares. Whether or not new shares are issued, the justification for the exception is that the shareholders are in effect buying new shares for a new contribution, just as third parties could. That transaction should be measured against market forces, making it unnecessary for the court to become embroiled in the vagaries of ... valuation.

In re Bjolmes Realty Trust, 134 BR 1000, 1010 (Bkrtcy. D.Mass. 1991). Accordingly, an auction of 100% of the equity interest in Debtor will be ordered if the Plan is confirmed.

Debtor is to submit an order consistent with the views expressed in this Memorandum of Decision upon five days' notice to WHBB.

FN1. Our subject matter jurisdiction over this controversy arises under 28 USC §1334 (b) and the General Reference to this Court under Part V of the Local District Court Rules for the District of Vermont. This is a core matter under 28 USC §§157(b)(2)(A), (B), (K), (L), and (O). This Memorandum of Decision constitutes findings of fact and conclusions of law under F.R.Civ.P. 52, as made applicable by F.R.Bkrtcy.P. 7052.

FN2. WHBB holds three mortgages on the Inn real estate, and a security interest in all inventory, equipment, machinery, accounts and contract rights.

FN3. We do not determine here whether we will confirm a Plan that primes WHBB's security interest in this fashion, reserving that issue for the hearing on confirmation.

FN4. Debtor's Plan proposes to raise an additional $55,000 for capital improvements out of its ongoing operations.

FN5. If the buyer finances 65% of the $1.1 million purchase price, the debtload would be $715,000.

1995 WL 264023 (Bankr.D.Vt.)

[Back to Opinions by Citation]
[Back to Opinions by Date]

OR
[Or Search for Keywords]