I. Jurisdiction and Venue

Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(G) and (L). The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334.

II. Facts and Background

This matter is before the Court for determination of Confirmation of the Amended Chapter 11 Plan of GAC Storage Copley Place, LLC (the "Debtor"), Bankruptcy No. 11–40953. The Debtor's case is being jointly administered with the Chapter 11 cases of GAC Storage Lansing, LLC (Case No. 11–40944); GAC Storage El Monte, LLC (Case No. 11–42638); the Makena Great America Anza Company, LLC (Case No. 11–48549) and San Tan Plaza, LLC (Case No. 11–48939) for administrative purposes under Lead Bankruptcy Case Number 11–40944.

The Debtor was formed on or about March 27, 2007 for the purpose of developing approximately 3.9 acres of real property located at 5871 Copley Drive, San Diego, California into 2 buildings of 112,000 square feet of storage space (the "Property"). The Debtor is the owner and operator of the self-storage facility. *See* Debtor's Exhibit B, Second Amended Disclosure Statement.

The sole member of the Debtor is GAC Storage, LLC. The members of GAC Storage LLC are D.M.S.I., LLC (74%) (also a Guarantor), Sunset Storage Partners, LLC (25%) and Silver Valley Investments, LLC ***179** (1%). The members of D.M.S.I., LLC are Noam Schwartz (Guarantor), Y & T Iny Trust (Guarantor), CAT Investments, LLC, TAD 1993 Family Trust, and NS 1998 Family Trust. Ronnie Schwartz ("Schwartz"), who will be the sole and managing member of the Reorganized Debtor under the Plan ("Newco" or the "Reorganized Debtor"), is the brother of Noam Schwartz and the Secretary of Great American Capital, Inc., which is the Manager of D.M.S.I., LLC. Ronnie Schwartz also holds a beneficial interest in the TAD 1993 Family Trust. *Id.*

On or about April 13, 2007, the Debtor and Bank of America, N.A. (the "Bank" or "BANA") entered into a Construction Loan Agreement by which the Bank agreed to lend the Debtor up to the maximum principal amount of $10,242,500 (the "Loan") to build the facility. In 2008, construction of the Property was completed, and the Debtor opened for business with a total of 1000 storage units and 38 RV spaces which totaled 90,520 square feet of rentable space. *Id.*

The Loan had a maturity date of April 13, 2009, however, the Debtor and the Bank entered into a modification agreement which extended the maturity date to December 13, 2011 and reduced the loan amount to $10,026.00. As a condition of the extension, the Debtor was required to make quarterly principal payments in the amount of $62,500.00. The Debtor made the January and April payments, but was unable to make the additional quarterly payments to the Bank. *Id.*

On October 7, 2011, the Debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code (the "Petition Date"). Since the Petition Date, the Debtor has remained in possession and has continued to operate its business and administer its estate as a debtor in possession. *Id.* at 3.

On May 24, 2012, the Bank filed its Proof of Claim in the amount of $9,702,517.36 listing the amount of the secured portion of the claim as $8,300,000 and the unsecured portion as $1,402,517.36. (*See* Case no. 11–40953, Claim no. 2–3).

On September 27, 2012, the Debtor filed its Amended Plan of Reorganization. *See* Debtor's Exhibit A, dkt. no. 612.

The Bank filed its Supplemental Objection to Confirmation of the Amended Plan on October 8, 2012. *See* dkt. no. 626.

The Debtor's report of balloting, filed July 27, 2012, reflects that 2 ballots were cast accepting the Debtor's original plan by holders of unsecured claims, which amount totals $10,840.96. *See* Debtor's Exhibit D; dkt. no. 501.

The Debtor seeks confirmation of its Amended Plan over the objection of the Bank pursuant to the Bank-

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ruptcy Code's cramdown provision of 11 U.S.C. § 1129(b) which allows confirmation of a plan or reorganization without the unanimous consent of creditors.

Commencing on October 11, 2012 and concluding on November 5, 2012, the Court held a five-day evidentiary hearing on Confirmation of the Debtor's Amended Plan.

III. The Debtor's Amended Plan

A. Treatment of the Bank's Claim

Class 2 of the Amended Plan consists of the Bank's Claim in the amount of $10,200,000. The Amended Plan provides that the Bank's Claim shall be allowed as of the Effective Date in the amount of $10,200,000 (dkt. no. 612, Section 2.2.2.) [FN1]. The Amended Plan proposes two scenarios ***180** under which the Bank's Claim is to be treated. Section 2.2.2 states that in the event the Bank votes to reject the Amended Plan, which is the case herein, for purposes of confirmation of the Plan under § 1129(b), the Holder of the Allowed Claim will be deemed to have selected option (i).

> FN1. The Parties stipulated that for purposes of the Confirmation hearing that the Bank's Claim is to be valued as $10.2 million. *See* Trial Transcript, Volume II, at 219.

That provision provides as follows:

(i) The Reorganized Debtor shall pay to the Holder of the Allowed Bank Claim: (A) a lump sum payment in the amount of $200,000 from the Guarantor Contributions on the Effective Date; (B) monthly principal and interest payments ("**Monthly Payments**") on the unpaid balance of the Allowed Bank Claim, based on a thirty (30) year amortization, with interest calculated at 4.6%, [FN2] which Monthly Payments shall commence to accrue on the Effective Date, become payable on the fifth (5th) day of the first full month after the Effective Date (the "**First Payment Date**"), and continue to be paid on the same day of each month thereafter until the earlier of the date the Allowed Bank Claim is paid in full or the Maturity Date; and (C) a balloon payment of the unpaid balance of the Allowed Bank Claim plus any accrued and unpaid interest, which balloon payment shall occur and shall be due and payable on the Maturity Date.

> FN2. Per the testimony and trial exhibits, the Debtor proposes to pay the Bank with interest of 4.61%. *See* Tr. Vol. II, 233.

The Amended Plan further provides that in the event that option (i) governs the Amended Plan, Newco will fund a Payment Reserve [in the amount of $250,000] [FN3] which is to be used by the Reorganized Debtor to supplement its monthly payments to the Bank, in the event it is unable to fund the payments at the time the payments are due. If any balance of the Payment Reserves remains once the Bank's Claim is paid in full, those funds will be returned to the Reorganized Debtor. *See* dkt. no. 612, Amended Plan, Section 1.150, p. 6 & Section 2.2.2, p. 10.

> FN3. The Debtor's Second Amended Disclosure Statement provides for a New Equity Contribution in the amount of $385,000. *See* Debtor's Exhibit B; dkt. no. 396, p. 5. However, the evidence at trial establishes that this amount has been reduced to $250,000. See Tr. Vol. V, 1001–02.

In sum, the Amended Plan proposes to pay down the Bank's $10.2 million dollar claim over 7 years, at 4.61% interest. At the end of the 7–year term, the Amended Plan contemplates that a final balloon payment of approximately $8.7 million will be made to the Bank.

B. The Master Lease Agreement

The Amended Plan also contemplates a 7–year Master Lease Agreement (the "Master Lease") which was executed on October 9, 2012. Pursuant to the Master Lease, GAC Storage Copley, as landlord, will lease its real estate and storage facility business to the tenant, SE Copley Leasehold, LLC ("SE Copley"), who will operate the storage facility. *See* Debtor's Exhibit I, Master Lease Agreement. SE Copley, an affiliate of Storage, Etc., is a special purpose entity formed to be a party to

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the Master Lease Agreement. *See* Trial Transcript, October 11, 2012, Vol. I, 172 ("Tr."). The Master Lease requires that SE Copley Leasehold provide a $1 million dollar letter of credit, or cash deposit of $1,000,000 as security. (Tr. Vol. I., 94).

The Master Lease provides that SE Copley will pay the Debtor monthly rental payments equal to the amount of net operating income set forth in the Debtor's 7–***181** year cash flow projections. (*See* Tr. Vol. I, 88–89) The monthly payments are derived from the net operating income (less a 6% management fees) as set forth in the Debtor's projections. *See* Debtor's Exhibit J, Summation of Revenue of Master Lease Agreement. (*See* Tr. Vol. I, 98). The "year-one base rent" starts at $59,000 per month and increases annually to coincide with the anticipated increase of the Debtor's net operating income through the end of the 7–year plan term. *See* Debtor's Exhibit J, Master Lease Projections. The rent payments due under the Master Lease Agreement will yield the Debtor $717,000 per year. *Id.* Rent from the storage facility's tenants would effectively flow through the SE Copley entity to the Debtor, which would fund the Debtor's payments to the Bank. In the event that the storage facility does not meet cash flow projections, SE Copley would draw from its operating reserve, which would be funded by the capitalization of the SE Copley Leasehold. (*See* Tr. Vol. I, 98.)

The Master Lease Agreement is set to expire seven years after the rent commencement date. (*See* Debtor's Exhibit J; *See* Tr. Vol. I, 94).

C. The Guarantors Injunction

The source of funding for the Debtor's Amended Plan is a $250,000 new equity contribution by Ronnie Schwartz, the sole member of Newco, the reorganized Debtor, and a $200,000 contribution by the Loan's Guarantors, both of which are contingent upon court approval of a Guarantors Injunction in the Amended Plan. *See* Debtor's Exhibit A, Amended Pan, p. 20, Article VIII, Section 8.4.

D. The Debtor's Balloting report

The Debtor's Report of Balloting reflects that with respect to the Class 2 Bank Claim in the amount of 9,702,517.36, one vote rejected the Debtor's Amended Plan. Two ballots were received in connection with Class 4 Claims in the aggregate amount of $10,840.96 accepting the Debtor's Amended Plan. *See* Report of Balloting, dkt. no. 501, Ex. A.

IV. Discussion

A. Plan Confirmation

11 U.S.C. § 1129 sets forth the requirements for confirmation of a chapter 11 Plan. *See In re 203 N. LaSalle St. Partnership,* 126 F.3d 955, 960 (7th Cir.1997), ***rev'd on other grounds,*** 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999). That section provides in pertinent part as follows:

> (a) the court shall confirm a plan only if all of the following requirements are met:
>
> (1) The plan complies with the applicable provisions of this title.
>
> (2) The proponent of the plan complies with the applicable provisions of this title.
>
> (3) The plan has been proposed in good faith and not by any means forbidden by law.
>
> * * *
>
> (b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the plan.
>
> (2) For the purpose of this subsection, the condition that a plan be fair ***182** and equitable with respect to a class includes the following requirements:
>
> (A) With respect to a class of secured claims, the plan provides—

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(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a 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;

* * *

[1] The plan proponent bears the burden of proving by a preponderance of the evidence that each of the requirements of § 1129(a) are met. *In re Mayslake Village–Plainfield Campus, Inc.,* 441 B.R. 309, 316 (Bankr.N.D.Ill.2010); *In re Vita Corp.,* 358 B.R. 749, 750 (Bankr.C.D.Ill.2007), ***aff'd,*** 380 B.R. 525 (C.D.Ill.2008); *In re Repurchase Corp.,* 332 B.R. 336, 342 (Bankr.N.D.Ill.2005).

B. Feasibility of the Debtor's Amended Plan

[2] Section 1129(a)(11), which governs the Bankruptcy Code's feasibility standard, requires that: "Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." 11 U.S.C. § 1129(a)(11). "A bankruptcy judge has an affirmative obligation to ensure that a plan of reorganization is feasible." *In re Repurchase Corp.,* 332 B.R. at 343.

[3][4][5] "The feasibility requirement mandates that the plan proponent offer concrete evidence of cash flow to fund and maintain both its operations and its obligations under the plan." *In re American Consol. Transp. Cos., Inc.,* 470 B.R. 478, 489 (Bankr.N.D.Ill.2012) (citing *Coones v. Mut. Life Ins. Co. of N.Y.,* 168 B.R. 247, 255 (D.Wyo.1994), ***aff'd,*** 56 F.3d 77 (10th Cir.1995)). In determining feasibility, a plan proponent is not required to show that the plan is guaranteed to succeed. *In re 203 N. LaSalle St. P'ship,* 126 F.3d at 961–62. Rather, a reasonable assurance of commercial viability is required. *Id.* In making this determination, the court may examine:

(i) the adequacy of the capital structure; (ii) the earning power of the debtor's business; (iii) economic conditions; (iv) the ability of the management; (v) the probability of the continuation of the same management and (vi); any other matter that may affect the debtor's ability to perform the plan. *In re U.S. Truck Co., Inc.* 800 F.2d 581, 589 (6th Cir.1986).

1. The Debtor has not Proven that the Value of the Property Will be Sufficient at the End of the Plan to make the required balloon payment.

Here, the Bank argues that the Amended Plan fails to meet the feasibility standards of section 1129(a)(11) of the Bankruptcy Code because the Debtor cannot prove its ability to execute on a refinance or full payment sale by the maturity date. The Court agrees and finds that the Debtor has not established by a preponderance of the evidence that it will have the requisite financing to fund the final balloon payment.

183 *The Debtor's Expert

The Debtor called Mr. Robin Detling, a commercial real estate appraiser for Colliers International to testify as its expert on valuation. Detling attended Brigham Young University where he received a bachelor's degree in management. In 2003, Detling joined Colliers International Valuation and Advisory Services where he serves as the managing director of its San Diego offices. (*See* Debtor's Exhibit R; Tr. Vol. III, 521). Detling conducts appraisals for commercial income-producing real estate, including self-storage facilities. (*See* Tr. Vol. III, 532). In 2010, Detling obtained an MAI (Member Appraisal Institute) Appraisal designation from the Appraisal Institute, which is their commercial real estate appraisal designation. (*See* Tr. Vol. III, 529, 633–34). The MAI designation entails several hundred hours of professional education as well as submission of a sample demonstration appraisal report that is reviewed by peers in the appraisal industry. (*See* Tr. Vol. III, 529). One third of his work consists of appraising self-storage and mixed used developments. Within the past year, Detling estimates that he has appraised 10 storage

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facilities and averages 5–10 appraisals per month. (*See* Tr. Vol. III, 532). As a licensed appraiser, Detling is required to follow the Uniform Standards of Professional Appraisal Practice ("USPAP"), which he testified he followed in connection with preparing the appraisal of the Property herein. (*See* Tr. Vol. III, 534). Detling's valuation opinion for the Debtor's Property consists of a determination of the Property's as-is value, a 7–year prospective market value and a liquidation analysis.

Detling testified that he considered information on the Debtor's historical property performance, the building size, the percentage of income-producing units and rent rolls listing the tenants and the rent amounts paid. In addition, a physical inspection of the Property was conducted on May 16, 2012 by Lourdes Alamilla, Certified General Real Estate Appraiser. The inspection consisted of a partial walk-through of the storage facility. (*See* Tr. Vol. III, 550; Debtor's Exhibit R, pp. 11, 74.)

Detling employed the income and sales comparison approaches to valuation for this assignment and determined the as-is market value of the property to be $10,900,000, the stabilized value to be $11,500,000, and the 7–year prospective value to be $12,650,000 FN4. (*See* Debtor's Exhibit R, Letter of Transmittal; Tr. Vol. III, 528, 620). Under the Income Approach, Detling utilized the direct capitalization method, in which he analyzes the relationship of one year's stabilized net operating income to total property value. (*See* Debtor's Exhibit R, p. 47). Direct Capitalization entails converting an estimate of stabilized net operating income into an indication of value by dividing it by an overall capitalization rate. As explained in Detling's report:

> FN4. Detling's initial prospective value conclusion of $12,810,000 was re-calculated at trial to correct an error in his analysis. *See* Tr. Vol. III, 528, 620.

> the first step in the Direct Capitalization method is to estimate the subject's potential gross income. This process is accomplished through a comparison of the subject with similar properties having similar locations and utility. Vacancy allowance and operating expenses are deducted, based on market analysis. Finally, the resulting net operating income is capitalized at an appropriate supported rate.

See Debtor's Exhibit R, p. 47.

In determining the "as-is" value, Detling measured the economic and physical occupancy***184** levels of the Property and compared them with regional average occupancy rates. Physical occupancy measures the occupancy of a facility based on how many units are occupied by tenants, whereas economic occupancy factors in discounts, concessions received and credit loss. *See* Debtor's Exhibit R, p. 34. To account for vacancies and rent concessions, Detling applied a combined rate of 10%.

At the time of the Property's inspection, the physical occupancy rate was at 66%, which the evidence reflects was well below market rate for storage facilities. The evidence at trial revealed that the physical occupancy rate as of September 2012, had grown to 79%. Detling explained that generally, a property with a higher occupancy rate would have a higher value but noted that this increase in the Property's physical occupancy did not change his value conclusion. (*See* Tr. Vol. III., 557–58, 576–79).

To determine the 7–year prospective market value of the Property, Detling again employed the direct capitalization method (*See* Tr. Vol. III, 535) which takes the estimated income generated by the Property at a future point in time (in this case, 7 years through 2019), then divides that figure by a residual, or future capitalization rate which results in a prospective value. (*See* Tr. Vol. III, 535.) Detling explained that "when you're looking forward at future income, there's a bunch of uncertainties in the future FN5. You don't know exactly what the operating expenses will do ... You're not entirely certain if the rent of the Property is going to grow fast or slow...." (*See* Tr. Vol. III, 536). To account for such uncertainties, Detling testified that he applied a growth rate of 3% to the rental and other income beginning in year 2014; and an increase of 3% a year to account for the increase of expenses. *See* Debtor's Exhibit R, p. 72.

FN5. In the Court's view, those uncertainties

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include the status of the economy, whether lenders have tightened lending requirements, and Washington's monetary policies.

The Bank's Expert

The Bank called Mr. Terence M. Connolly ("Connolly") as its valuation expert. Connolly received a Bachelors of Science degree from the University of San Francisco and has been a licensed appraiser since 1985. He is licensed in California, Nevada, Oregon and Washington, and has an MAI designation with the appraisal institute. (*See* Tr. Vol. IV, 760). Connolly testified that he averages 350 appraisals per year and estimates that he has conducted "thousands" over the course of his career. Connolly's valuation opinion for this Property consists of the determination of the as-is value, and the value at its stabilized rate.

Connolly employed the income and sales comparison approaches in his valuation analysis and considered the Property's size, physical location, its historic occupancy and vacancy levels, and the May, 2012 rent roll provided by the Bank. According to his report, the income approach involves capitalizing net operating income to produce an indication of value. *See* BANA Exhibit 1, p. 36. Under the income approach, Connolly used the direct capitalization method, one of two capitalization methodologies used for this approach. *Id.* Under this approach, Connolly first conducted an analysis of existing revenue for the subject Property. *See* BANA Exhibit 1, p. 36. Connolly compared the subject Property with comparables using available market rental data. The occupancy rate and self-storage rents of the subject Property were then compared to five area self-storage properties. *See* BANA Exhibit 1, p. 36. Based on market data, Connolly concludes the stabilized occupancy rate for ***185** this Property to be 88%. (*See* Tr. Vol. IV, 856). Connolly's conclusion as to the Property's stabilized value is $9,960,000. BANA Exhibit 1, p. 53.

In the free rent and concessions portion of his analysis, Connolly notes that occupancy rates for area self-storage facilities range from 87% to 92%. A–1 Storage, the facility closest to the subject Property, had a 92% occupancy rate. The subject Property's occupancy rate at the time of his report was 67%. For the Debtor's Property, Connolly determined a 6% effective rent loss/concession discount to be appropriate, explaining that the Debtor offers one month free rent out of 12 months. (*See* Tr. Vol. IV, 785–86; BANA Exhibit 1, p. 44). Connolly also deducts an additional 12% to account for additional vacancy and collection losses. *See* BANA Exhibit 1, p. 45. To arrive at the 12% figure, Mr. Connolly compared the historic vacancy rate of the subject Property with the vacancy rates of self-storage rental comparables surrounding the Debtor's Property. *See* BANA Exhibit 1, p. 38.

Under the sales comparison approach, Connolly compared the subject Property with five comparables similar in terms of physical characteristics. His conclusion as to stabilized value under this approach was $9,980,000, which he contends supports his income approach number of $9,600,000. (*See* Tr., 811).

To determine the "as-is" value of the Property, Connolly began his analysis with the stabilized value estimate of $9,900,000. *See* BANA Exhibit 1, p. 70. Under this scenario, the value of absorption costs is discounted and includes marketing costs and time value to absorb the remaining unoccupied space to an 88% occupancy ratio, which corresponds to the vacancy rate (of 12%) used in the Income Approach. The absorption rate is the estimate of how many square feet the facility will rent monthly. (*See* BANA Exhibit 1, p. 66; Tr. Vol. IV, 813). Connolly applies a discount rate of 15% of the stabilized value estimate, less an additional $54,000 advertising expense, which brings the "as-is" value to $8,150,000. (*See* BANA Exhibit 1, p. 70; Tr., Vol. I, 816–18.)

The Debtor's Expert is not Credible

After giving due consideration to the testimony and reports of both experts, the Court finds that the inconsistencies in Detling's report and the lack of data supporting his conclusions render his valuation conclusion unreliable. The most damaging to Detling's credibility was his failure to properly provide for rental concessions and the vacancy rate when calculating gross potential rent under the income approach. (*See* Debtor's Exhibit R, p. 54. Tr. Vol. III 669–71.)

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In general, both experts agreed that rent concessions are commonplace in the self-storage industry, however, they differed on how to correctly provide for these rates in their analysis. Connolly explained that it is important to separate the vacancy rates from concessions rates because the concessions loss is not accounted for in the market survey of vacancy rates. (*See* Tr. Vol. IV, 827–28). He further explains that concessions are an important factor in the analysis because they represent money that the property owner does not collect. (*See* Tr. Vol. IV, 785). According to his report, "self-storage properties tend to offer concessions to potential customers in order to gain business and occupy vacant units ... The typical concession is one month free." *See* BANA Exhibit 1, p. 44. Accordingly, Connolly based his concession conclusion on the concession rates for comparable properties, the Debtor's historic concession rate, and self-storage industry guidelines. (*See* Tr. Vol. IV, 787). Connolly concluded 6% to account for concessions and rent loss and noted in his report ***186** that market data supports a 12% stabilized vacancy and collection loss projection. *See* BANA Exhibit I, p. 44–45.

Detling, on the other hand, applied a vacancy factor of only 5.6% although, as noted in his report, self-storage operators and brokers report that a vacancy factor range of 10%–20% is general industry standard for this market. *See* Debtor's Exhibit R, p. 41. To arrive at his vacancy conclusion, Detling testified that he "loaded up" [the 5.6%] for concessions and attributed a combined vacancy factor of 10%. (*See* Tr. Vol. III, 737; Debtor's Exhibit R, p. 56.) Further, the evidence reveals that only half of Detling's market area comparables reported vacancy rates. Thus, his analysis as to the appropriate rate is limited to 3 market comparables. (Tr. Vol. III, 658–59). The evidence also reveals that this variance in the rent concession and vacancy loss calculations resulted in a higher net operating income conclusion by Mr. Detling, thus skewing his ultimate valuation conclusion. (Tr. Vol. III, 627). According to Detlings's own testimony, "net operating income drives value," thus, "an increase in net operating income would cause a higher value, and a decrease in net operating income would cause a lower value." (Tr. Vol. III, 676). In the Court's view, these anomalies render Detling's conclusions unreliable.

In addition to the inaccuracies in his vacancy calculation, Detling admitted that he failed to provide for the vacancy rate of RV rental spaces in his analysis, which led to an in-court calculation to correct the figures set forth in his appraisal report. (Tr. Vol. III, 570, 572–73).

The Court also finds that Detling's prospective value conclusion is unreliable. The Debtor's Amended Plan proposes to leave the majority of the Bank's claim unpaid until the end of the 7–year term, at which time it will pay off the balance of $8,700,000 in full. *See* Debtor's Response to Objection to Confirmation, Case No. 11–40944, dkt. no. 618, p. 7. Thus, Detling's $12,650,000 prospective value opinion is offered to support the Debtor's assertion that it will have the requisite financing based on future value at the end of the Amended Plan to pay the Bank's Claim. However, Mr. Detling's own testimony seems to undermine his ultimate value conclusion. In opining on the state of the economy, Detling testified that although there has been some evidence of recovery in the San Diego area, there is still potential for further recovery, and job growth. (Tr. Vol. III, 561). He also opined that the storage facility market remains highly uncertain (Tr. Vol. III, 652) and that he did not consider San Diego to be in true recovery from the recession. The evidence also reveals that the unemployment rate in San Diego, which according to his report was 9.3% in February of 2012, remains above the national average. (*See* Debtor's Exhibit R, p. 17; Tr. Vol. III, 652). Despite these meager economic indicators, Detling opines that applying an annual 3% growth rate in income and expenses adequately captures the uncertainties associated with projecting income 7 years in the future. The Debtor's aggressive projections simply do not line up with economic reality.

In contrast, the Court found the testimony provided by the Bank's expert, Mr Connolly, respecting prospective value conclusions to be particularly persuasive and credible. Mr. Connolly, an appraiser with 25 years' experience testified credibly that applying projected rates that far out in the future is not something that he believes can be done with any degree of accuracy. He test-

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ified that he would not make a 7–year projected calculation for the purpose of establishing value. (*See* Tr. Vol. IV, 974–75).

***187** [6] In sum, the Court finds that the discrepancies in Detling's appraisal report and testimony cast serious doubts on the accuracy of his valuation conclusions. The Court therefore concludes that the Debtor has not proven by a preponderance of the evidence that it will have sufficient equity or other resources to pay off the bank's claim in seven years. Thus, the requirements of section 1129(a)(11) have not been met.

The Court finds the valuation conclusion proffered by Connolly to be reliable, well reasoned and fully supported by the evidence.

Accordingly, the Court accepts the Bank's valuation and determines the as-is value of the Property to be $8,150,000.

2. The Debtor's Plan is based on Unsupported Projections

[7] Next, the Bank argues that the Plan is not feasible because it is based on unrealistic projections. The Debtor in turn argues that the income generated by the reorganized Debtor under the Master Lease Agreement will be more than adequate to fund Plan payments to the Bank with a $2 million cash buildup over the life of the Plan. Debtor's Response, dkt. no. 618, p. 6.

The Debtor did not present a feasibility expert in support of its Plan, but called Mr. Chris Lyons ("Lyons") to testify as a representative of Storage, Etc., a real estate company which owns, manages and develops self-storage properties. (Tr. Vol. I, 14). Lyons has been in the self-storage industry for 24 years and has served as Storage, Etc.'s Vice President for 12 years. In March, 2012, Storage, Etc. took over management of the Debtor's Property. (Tr. Vol. I, 31).

Lyons, who assisted with the preparation of the Debtor's 7–year cash flow projections, testified that since Storage, Etc. took over management of the Debtor's property, the physical unit occupancy has increased from 66% to 79% and that the Property is doing better than initially projected. According to Lyons' projections, by the end of year one (2013), the Debtor will have an economic occupancy of 86.3% and a physical occupancy of 90.3%. (*See* Debtor's Exhibit O, Storage, Etc.'s September 2012 Projections.). To achieve those projections, Lyons explained that Storage, Etc. will continue to rent the storage units at prices similar to their current rate, with 3% annual rent increases through year 7. (Tr. Vol. I, 76–77). The projections forecast that the Debtor will remain at a stabilized occupancy level of 90% throughout the Plan term. (*See* Debtor's Exhibit O).

The Bank called Mr. Keith Bierman ("Bierman"), a Certified Public Accountant, who testified as its feasibility expert and as an interest rate expert. Mr. Bierman has a degree in accounting from the University of Arizona, and has been in the accounting field for 12 years. He currently works at MCA Financial Group, where he has served as the Senior Managing Director for 12 years. The MCA Financial Group report was prepared by Morris C. Aaron, President and Senior Managing Director of MCA Financial Group, and Mr. Bierman. Bierman testified that he was very involved with the analysis, writing, findings and opinions contained therein. (*See* BANA, Exhibit 3, p. 1; Tr. Vol. II, 400.)

In his report, Bierman opined that the Debtor's Plan is not feasible due in part to the aggressive projections which are not consistent with the Debtor's current performance. He opined that the Plan fails to take into consideration factors such as anticipation of potentially declining future rental rates and additional rental rate concessions extended to entice existing tenants***188** to stay. Further, Bierman observes that just a 10% deviation in the Debtor's revenue forecast results in negative cash flow of $(232,720) and $(60,439) in years 1 and 2. *See* BANA Exhibit 2, p. 4, Report of MCA Financial Group, Ltd. Bierman concludes that Debtor's Plan provides for aggressive assumptions for the leasing of vacant space which are not in line with current market conditions. The Court agrees.

Beyond the annual rent increases and the addition of internet marketing, the Court heard little evidence to substantiate the significant growth projected in the Debtor's Amended Plan.

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The evidence reveals that the Debtor's projections require an average growth rate of 2.16% in the economic occupancy in the next 8 months when the Debtor averaged a monthly growth rate of only 1.44% in the in the past 8 months. *See* BANA, Exhibit 5, Analysis of Key Statistics Prepared by Debtor 10/8/12. The Court finds these projections to be speculative given the economic conditions of the area and the proximity of Debtor's competitor A–1 Storage which has better visibility, and according to Mr. Lyons, has had a 90% occupancy rate for "as long as [he] can remember." (Tr. Vol. I, 79).

The Court notes that although some of the Bank's concerns and the issues raised in Bierman's appraisal report have been addressed by the Debtor, such as the replacement of a non-binding letter of intent with the Master Lease agreement, many feasibility issues remain unresolved. The evidence presented at trial reveals that the entity SE Copley, the Debtor's tenant and sole source of income through the pendency of the Amended Plan, had yet to be capitalized at the time of the confirmation hearing. Further, Storage, Etc. had not obtained the letter of credit or the $1 million dollar security deposit due under the Master Lease. At trial, Lyons was unable to provide the name of a financial institution willing to provide a letter of credit, yet he remained optimistic that one would be obtained within 30 days. (*See* Tr. Vol. I., 102–05). In the event that the storage facility is unable to achieve the net operating income projections which dictate SE Copley's rental payments to the Debtor, there is no evidence that SE Copley has sufficient capital reserves to fulfill its contractual obligations to the Debtor, leaving the Debtor without funds to provide its payments to the Bank. When questioned on cross examination regarding the likelihood that Storage, Etc. would obtain these securities, Mr. Lyons replied that he was "very comfortable that will happen." *See* Tr. Vol. I., 102–05. Unfortunately for the Debtor such assurances absent concrete evidence are insufficient to establish that the terms set forth in its Amended Plan are feasible. *Chase Manhattan Mortgage & Realty Trust v. Bergman (In re Bergman)*, 585 F.2d 1171, 1179 (2d Cir.1978) ("Sincerity, honesty, and willingness are not sufficient to make the plan feasible, and neither are any visionary promises."). The scarcity of such vital information is fatal to the Debtor's Plan, as the rental income under the Master Lease Agreement is the sole source of funding for the Debtor's Plan.

For those reasons, the Court finds that the Debtor has not met its burden of showing that the Amended Plan is feasible under 11 U.S.C. § 1129(a)(11), which requires in part that confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan.

C. The Debtor's Plan fails to meet the Cram Down Requirements of Section 1129(b).

The Bank also objects to Confirmation of the Amended Plan because the Debtor's ***189** proffered interest rate of 4.61% does not reflect the risk of nonpayment and submits that an appropriate rate of interest for the Bank's claim is at least 8.2%. It contends that the Plan's treatment of the Bank's claim violates the fair and equitable test and for that reason confirmation of the Plan should be denied.

Section 1129(b) provides that a plan that satisfies the requirements set forth in 1129(a), except for subsection (a)(8), may be confirmed over a creditor's objection, if the plan does not discriminate unfairly between impaired classes and is fair and equitable to the class of creditors that have rejected the plan. 11 U.S.C. § 1129(b)(1). *In re Mayslake*, 441 B.R. at 316.

[8] Where the plan provides for the retention of the creditor's collateral, the condition that the plan be fair and equitable with respect to a class includes the following requirements: i) that the plan provides that the creditor retains its lien on the collateral; and ii) the creditor receives deferred cash payments equal to the present value of the allowed claim. 11 U.S.C. § 1129(b)(2)(A). Further, the plan of reorganization cannot unfairly shift the risk of a plan's failure to the creditor. *In re Monarch Beach Venture Ltd.*, 166 B.R. 428, 436 (C.D.Ca.1993).

Accordingly, the Debtor's Plan must propose an interest rate adequate to assure the realization of the Bank's claim, which for purposes of confirmation, is

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$10,200,000. *See In re Bloomingdale Partners, LLP,* 155 B.R. 961, 977 (Bankr.N.D.Ill.1993).

[9] While the Debtor bears the burden of proof on plan confirmation issues, it is the Bank that bears the burden of establishing that an additional risk adjustment is necessary. *See In re American Consol. Transp. Cos., Inc.* 470 B.R. at 487; *Till v. SCS Credit Corp.,* 541 U.S. 465, 484–85, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004) ("[T]he formula approach, which begins with a concededly low estimate of the appropriate interest rate and requires the creditor to present evidence supporting a higher rate, places the evidentiary burden on the more knowledgeable party, thereby facilitating more accurate calculation of the appropriate interest rate.") FN6.

FN6. Compare with *In re DeTienne Assocs. L.P.,* 2005 Bankr.LEXIS 3122, *18–19 (Bankr.D.Mont.2005), where a bankruptcy judge opined that the burden of satisfying the cramdown requirements under section 1129(b) remain with the debtor despite the Supreme Court's decision in *Till v. SCS Credit Corp.*

1. Determination of an Appropriate Rate of Interest

The Court finds that the rate asserted by the Debtor fails to capture the risk inherent in its Plan and concludes that 8.2% is an appropriate rate of interest given the Debtor's circumstances.

In support of its proffered rate, the Debtor called Mr. Kenneth Funsten ("Funsten"), CFA to testify as its expert interest rate analyst. Funsten received an MBA in finance and real estate from the University of Southern California and has over 20 years experience as a debt analyst, trader and portfolio manager. (Tr. Vol. II, 225–27; Debtor's Exhibit T, p. 32.) To prepare for his report, Funsten reviewed the Debtor's Amended Plan and Second Amended Disclosure Statement, cash collateral budget, rent rolls, and conducted a site visit of the Property. He also relied on the figures and assumptions set forth in the Master Lease with Storage, Etc., and the appraisal report of Mr. Robin Detling, the Debtor's appraiser. (Tr. Vol. II, 234.). He ultimately concluded that the interest rate of 4.61% was adequate. *See* Debtor's Exhibit U.

***190** Funsten opined that no market exists for the Loan, as the Debtor's Property is over-leveraged with a Loan–to–Value ratio of 90%, which is above the level at which commercial banks are making loans. (*See* Debtor's Exhibit T, p. 16; Debtor's Exhibit U, Tr. Vol. II, 235–39, 316.) Therefore, Funsten followed the Blended Rate Approach, which he describes as a " *Till*-guided" formulaic method, and concluded that 4.61% is an appropriate rate of interest for this loan as required by section 1129(b)(2)(A).

Funsten explains that the Blended Rate Approach entails dividing a single loan into a series of risks, or tranches, and then using weighted factors to evaluate each risk's appropriate interest rate before "blending" those rates together into a single interest rate. *See* Debtor's Exhibit T, p. 20. The Blended Rate Approach fixes how much of a plan's proposed new loan deserves an interest rate of prime (the "A" tranche, or the conforming loan piece) and how much of the new loan deserves a rate substantially higher than prime (the "B" tranche). This approach gives degrees of risk their own interest rate, their own risk-rates, and then weighs and reblends the results to determine a single number. Debtor's Exhibit T, p. 21. Funsten first selected the prime rate of 3.25% to the A tranche. To the B tranche, he assigned a blended interest rate which of 8.18% which he derived from combining a treasury bill rate and a junk bond rate. *See* Debtor's Exhibit U, p. 1. The Blended rate totals 4.61%.

In his report, Funsten provides a narrative of the collateral, the capacity, plan circumstances and property characteristics (commonly referred to as the four C's of Credit) that were considered in formulating his interest rate conclusion. *See* Debtor's Exhibit T, Section F, p. 14. Funsten considered the current performance of the Debtor's Property, noting that "[c]urrent and projected financial performance shows rapidly improving operations." Funsten also noted in his report that the marketing efforts by the Debtor, and its manager, Storage, Etc. have resulted in improved financial results which are expected to continue to improve in the future. Debtor's Exhibit T, Section E, p. 13. He also relied on the Debtor's 7–year cash flow projections, which show that the

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Debtor will need $615,000 annually to fund its payments to the Bank. (*See* Tr. Vol. II, 261.).

In his discussion of the Property Characteristics, Funsten expressed that the diversity of the Debtor's cash flow, with over 1000 tenants, was one of the positive aspects of the Debtor's Plan. *See* Debtor's Exhibit T, p. 15. He explained that this characteristic has a "more certain prospect of creditor repayment, than other smaller, less diversified properties." *Id.* However, when questioned about the newly executed Master Lease, which in essence replaces that "1000 tenants" with one master tenant, (SE Copley), Funsten suggested that this too is a positive characteristic because it improves the certainty of the Debtor's cash flow and assures a revenue stream. (Tr. Vol. II, 269, 337.) Funsten explained this variance in his opinion by noting that with the Master Lease, the Debtor now has a lessee that has contractually guaranteed payments over 7 years, as opposed to having multiple lessees to provide the same revenue stream. (Tr. Vol. II, 255.) Funsten also opined that the Property is in good repair, and therefore has low need for capital improvements.

Funsten defended his interest rate opinion by explaining that because appraisals by nature reflect the risk that the borrower may not be able to perform, care must be taken not to "double-count," thereby artificially increasing the Debtor's risk and ***191** the Property's risk. (*See* Debtor's Exhibit T, p. 17.)

The Bank counters that an interest rate in excess of the 4.61% per annum is necessary to provide it with the present value of its secured claim and submits that 8.2% is an appropriate rate of interest.

Mr. Keith Bierman, the Bank's interest rate expert, also employed a formula approach (also referred to as the "build-up" method), and the market approach to his analysis and determined 8.2% to be an appropriate rate of interest given the circumstances surrounding the Debtor's Plan. *See* BANA, Exhibit 2, p. 5.

Under both approaches, Bierman assumes that the value of the Debtor's Property is $8.15 million, and has a Loan to Value rate in excess of 100%. (Tr. Vol. II., 402–03.) According to Bierman's report, the Formula Approach consists of a base rate, plus additional factors to compensate for risks associated with a specific borrower or terms of repayment. He explains that his risk analysis is dependent upon risk factors such as i) default risk; ii) security risk, and iii) interest rate risk. *See* BANA, Exhibit 2, pp. 5–7.

Under the formula approach Bierman began, as did the Debtor's expert, with the prime rate of 3.25%. However, Bierman assigns an additional security and default risk adjustment of 2% to account for the additional default risk that the Debtor will be unable to make the payments under the Plan. Bierman makes this risk adjustment because in his view, the Debtor's Plan relies on "unreasonably optimistic" and aggressive assumptions for rental rates and the lease-up of the existing vacant storage space. *See* BANA, Exhibit 2, p. 6. He observes that the risk of default is considerable given that the Debtor has not established that sufficient income can be generated from the Property or that the New Equity contribution under the Amended Plan is available and sufficient. *See* BANA, Exhibit 2, p. 6. Bierman next assigns a 1% risk adjustment as the Interest Rate risk for the 7–year term of the Debtor's loan. Interest rate risk is the risk a lender takes by providing fixed financing while its cost of capital is variable. He explains that the interest rate risk adjustment is necessary because the Debtor's Plan exceeds the conventional 3–year term, and this adjustment compensates the Bank for fluctuations in interest rates over the course of the Debtor's 7–year plan term. (*See* BANA, Exhibit 2, p. 6.)

Bierman next applied a 2% adjustment to account for Security and Default Risk for a loan above 65% to 90% loan to value. He notes that in this case, the loan to value ratio is assumed to be 100%, which is outside of traditional lending guidelines. *Id.* at 6; Tr. Vol. II, 412. Bierman explains that 2% is an appropriate risk adjustment because this is the riskiest piece of the Debtor's loan. Thus, the 2% is combined to 6.25% to arrive at the interest rate of 8.25%. Bierman then applies a weighted interest calculation to portions of the loan amount to arrive at the appropriate rate of interest of 8.2% [FN7]. (*See* BANA Exhibit 2, p. 8; Tr., 414–15.). A chart illustrat-

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ing Bierman's build-up rate approach has been reproduced below:

FN7. In his supplemental report on feasibility, Bierman expressed additional concerns regarding the non-binding nature of the letter of intent. As noted above, the letter of intent has since been replaced with a 7–year Master Lease Agreement between Storage, Etc. and SE Copley. *See* BANA, Exhibit 4. However, Bierman testified that even with these changes, his ultimate interest rate conclusion is unchanged.

	Rate Build Up
Prime Rate	3.25%
Security & Default Risk—	2.00%
Interest Rate—conforming 65% LTV, 3–year term	5.25%
Interest Rate Risk for 7–year term	1.00%
Interest Rate—conforming 65% LTV, 7–year term	6.25%
Security & Default Risk for loan above 65% to 90% LTV	2.00%
Interest Rate for portion above 65% to 90% LTV	8.25%

***192** *See* BANA, Exhibit 2, p. 8.

Bierman next employed the market approach, whereby market lenders are surveyed to determine the terms lenders offer to the very best borrowers under conforming loan conditions. The market rate approach is a separate analysis used to verify the reasonableness of the assumptions in the formula rate approach. (Tr. Vol. II, 490–91.) This approach consists of a market survey of lenders to determine a) if a market for the Debtor's loan exists; and b) the current market rate of interest if such a loan were available to the Debtor. (*See* BANA, Exhibit 2, p. 5; Tr. Vol. II, 409.) Bierman testified that he uses the market approach to verify that the assumptions made under the formula approach are accurate. (Tr. Vol. II, 417.)

In opining on the Debtor's proposed interest rate, Bierman testified that the Debtor's expert failed to account for the risks associated with the Bank's claim. (Tr. Vol. II, 421.) He opined that the interest rate proposed by the Debtor is not an appropriate interest rate, given the repayment terms of the Plan, the risk inherent in the Plan, the current occupancy level and cash flow of the Property, as well as current market conditions. (*See* BANA, Exhibit 2, p. 3).

2. The Bank's proffered rate is the appropriate Rate of Interest

Although both experts contend they followed the guidelines set forth in the Supreme Court's plurality decision in *Till v. SCS Credit Corp.,* the Court finds that the interest rate proffered by the Debtor does not provide an adequate risk adjustment given the circumstances of the Debtor's Plan.

In *Till v. SCS Credit Corp.,* 541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004), the Supreme Court opined on the correct approach for selecting an appropriate rate of interest for cramdown in a Chapter 13 context. There, the plurality concluded that a "prime plus" formula rate approach, which is based upon the prime rate of interest, best carries out Congress's intent for the Bankruptcy Code provisions requiring discounting to present value. 7 COLLIER ON BANKRUPTCY ¶ 1129.06[1][c] (Alan N. Resnick & Henry J. Sommer eds., 16 ed. Rev.). Speaking for the plurality, Justice Stevens opined that "[t]he 'prime plus' rate of interest depends only on the state of financial markets, the circumstances of the bankruptcy estate, and the characteristics of the loan, not on the creditor's circumstances or its prior interactions with the debtor." *Till,* 541 U.S. at 478–80, 124 S.Ct. 1951. While declining to decide the scale for risk adjustment, the Court noted that other

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courts generally approved adjustments of 1–3%. *Id.* at 480, 124 S.Ct. 1951. The Court went on to note that the cramdown requirement "obligates the court to select a rate high enough to compensate the creditor for its risk but not so high as to doom the plan. If the court determines that the likelihood of default is so high as to necessitate an "eye-popping" interest rate, the plan probably should not be confirmed." *Id.*

[10] Here, the Court finds that the circumstances of the Debtor's Amended ***193** Plan and the characteristics of the loan indicate that a 1–3% risk adjustment does not adequately compensate the Bank for all of the risks it faces. Accordingly, the Court determines that the higher interest rate adjustment proffered by the Bank is appropriate under the circumstances.

The Debtor's expert provides a cursory review of the collateral, capacity, plan circumstances and property characteristics he considered in his analysis, however, it is not clear from his report or from his testimony at trial that those risks were actually provided for in his ultimate interest rate conclusion.

The Court finds that Bierman's report by contrast more aptly evaluates all of the risks in light of the circumstances of the Debtor's Amended Plan. Mr. Bierman identified and explained the specific risk factors of the Loan and applied a series of rates using a formula approach. His report provides a detailed study of the Debtor's Plan, the projections therein, and the risks inherent given those figures. Bierman provides a well-reasoned analysis of the build-up approach, in which he begins with a prime rate of 3.25%, and assigns additional rate adjustments to account for the Debtor's non-conforming self-storage building loan with a loan to value of 65%, to account for specific risk factors associated with the 7–year plan. Bierman then conducts a market survey to ensure that his interest rate conclusion is consistent with rates in the appropriate market. (Tr. Vol. II, at 417; Bank's Exhibit 2, pp. 8–9).

Accordingly, the Court finds the interest rate advanced by the Debtor does not sufficiently capture the risk that the Debtor will not satisfy the Bank's claim. The 8.2% interest rate conclusion submitted by the Bank is supported by the data provided in Bierman's report and the additional evidence presented at trial.

D. Debtor's Plan Fails to Satisfy Disclosure Requirements.

The Bank also complains that the Plan cannot be confirmed because the Debtor has not complied with the disclosure requirements of section 1127 of the Bankruptcy Code.

Section 1127(a) provides that the proponent of a plan may modify a plan at any time before confirmation. 11 U.S.C. § 1127(a). However, the plan proponent must also satisfy disclosure requirements of section 1125 with respect to the plan, as modified. *See* 1127(c). 11 U.S.C. § 1125 provides:

(a) In this section—

(1) "adequate information" means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan and in determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information.

[11][12] The purpose of a disclosure statement is to provide creditors the information they need to decide whether to accept or reject the debtor's plan. The determination of whether the disclosure ***194** statement contains adequate information is made on a case-by-case basis under the facts and circumstances presented. *In re Scioto Valley Mortgage Co.*, 88 B.R. 168, 170 (Bankr.S.D.Ohio 1988).

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[13] Upon review of the Amended Plan, it is clear that the Debtor has not complied with the disclosure requirements of section 1125 as the Debtor fails to provide any information regarding the recently executed Master Lease Agreement or about the identity of the tenant under the agreement, SE Copley. Because the rental income due the Debtor under the Master Lease Agreement is the sole source of funding under the Plan, the Court finds it critical that this information be included so that creditors can make an informed decision on whether to vote for the Debtor's Amended Plan. As noted by the Bank in its Supplemental Objection, the Second Amended Disclosure Statement is also devoid of information concerning the financial condition of the newly formed tenant entity, SE Copley, its parent Storage, Etc., and the business relationships between the Master Lease tenant, the Debtor, and its guarantors. *See* dkt. no. 626, p. 5.

The Second Amended Disclosure Statement is also defective in that it fails to accurately provide for the amount of the new equity contribution under the Amended Plan. The Debtor's Second Amended Disclosure Statement provides in part that Schwartz will make a new equity contribution in the amount of $385,000. *See* Debtor's Exhibit's B, Section III, p. 5. However, according to the evidence presented at trial, Schwartz's contribution will be $250,000. (*See* Tr. Vol. V, 1001–02). Accordingly, the Court concludes that the Debtor's Amended Plan fails to comply with the disclosure requirements of Section 1127.

In a related objection, the Bank also argues that the Amended Plan does not satisfy Section 1129(a)(5) of the Bankruptcy Code because it does not provide information regarding post-confirmation management of the Reorganized Debtor.

Subsection 1129(a)(5)(A)(i) requires that:

> The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan

11 U.S.C. § 1129(a)(5)(A)(i).

[14] The Court notes that the Debtor's Second Amended Disclosure Statement provides some indication of the management structure of the Reorganized Debtor. There the Debtor discloses that none of the Debtor's current owners or Guarantors shall have any ownership interest in the Reorganized Debtor, but explains that "it is possible that third party investors, such as Storage, Etc., may at some time in the future acquire ownership interest in [the reorganized Debtor]." *See* Debtor's Second Amended Disclosure Statement, dkt. no. 396, Section III. A, p. 5. However, the Amended Plan is silent as to the management structure of the Reorganized Debtor. According to Mr. Schwartz's testimony at trial, he intends to bring on either himself or another entity which he would control as the manager of Newco (Tr. Vol. V, 1057–58) and that the manager would have a 1% ownership interest in Newco. This information is not noted in the Debtor's Amended Plan. Without that disclosure, creditors have no way of knowing this until after the Amended Plan has been confirmed. Debtor's failure to supply this information in its Amended Plan constitutes a failure to comply with section 1129(a)(5)(A)(i).

***195 E. Application of Absolute Priority Rule**

The Bank also objects to confirmation of Debtor's Amended Plan under the "absolute priority rule." It argues that because the Amended Plan proposes to transfer the equity interests of the Debtor to certain insiders, it allows the current principals to determine who will own equity of the reorganized debtor and how much they will pay. The Debtor argues that the Bank has no standing to assert the absolute priority rule as the class of unsecured creditors has voted to accept the Amended Plan. 11 U.S.C. § 1129(b)(1) provides:

> Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is im-

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paired under, and has not accepted, the plan.

* * *

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property....

11 U.S.C. § 1129(b)(1) and (b)(2)(B).

[15][16][17] Under the "absolute priority" rule, claims of any objecting, impaired class must be paid in full before a class of claims junior to it is allowed to retain any interest under a Chapter 11 plan. 11 U.S.C. § 1129(b)(2)(B)(ii); *In re Greenwood Point, LP,* 445 B.R. 885, 909 (Bankr.S.D.Ind.2011). The absolute priority rule is one of the conditions of the "fair and equitable" standard necessary for cram down of a proposed Chapter 11 plan over objection of an impaired creditor. *In re Sentinel Mgmt. Group, Inc.* 398 B.R. 281 (Bankr.N.D.Ill.2008). Where one or more classes of claims entitled to vote reject the plan, any member of the rejecting class may file an objection to confirmation of the plan based on any alleged violation of the absolute priority rule.

In this case, the Bank argues that it is undersecured and thus, has a deficiency claim which would grant it standing as a member of the class of unsecured creditors.

[18] Under the Amended Plan, the Bank's claim is treated as wholly secured. However, as noted above in this Court's opinion, the Court has accepted the Bank's appraisal value of $8,150,000. Thus, pursuant to section 506(a), the Bank has a deficiency claim in the amount of $2,050,000 [FN8] and may have standing to invoke application of the absolute priority rule.

FN8. This amount reflects the parties stipulation that for purposes of confirmation, the Bank's claim be treated as $10.2 million. *See* Trial Transcript, Volume II, at 219.

Next, the Bank argues that the "insider nature" of the Plan warrants application of the absolute priority rule. The Bank submits that Schwartz formulated the Amended Plan primarily for his own benefit, and for the benefit of Noam Schwartz, Yoel Iny and their families. The Debtor responds that applying the absolute priority rule in this case violates the plain meaning of the statute, as the Debtor's Plan does ***196** not involve the transfer of "old equity." Accordingly, the Debtor urges this Court to interpret the statute literally. *See* Tr. Vol. VI., 1240–44.

[19] The Absolute Priority Rule prohibits "current holders of equity from retaining any interests or property on account of their equity interests unless senior classes are paid in full." *In re Greenwood Point, LP,* 445 B.R. at 910. The current ownership structure of the Debtor is as follows: GAC Storage, LLC is the sole member of the Debtor. The members of GAC Storage, LLC are D.M.S.I., LLC (74%), Sunset Storage Partners, LLC (25%) and Silver Valley Investments, LLC (1%). *See* Debtor's Exhibit B, p. 2, Second Amended Disclosure Statement. The five members of D.M.S.I., LLC are Noam Schwartz, Y & T Iny Trust, CAT Investment, LLC, TAD 1993 Family Trust, and NS 1998 Family Trust. Schwartz, who will be the sole and managing member of the reorganized Debtor, holds a beneficial interest in the TAD 1993 Family Trust. The Bank argues that given this interest in the Debtor, application of the absolute priority rule is appropriate.

[20] The transfer of new equity here does not trigger the absolute priority rule. It is clear from the evidence that Mr. Schwartz is not a "current holder" of an equity interest of the Debtor within the plain meaning of the statute. GAC Storage is the owner of the Debtor. Mr. Schwartz is a partial owner of GAC Storage through the TAD 1993 Family Trust. *See In re Greenwood Point, LP,* 445 B.R. at 910 ("[T]he absolute priority rule does not apply to individuals who are not current owners of the debtor, whether or not those indi-

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viduals are insiders."). Schwartz testified that none of the current members or Guarantors will be involved in the management of the Reorganized Debtor after confirmation, which testimony was not rebutted by the Bank. The Bank nonetheless points to Schwartz's personal and business relationships with his friend, Mr. Yoel Iny, and brother Noam Schwartz as "motivation" for Schwartz to preserve the equity in the Property. Beyond the Bank's suspicion in this regard, there is no evidence to suggest that Schwartz's purchase of new equity allows the current owners of the Debtor to retain their interest or that Schwartz will later act as a "straw man" to subsequently transfer his interest to the former equity holders. *Id.* at 911. To the contrary, the Debtor notes in its Second Amended Disclosure Statement that none of the Debtor's current owners or Guarantors shall have any ownership interest in the reorganized Debtor. *See* Debtor's Exhibit T, Section III. A., p. 5. Although the Court deems the absolute priority rule to be inapplicable here, it reminds the Bank that the Bankruptcy Code nonetheless provides additional "safety nets" to guard against such suspected collusive efforts. *See In re Greenwood Point, LP,* 445 B.R. at 910, citing *Beal Bank, S.S.B. v. Water's Edge Ltd. Partnership (In re Beal Bank),* 248 B.R. 668, 680 (D.Mass.2000) ("The Bankruptcy Code does not prohibit such sales, and instead relies on the confirmation requirements as the safety net."); *See* also 11 U.S.C. §§ 1125, 1129(b)(1).

F. The Guarantors Injunction is Overly Broad and is Not Essential to the Debtor's Reorganization.

The Bank objects to the inclusion of the Guarantors Injunction, which it contends is not essential to the Debtor's Plan and improperly deprives it of its bargained for state law rights under the Loan Guaranties.

[21] The proper standard for approval of a release in a plan of reorganization in favor of a non-debtor third party is that ***197** the provision be narrowly tailored and essential to the reorganization plan as a whole. *See In re Ingersoll, Inc.,* 562 F.3d 856, 864–65 (7th Cir.2009); *In re Airadigm Commc'ns, Inc.,* 519 F.3d 640, 657 (7th Cir.2008).

Thus the Court must determine whether the injunction in question is appropriate for the Debtor's Amended Plan. The Court determines that it is not.

The release at issue herein provides as follows:

> Guarantors Injunction. In consideration for Newco funding the New Equity Contributions and for the Guarantors funding the Guarantor Contributions, entry of a Confirmation Order will operate as an injunction against the commencement or continuation of any action, the employment of process, or any act to collect, recover or offset any Claim of any Holder against the Guarantors under the Bank Loan Documents or otherwise, which Guarantors Injunction shall be effective so long as the Reorganized Debtor is performing its obligations under the Plan and non Default has occurred.

See Debtor's Exhibit A, Amended Plan, p. 20, Article VIII, Section 8.4.

The Guarantors of the Loan Documents include: D.M.S.I., LLC, Noam Schwartz, Yoel Iny, and Y & T Iny Trust. The inclusion of the Guarantors Injunction is a condition precedent to the $250,000 New Equity Contribution by Schwartz, and the $200,000 Guarantors' contribution to the Plan. Schwartz is an officer of Great American Capital, the former manager of the Debtor. Schwartz, who will be the sole member of the newly organized Debtor, testified that he will contribute the $250,000 only if the Guarantor's Injunction is approved. He also testified that this amount would be placed into a reserve account, untouched until the Bank's loan was "taken care of." He explained that this reserve would be used for unknown expenses, or shortfalls to take care of monthly payments to the Bank. In addition, the Guarantors would contribute $200,000 in exchange for the Guarantor's Injunction, characterized by Schwartz as a "temporary injunction."

Schwartz testified that the provision is necessary because of concerns that the Bank would initiate unnecessary litigation against the Guarantors. When asked to expound on this, however, Schwartz merely stated "if the Guarantors are going to have to defend a legal action, you never know what the outcome is ... maybe the debtor would be dragged into it somehow...." (Tr. Vol.

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V, 1010.) Schwartz was unable to articulate any sound business reasons for including this provision or why the success of the Amended Plan is contingent upon its inclusion. Schwartz also testified that he made no efforts to solicit third party equity contributions in lieu of the injunction because he did not believe investors would walk into the shoes of a debtor in bankruptcy that could also be subject to the Bank's claims.

In support of the proposed Guarantors Injunction, the Debtor relies on the Seventh Circuit's decision *In re Airadigm Commc'ns, Inc.* In *Airadigm,* the court considered whether a bankruptcy court has the authority to release a non-debtor third party from creditor liability over the creditor's objection. The court ultimately held that such a release is "appropriate," but explained that "[w]hether a release is 'appropriate' for the reorganization is a fact intensive inquiry and depends on the nature of the reorganization." *Airadigm,* 519 F.3d at 657. For the release at issue in that case, the court first determined that the limitation itself was narrow, in that it applied only to claims "arising out of or in connection with" the reorganization itself; next the court determined that ***198** "the limitation is subject to the other provisions of the plan"; and third, there was 'adequate' evidence that the financier of the plan "required the limitation before it would provide the requisite financing, which was itself essential to the reorganization." *Id.* at 657. *See also In re Berwick Black Cattle Co.,* 394 B.R. 448, 459 (Bankr.C.D.Ill.2008) ("The release at issue in *Airadigm* was nothing more than the kind of narrowly tailored release that is customary in Chapter 11 plans ... [N]evertheless, it was not simply rubber stamped by the Seventh Circuit, which applied a three-part analysis.")

The bankruptcy court in *In re Berwick Black Cattle Co.* denied confirmation of a plan that included a blanket third party lease provision. 394 B.R. at 457. The release at issue in that case included pre-petition claims and claims that were unrelated to the bankruptcy proceedings. The court held that such releases went well beyond what the Seventh Circuit approved in the *Airadigm* decision, as they purported to release from liability third parties in a non-bankruptcy suit over which the court had no jurisdiction. *Id.* at 462.

[22] Here too, the Court finds that the Guarantors Injunction is overly broad. The Guarantors Injunction at Section 8.4 of the Amended Plan purports to enjoin Bank of America from the "commencement or continuation of an action, the employment of process, or any act to collect recover or offset any Claim of any holder against the Guarantors under the Bank Loan *or otherwise,* which Guarantors Injunction shall be effective so long as the Reorganized Debtor is performing its obligations to the Bank under the Plan and no Default has occurred." (Emphasis added). The provision is not narrow in scope, as the clause "or otherwise" seems to categorically enjoin the Bank from pursuing its contractual remedies against the Guarantors for other loans that the Bank has with the Guarantors herein. The Bank rightfully has cause for concern given this broad language, as the Guarantors have additional obligations under additional loan documents. For example, the Bank notes in its Supplemental Objection that the Guarantors have obligations under an environmental Indemnification and Release Agreement dated April 13, 2007 and that the Guarantors are obligated to provide financial statements and have made representations, warranties and covenants to the Bank. *See* dkt. no. 626, ¶ 2. The Bank also alleges that the Guarantors are in default on numerous covenants and agreements under the Guarantees. *Id.* at ¶ 23. At trial, Schwartz was unable to clarify with any degree of certainty whether the injunction applies to the Bank's loan with the Debtor as well as other loans and obligations. (Tr. Vol. V, 1132.). Further, Schwartz acknowledged that the Guarantors have six civil matters pending against them in a non-bankruptcy forum. In light of the foregoing, the Court finds that the Guarantors Injunction provision is overly broad.

The Court also finds that Schwartz's proffered goal to protect the Guarantors from "unnecessary litigation" is not tantamount to unusual circumstances that render the release terms important to the success of the plan. *See In re Ingersoll, Inc.,* 562 F.3d 856, 864–65 (7th Cir.2009), citing *In re Metromedia Fiber Network, Inc.,* 416 F.3d 136, 143 (2d Cir.2005) ("A nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the

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plan...."). The evidence establishes that none of the Guarantors have claims against the Debtor's estate, or the reorganized Debtor. (Tr. Vol. V, 1121). Schwartz's concern that the Debtor ***199** could be dragged into litigation involving the Guarantors is not warranted, as the Guarantors have no claims against the Debtor, at least none filed in this bankruptcy case. The Order Setting Deadline to File Proof of Claims in this case required that proofs of claims be filed on or before May 25, 2011. *See* Case No. 11–40944, dkt. no. 301. The Claims registry reflects no claims by the Guarantors against the Debtor, nor do the Debtor's schedules reflect such claims. Thus, the Court concludes that the Guarantors Injunction is not essential to the Debtor's reorganization.

The Court declines to approve the Guarantors Injunction, especially where there is no evidence suggesting that the Guarantors will spend any time managing the reorganized Debtor. *See e.g. Gander Partners, LLC v. Harris Bank, N.A. (In re Gander Partners, LLC),* 432 B.R. 781, 788 (Bankr.N.D.Ill.2010) (noting that an injunction restraining creditors from proceeding against nondebtors is justified only if creditor actions in that regard would frustrate the Debtor's reorganization efforts by distracting the guarantors from reorganizing the debtor).

[23] In *In re Gander Partners,* this Court observed that "A Section 105 injunction restraining creditors from proceeding against nondebtors is justified only if the creditor actions would interfere with, deplete or adversely affect property of a debtor's estate or which would frustrate the statutory scheme embodied in Chapter 11 or diminish a debtor's ability to formulate a plan of reorganization." 432 B.R. at 788. Courts recognize that the entry of an injunction may be appropriate under the following circumstances:

1. there be the danger of imminent, irreparable harm to the estate or the debtor's ability to reorganize;

2. there must be reasonable likelihood of a successful reorganization;

3. the court must balance the relative harm as between the debtor and the creditor who would be restrained.

4. the court must consider the public interest; this requires a balancing of the public interest in successful bankruptcy reorganizations with other competing societal interests.

Id. at 788 (citing *In re Monroe Well Service, Inc.,* 67 B.R. 746, 751–52 (Bankr.E.D.Pa.1986)).

Here, the Court determines that there has been no showing of danger of imminent, irreparable harm to the Debtor's ability to reorganize. There is no reasonable likelihood of a successful reorganization, as the Debtor's financial projections are unreasonable. Balancing the harm as between the Bank and the Debtor, the Court finds that restraining the Bank is not justified because the Guarantors' time, money and energy are not directed toward the Debtor's reorganization. The public interest would not be served by issuing the Guarantors Injunction as the reorganization proposed herein is not likely to be successful.

G. Failure to Comply with Bankruptcy Code section 1122(a)

[24][25] The Bank also objects to Confirmation because the Amended Plan treats the Bank's claim as fully secured, leaving it with no deficiency claim. Section 1122(a), which governs classification of claims or interests provides: "Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." 11 U.S.C. § 1122(a). Section 1122(a) does not mandate that a plan proponent classify similar claims together. However, it provides***200** that dissimilar claims cannot be placed into the same class. *In re Loop 76, LLC,* 465 B.R. 525, 536 (9th Cir. BAP 2012). Although debtors are prohibited from separately classifying claims to "gerrymander an affirmative vote on reorganization, claims may be classified separately if significant disparities exist between the legal rights of the holder which render the two claims not substantially similar." *In re Wabash Valley Power Ass'n, Inc.,* 72 F.3d 1305, 1321 (7th Cir.1995).

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Section 506(a) governs the determination of secured status. That provision provides in part:

(a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim.

* * *

11 U.S.C. § 506(a)(1).

Thus, the Bank has a secured claim to the extent of the value of the Property, and an unsecured claim as to any deficiency amount. Although the Bank has filed a proof of claim in the amount of $9,702,517.36, the parties have agreed that for purposes of confirmation and feasibility, the amount of the Bank's Claim is $10,200,000. *See* BANA Exhibit 7, Section IV, B, 1. In accordance with section 506(a), the Court determines the value of the secured portion of the Lenders claim to be $8,150,000. Thus, the unsecured portion is the Bank's claim is $2,050,000.

[26] Here, the Debtor's Amended Plan fails to separately classify the unsecured portion of the Bank's Claim in accordance with section 1122(a). *See In re SunCruz Casinos, LLC,* 298 B.R. 833, 837 (Bankr.S.D.Fla.2003) ("While the statute itself deals with only the requirement that dissimilar claims may not be classified together, courts have uniformly held that it also prohibits separate classification of similar claims unless supported by legitimate business reasons."). Thus, the Amended Plan fails to satisfy section 1129(a)(1) which mandates that a plan comply with the provisions of the Bankruptcy Code. Had the Amended Plan placed the Bank's unsecured claim in an unsecured class, the Bank could have made the absolute priority objection. Even so, that objection lacks merit as noted above because holders of junior claims are not retaining property under the Amended Plan on account of junior claims.

H. The Plan is not proposed in good faith

[27][28] The Bankruptcy Code requires that a debtor's plan be proposed in good faith and not by any means forbidden by law. 11 U.S.C. § 1129(a)(3). Bankruptcy Court judges have broad discretion in determinating whether a debtor's plan has been filed in good faith. *In re American Consol. Transp. Cos., Inc.,* 470 B.R. at 493. Good faith is "generally interpreted to mean that there exists a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code." *203 N. LaSalle St. Partnership,* 126 F.3d at 969, ***rev'd on other grounds*** (internal citation omitted). Further, the plan must have "a true purpose and fact-based hope of either 'preserving going concern' or maximizing property available to satisfy creditors." *In re American Consol. Transp. Cos., Inc.,* 470 B.R. at 493.

The Bank argues that the Amended Plan is not proposed in good faith and asserts that the main focus of the Amended***201** Plan is to protect the nondebtor Guarantors.

[29] Schwartz testified that the main purpose of the Amended Plan is to stabilize the Property and to pay off the Bank's claim. (*See* Tr. Vol. V, 999–1000) The evidence presented in these proceedings suggests otherwise. Rather than offer the new investment opportunity to third-party investors, which might have procured additional funds for the Debtor's cash reserve, Mr. Schwartz elected to condition his $250,000 new equity contribution upon the entry of a non-consensual Guarantors Injunction. In doing so, Schwartz effectively foreclosed the opportunity for third-party investors to provide a larger new equity contribution which could have been used to satisfy the Bank's claim. In light of these circumstances, the Court concludes that the Debtor's Amended Plan was not proposed in good faith.

V. The Bank's Motion for Relief From Stay

On August 27, 2012, the Bank filed a motion seeking relief from the automatic stay, pursuant to section 362(d) of the Bankruptcy Code. *See* dkt. no. 548.

That section provides in pertinent part as follows:

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On request of a party in interest and later 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—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(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).

[30] Generally, a secured creditor is entitled to relief from the automatic stay under section 362(d)(1) for "cause." Under section 362(d)(2), a secured creditor is entitled to stay relief if the debtor lacks equity in the property, and the property is not necessary for an effective reorganization. "To be 'effective,' a plan must be confirmable." *Edgewater Walk Apartments v. MONY Life Ins. Co. of Am.,* 162 B.R. 490, 498 (N.D.Ill.1993). Thus, the confirmation requirements of 11 U.S.C. § 1129 must be met. *Id.*

[31] The Bank, as the moving party, bears the burden of proof on the issue of Debtor's equity in the Property. The Debtor bears the burden of proof on all other issues, such as whether the property is necessary to an effective reorganization. *Edgewater Walk Apartments,* 162 B.R. at 494, n. 9. 11 U.S.C. § 362(g).

[32] The Debtor must show that there "is a reasonable possibility of a successful reorganization within a reasonable time." *In re Cadwell's Corners Partnership,* 174 B.R. 744, 759 (Bankr.N.D.Ill.1994) (citing *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.,* 484 U.S. 365, 376, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988)). "This is known as the feasibility standard." *In re 8th Street Village L.P.,* 94 B.R. 993, 995 (N.D.Ill.1988)

The Bank's Relief from Stay Motion is premised in part on the Debtor's inability to propose a confirmable plan of reorganization. As discussed in the Bank's objection to Plan confirmation, it asserts that the Debtor's Plan fails to met the requirements of Section 1129(a)(1), (7), (8) and (11) of the Bankruptcy Code. As discussed above in this opinion, Section 1129(a)(11) requires that the plan proponent establish ***202** that the Plan is feasible, that is, not likely to be followed by liquidation, the need for further financial reorganization, of the debtor or any successor to the debtor. 11 U.S.C. § 1129; *Sentinel Mgmt. Group, Inc.,* 398 B.R. at 317. The proponent of the plan bears the burden of establishing that the Plan is feasible by a preponderance of the evidence. *In re Repurchase Corp.,* 332 B.R. at 342.

[33] As discussed above, the Court finds that the Debtor has not established by a preponderance of the evidence that its Amended Plan is feasible.

The Debtor presented no credible evidence to support its contention that the Debtor will be able to finance the nearly $8.7 million balloon payment to the Bank at the end of the 7–year plan. The Court accords little weight to Detling's testimony that in year 2019, the Property will be worth $12,650,000 as his opinion is highly speculative in light of the Debtor's historic performance and existing economic conditions.

Further, the Amended Plan relies on highly speculative revenue projections, the achievement of which are not supported by the evidence. The Court also finds that the Debtor's cash flow projections, which govern the rental payments under the Master Lease, are overly aggressive and highly speculative. According to the Bank's feasibility expert, if the Property fails to meet its forecasted cash flow by 10%, it will lead to a substantial deficiency throughout the Plan term. *See* BANA Exhibit 2, p. 4; *In re Made in Detroit, Inc.,* 299 B.R. 170, 179–80 (Bankr.E.D.Mich.2003) (denying confirmation of a plan where the proponent failed to show the ability to obtain financing). The evidence also establishes that at the conclusion of the confirmation hearing, the Debtor's sole tenant under the Master Lease Agreement, SE

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Copley, had yet to be capitalized. Thus, in the event the Debtor's Property is unable to perform according to the aggressive projections set forth in the Plan, the Debtor has not shown that SE Copley will have the cash reserves needed to satisfy its rental obligations to the Debtor.

The Court also finds that the Debtor has failed to prove the reasonable possibility of a successful reorganization within a reasonable period of time. The Debtor's Bankruptcy Case has been pending for over a year, and after two attempts, the Debtor has been unable to propose a confirmable Plan of Reorganization. Notwithstanding the length of time since the Petition Date, the Debtor has yet to obtain a letter of credit or the cash deposit pursuant to the Master Lease Agreement which was executed just 2 days before the commencement of the confirmation hearing.

Finally, the Court finds that the Debtor has failed to establish that there is equity in the Property. The Bank filed a proof of claim in the amount of $9,702,517.36. As noted above, the Court rejects the Debtor's **valuation** of the Property, and finds that the value for purposes of plan **confirmation** is $8,150,000, the figure proffered by the Bank. At that value level, and a claim amount of $9.7 million, there is no equity in the Property.

For those reasons, the Court determines that cause exists to lift the stay.

VI. Conclusion

In sum, the Court denies confirmation of the Debtor's Amended Plan. The Debtor has failed to comply with Bankruptcy Code Sections 1122(a), 1127(c), and the cram down requirements of Section 1129(b).

The Bank's Motion for Relief from the automatic stay is GRANTED.

This opinion constitutes the Court's findings of fact and conclusions of law. Separate***203** Orders will be entered consistent with this opinion.

Bkrtcy.N.D.Ill.,2013.
In re GAC Storage Lansing, LLC

485 B.R. 174, 57 Bankr.Ct.Dec. 152

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United States Bankruptcy Court,
S.D. New York.
In re **785 PARTNERS** LLC, Debtor.

No. 11–13702 (SMB).
March 20, 2012.

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MEMORANDUM DECISION REGARDING VALUE OF DEBTOR'S BUILDING

STUART M. BERNSTEIN, United States Bankruptcy Judge.

***1** The Debtor seeks to confirm its plan in this single asset real estate case, and First Manhattan Developments REIT ("First Manhattan" or "FM"), the principal secured creditor, has filed objections. The amount of First Manhattan's claim and the value of the Debtor's building (the "Building") represent two of the most significant and contentious issues in connection with the confirmation of the plan. Accordingly, and with the agreement of the parties, the Court first proceeded to determine the value of the Building. Following a five day of evidentiary hearing, I find that the value of the Building as a rental, its highest and best use, is $91.7 million.[FN1]

FN1. The following conventions are used in this decision. The hearing transcripts are cited as "Tr." with the date of the hearing noted parenthetically. "DX" refers to the Debtor's trial exhibits and "FMX" refers to First Manhattan's trial exhibits.

A. Introduction

The Building is forty-three stories, consists of 122 residential apartments or units, and covers between 94,142 and 94,311 aggregate square feet in addition to retail space whose precise area is open to question for reasons discussed below. The Building is located at 48th Street and Eighth Avenue in the Hell's Kitchen/Clinton area of Manhattan, bounded by Eighth Avenue on the east, the Hudson River on the west, 59th Street on the north and 34th Street on the south. It is an anvil-shaped "sliver" building with approximately twenty-four feet of frontage on Eighth Avenue and seventeen feet of frontage on 48th Street. The Building, which is new and presently vacant, stands as security for a loan now held by First Manhattan, which purchased the note in or around July 2011 for approximately $78 million.

With certain exceptions, each floor typically contains three apartments. Ninety apartments consist of one bedroom and one bathroom. The average size of the one bedroom apartments is between 734 and 736 square feet, depending on which expert's report you read. I will use 735 square feet. Seventeen apartments are studio apartments that average 604 square feet. Thirteen apartments are two bedroom apartments and range between 1,104 square feet and 1,186 square feet. One three bedroom apartment, the penthouse, is 2,725 square feet. Finally, the superintendent's apartment measures 556 square feet. (*See generally* DX 1 at 51–52; FMX J at 42.) All agree that the Building enjoys excellent views to the west above the lower floors and very good views from the upper floors in other directions. The principal and only amenity in the Building, aside from a doorman, is a small fitness center.

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As noted, the Court conducted a five-day evidentiary hearing for the purpose of determining the value of the Building. Several witnesses testified, but the most important witnesses on the issue of valuation were the Debtor's expert, Michael Falsetta, and First Manhattan's expert, Dennis Ryan. Both experts testified honestly and credibly, and the stark difference in their appraisals illustrates the subjective nature of valuation. Each expert submitted a report, referred to as the *Falsetta Report* (DX 1) and the *Ryan Report* (FMX J), and each also submitted a supplement, referred to as the *Falsetta Supplement* (DX 2) and the *Ryan Supplement* (FMX N). The Debtor contends that the highest and best use for the Building is as a rental. According to Mr. Falsetta, the Building is worth $103 million as a rental and $93.3 million as a condominium. First Manhattan maintains that the highest and best use for the Building is as a condominium. According to Mr. Ryan, the Building is worth $76.4 million as a condominium and $70.3 million as a rental.

B. Value as a Condominium

***2** Both experts valued the Building as a condominium on a net sellout basis. The net sellout approach is essentially a discounted cash flow analysis that assumes a buyer will buy the entire building at wholesale and then sell the apartments over time at retail. The net income realized over the period of the sellout is then discounted back to present day.

The spread between the experts' opinions regarding the value as a condominium is $16,900,000. The principal factors that affect the value are the absorption or sellout period, the assumed selling price of the apartments and the commercial space, and the expenses that the buyer must pay during the period of the sellout and before the expenses are picked up entirely by the unit owners as part of the common charges.

1. Selling Price of the Residential Units

The principal difference in the two appraisals relates to the assumed selling price of the apartments.[FN2] According to Mr. Falsetta, the average selling price of the residential space is $1,250 per square foot and the saleable area of the Building is 94,311 square feet. This yields a gross undiscounted sellout value of the residential space of $117,888,750. (*Falsetta Report* at 100.) According to Mr. Ryan, the average selling price of the residential space is currently $1,100 per square foot and the saleable area of the Building is 94,142 square feet. This yields a gross undiscounted sellout value of the residential space of $109,543,631.[FN3] (*See Ryan Report* at 104.)

FN2. Both sides assumed a similar absorption period, 30 versus 34 months, although they disagreed on when the sales would actually begin. In addition, and as discussed below, the different assumptions relating to the value of the commercial unit and the expenses did affect the respective value opinions, but not to the degree of the different conclusions regarding the selling price of the units.

FN3. Mr. Ryan's analysis assumed that the price per square foot would rise incrementally to $1,199 during the sellout period. (*See Ryan Report* at 104.)

Both experts supported their opinions with data derived from the sales of apartments in other, comparable buildings. Comparability, however, as well any adjustments needed to make the comparison more comparable is highly subjective. For the most part, Mr. Ryan's methodology was easier to follow because he showed how he made adjustments to his comparables based on location, apartment features, views and amenities.[FN4] (*See Ryan Report* at 77.) In addition, the *Ryan Supplement* included data about many recent sales in buildings described in the *Ryan Report.*

FN4. Residents must pay separately for certain amenities (e.g., parking). Mr. Ryan nevertheless opined that their availability, even at an added cost, adds value to the condominium unit. I credit this testimony.

In particular, Mr. Ryan's reports suggest that the Debtor has overestimated the selling price of the condominium units. The overwhelming majority of the apartments in the Building (nearly 90%) are one bedroom, one bathroom units with an average size of 735

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square feet. Sticking as close as possible to these criteria, the Court reviewed the comparables in the *Ryan Report* and the *Ryan Supplement* to determine the selling price of one bedroom, one bathroom apartments between 700 and 800 square feet in size.[FN5] No apartment met these criteria in the Platinum, the Dillon and the Hudson Hill. A number of apartments met these criteria in his other buildings:

FN5. Mr. Ryan dropped certain comparable buildings in his *Supplement,* and I have ignored these buildings. I also ignored apartments that were merely *listed* at a price or were in contract but not yet closed. Listings reflect the seller's asking price which may be negotiated downward. Contracts may not close, or may close at different prices.

Building	No. of sales	Avg. price per sq. foot	Adjustments per Mr. Ryan	Adjusted avg. price per sq. ft.
Orion	13	1,191.08	–30%	883.76
Link	3	1,296.00	–20%	1,036,80
Element	5	1,171.80	–20%	937.44
Atelier	8	1,066.88	–10%	960.19
Griffin Court	1	931.00	+10%	1,024.10

***3** Although these results support Mr. Ryan's opinion that the appropriate sale price is $1,100 per square foot if not less, another portion of the *Ryan Report* undercuts this conclusion. In projecting the common charges attributable to the unit owners, which include the cost of financing the condominium association's purchase of the superintendent's apartment, Mr. Ryan estimated the market value of the superintendent's apartment at $1,150 per square foot. (*Ryan Report* at 99.) It is difficult to believe that the superintendent's fourth floor apartment, lacking a view in a view-driven building, is one of the more valuable apartments in the Building on a square foot basis.

This leads me to conclude that Mr. Ryan's opinion regarding the value of the apartments in the Building, based in large part on the adjustments he adopted, is too conservative; with less "adjustment," his conclusion regarding value would be higher.[FN6] Consequently, I give more credit to his value of the superintendent's apartment, and for the reasons indicated, view it as setting the lower end of value. Accordingly, I find that the average value of the residential space is $1,175 per square foot, the average price of a one bedroom, one bathroom apartment is $863,625, and the gross undiscounted selling price of all of the residential space is $110,716,725.[FN7]

FN6. In addition, Mr. Ryan's valuations, both as a rental and as a condominium, are less than the $78 million that First Manhattan paid for the note in July 2011, when it was already in default. The trial evidence did not suggest that the value of the Building declined after First Manhattan purchased the note.

FN7. In making this calculation, I have split the 169 square foot difference between the parties' assumptions regarding the saleable area, and assumed that the saleable residential space is 94,227 square feet.

2. Selling Price of Retail Unit

The contours of the retail space are unclear. According to Mr. Falsetta, it totals 2,578 square feet, consisting of 1,838 square feet of grade level space and 740 square feet of storage space in the cellar. In addition, the space includes an outdoor terrace/patio of approximately 730 square feet which can be used for seating if the retail space is a restaurant. (*Falsetta Report* at 1.) Mr. Falsetta valued the grade level space at $225 per square foot and the patio at $50 per square foot, but did

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not ascribe any value to the cellar space. (*Id.* at 73–74.) According to Mr. Ryan, the retail space comprises 2,766 square feet, all located at the grade level, which he valued at $150 per square foot. (*See Ryan Report* at 92.) It is not clear whether his valuation included the patio or the basementit couldn't include both based on the aggregate square footagebut it is clear that he ascribed the same value to all of the space. Although Mr. Falsetta criticized Mr. Ryan's reliance on rentals paid by Ninth Avenue stores (the Building and its commercial unit are located on Eighth Avenue), Mr. Ryan's use of a uniform rate, well above the rate Mr. Falsetta applied to the patio space, minimizes the perceived error in using Ninth Avenue comparables.

Indeed, in the end, the parties' disagreement regarding the value of the retail space was immaterial to the ultimate question of value. Both parties valued the retail space for condominium purposes based on the amount of rental income that it could generate. Mr. Falsetta predicted gross annual income of $450,000.00, deducted a vacancy and credit loss of 5% and other expenses aggregating $13,707.00 and arrived at net operating income of $413,841. (*Falsetta Report* at 101.) He divided the net operating income generated by the commercial space by a 5.5% capitalization rate and arrived at a value of $7,524,374, which he rounded down to $7.5 million. (*Id.* at 101–02.) Mr. Ryan estimated the gross annual rental at $414,900.00. He also deducted a 5% vacancy and collection loss as well as unabated base real estate taxes ($36,009), arrived at a net operating income of $358,146, divided this amount by a 6% capitalization rate, and concluded that the value of the retail space was $5,969,100, rounded up to $6 million. (*Ryan Report* at 93.) In the end, the experts were $1.5 million apart.

***4** Neither party provided any meaningful evidence about the deductions from the retail income other than the vacancy loss or the different capitalization rates. Given the state of the record, and in light of the immaterial difference in their ultimate opinions, I find that the appropriate value is the intermediate value, and the selling price of the commercial space is $6,750,000.

Accordingly, the undiscounted gross sellout price of the residential and commercial units is $117,466,725.

3. Sellout Expenses

Although the valuation of the retail space reflected certain deductions, the undiscounted gross sellout price of the residential space did not. Mr. Ryan estimated that the sellout expenses would come to $24,290,620 (net of "recapture") [FN8] during the absorption period, (*Ryan Report* at 104), while Mr. Falsetta valued the gross sellout expenses at $20,706,160. (*See Falsetta Report* at 105–08.) More than 50% of the difference is attributable to their assumptions regarding common charges and real estate taxes.

FN8. "Recapture" refers to the owner's declining share of the real estate taxes and common charges resulting from the sale of the units. Mr. Ryan computed the total cost to the owner of the common charges and taxes during the sellout without regard to any sales, but also treated the "recaptured" amount as income. (*See Ryan Report* at 104.) Mr. Falsetta essentially aggregated the amounts, and showed the declining cost to the owner as the units are sold. (*See Falsetta Report* at 105–08.)

Mr. Ryan assumed common charges of $13.89 per square foot, (*Ryan Report* at 100), which was substantially higher than his other comparables. (*Id.* at 97.) Based on his analysis, the owner would bear common charges of $2,244,161.00 (net of "recapture") during the sellout. (*See id.* at 104.) The owner would initially bear all of the common charges (as well as real estate taxes, marketing, selling expenses and other expenses) until it began to close on sales. As the units were sold and the unit owners became responsible for the common charges, the owner would pay less each month on a net basis. Thus, the effect of any overestimation of the common charges would diminish with time.

Mr. Falsetta assumed that the owner of the project would not pay any common charges (or any other expense) for the first fifteen months that it owned the Building, and estimated that the owner would ultimately pay $718,960.00 in common charges (inclusive of real estate taxes) during the sellout. (*See Falsetta Report* at 105–06.) This assumption, which is based on Mr. Falsetta's prediction as to when unit sales would begin to

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close, is not reasonable. The common charges reflect, among other things, the Building payroll, fuel and utilities, water and sewer charges, and insurance. (*See Ryan Report* at 100.) Although the costs of an occupied building are undoubtedly higher, the owner would still have to bear some of these expenses during the early part of the absorption period, and before it began to close on the sale of condominium units. For example, the owner would have to pay to secure the Building, maintain insurance coverage, and provide for the upkeep of the Building especially while potential unit buyers viewed the premises. The owner would also have to pay legal and accounting fees; its professionals might not be willing to wait a year for payment from the sales proceeds.

The same holds true for the real estate taxes. While the experts disagree over the amount of the real estate taxes as a result of the section 421–a tax benefits, some taxes will still become due and will have to be paid. Mr. Falsetta's sellout analysis does not account for any of these costs during the first fifteen months.

***5** Another significant difference between the two experts concerned their assumptions regarding a contribution to the Building's reserve fund. Mr. Ryan observed that the sponsor of a new for-sale development will typically contribute to the working capital fund on a per unit basis. (*Ryan Report* at 100.) He estimated that the contribution would be $2,500 per residential unit, or a total of $305,000. (*Id.* at 100.) He also estimated that the owner would have to spend $500,000 to address the water damage to several apartments on the third and fourth floors. (*Id.* at 100.) Both assumptions are reasonable. In fact, Mr. Falsetta noted that it would cost the owner $540,000 to complete some minor punch list items and repairs, (*Falsetta Report* at 50), but his analysis does not appear to account for this expense which the owner would presumably have to absorb to ready the Building for unit sales. Nor does he account for a contribution to the reserve fund.

Accordingly, I reject Mr. Falsetta's estimate of the expenses during the absorption period, and conclude that Mr. Ryan's estimate is more reliable. However, because Mr. Ryan overestimated the common charges that the owner must pay during the sellout period, I have reduced Mr. Ryan's total sellout expenses by approximately 5% to $23 million. Deducting this latter sum from the undiscounted gross sellout income of $117,466,725, I find that the undiscounted net sellout income for the Building as a condominium is $94,466,725.

4. The Discount Rate

The last aspect of the experts' opinions concerns the discount rate. Mr. Falsetta used a 6% discount rate, (*Falsetta Report* at 104), and Mr. Ryan used a 10% rate. (*Ryan Report* at 102.) The higher the discount rate the lower the value. Neither of their Reports explained how the rate was selected, and the experts' testimony did not touch on it. Under the circumstances, I will treat their divergent opinions as the range of rates, and select an intermediate rate of 8%.

Although it may prove difficult to apply the 8% rate to stream of uneven cash flows, it is unnecessary to do so in order to arrive at a present discounted value of the Building's income stream as a condominium. The first step is to determine how the application of the 6% and 10% discount rates reduced the value of the undiscounted net income predicted by the experts. Mr. Falsetta's analysis resulted in undiscounted net sellout income of $104,693,840 ($125,400,000 minus $20,706,160.00). When he applied his 6% discount rate, he arrived at a present value of $93,300,000, (*see Falsetta Report* at 110), or 89.12% of the undiscounted amount. Mr. Ryan computed the undiscounted net sellout income as $91,253,070.00, and after applying his 10% discount rate, came up with a present discounted value of $76,400,000. (*See Ryan Report* at 103.) This reflected 83.72% of the undiscounted value.

The use of an 8% discount rate should result in a reduction between 83.72% and 89.12% to the amount of undiscounted net sellout income computed by the Court. While the actual percentage reduction would depend on the timing, number and amount of the uneven cash flows, a fair approximation of the effect of the 8% discount rate would be a reduction of 86.42%, the mathematical average of the reductions resulting from the applications of the 6% and 10% rates. This percentage reduction applied to the undiscounted net sellout income computed by the Court—$94,466,725—yields a present

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discounted value of $81,638,143.75, rounded up to $81,650,000, which the Court finds to be the present value of the Building as a condominium.

C. Value as a Rental

***6** Both experts valued the Building as a rental using the income capitalization approach.[FN9] Under this approach, the expert computes a single year's stabilized net operating income, divides that amount by an overall capitalization rate ("OAR" or "Cap Rate"), makes some further adjustments and arrives at value. The principal factors that affect the value determination are the rental value per square foot of the residential and commercial space, the amount of time it will take to reach a stabilized rental (*i.e.,* the absorption period), the operating and lease up expenses and the Cap Rate.

FN9. Mr. Falsetta also performed a discounted cash flow analysis and concluded that the value of the Building as a rental under this approach was $103 million. (*Falsetta Report* at 80.)

Initially, the rentable area is less than the saleable area. In the condominium scenario, the owner will sell the superintendent's apartment to the condominium association, and receive sale income. (*Ryan Report* at 41.) In the rental scenario, however, the landlord will not receive any rent from the superintendent. Both experts recognized that the space attributable to the superintendent's apartment had to be discounted. After deducting the superintendent's apartment, Mr. Ryan calculated the rentable area at 93,627 square feet, (*Ryan Report* at 82), and Mr. Falsetta calculated it at 93,755 square feet. (*See Falsetta Report* at 72.) There is no explanation for why the previous difference of 169 square feet declined to 128 square feet, but as with the condominium scenario, I will assume that the intermediate value, 93,691 square feet, represents the rentable area.

The experts differed substantially in their opinions regarding the value of the Building as a rental. According to Mr. Falsetta, the Building is worth $103 million. (*Falsetta Supplement* at 7.) Mr. Ryan valued the Building at $70.3 million, or nearly $33 million less than Mr. Falsetta.[FN10] (*Ryan Report* at 88.) Many of the components of their respective analyses yielded immaterial differences. These included the projected gross rental income from the retail space ($414,900 (FM) versus $450,000 (Debtor)), certain additional income ($61,000 (FM) versus $60,000 (Debtor)), operating expenses ($3,054,869 (FM) versus $3,013,556 (Debtor)), the value of the real estate tax abatement ($7.1 million (FM) versus $7.2 million (Debtor)), the vacancy and credit loss (5% (FM) versus 4% (Debtor)) and the absorption period (five months (Debtor) versus six months (FM)). For the purposes of my analysis, I have treated these differences as ranges, and selected a midpoint value that is reflected in the table at the end of this portion of the opinion. The principal differences in the appraisals centered on the assumptions regarding the Cap Rate and the rental value per square foot.

FN10. Although Mr. Ryan reduced the absorption period and the Cap Rate in his Supplement, he did not modify his opinion regarding value because the "as stabilized" date would be reached in a new tax year.

1. Cap Rate

The Cap Rate is determined by examining recent building sales, preferably in Manhattan. It represents a fraction, expressed as a percentage, in which the numerator is the annual net operating income of the subject building and the denominator is the selling price of the building.

***7** The Cap Rate has a multiplier effect on value. For example, a Cap Rate of 4% means that every additional dollar of net operating income adds $25 of additional value. Mr. Ryan initially selected a Cap Rate of 4.75% which he subsequently reduced to 4.5% (*Ryan Supplement* at 2); Mr. Falsetta used a rate of 4%. (*Falsetta Report* at 79.) The comparable Cap Rates used by Mr. Falsetta in his Report, (*see id.* at 78), were sometimes incomplete and inexact, in some cases outdated, included buildings outside of Manhattan, and I reject them. While Mr. Ryan provided more detailed and useful information, the information did not support his conclusion.

His Supplement and Report listed a total of seven comparable Cap Rates. (*See Ryan Report* at 85; *Ryan*

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Supplement at 5.) All but one of his rates fell slightly above, slightly below or right at 4%, and averaged approximately 4.05%. The seventh Cap Rate was reported as 5%, something of an outlier compared to the other Cap Rates reported by Mr. Ryan. It concerned the sale of the building located at 120 West 21 st Street, and was the subject of a fair amount of testimony and other evidence. The Debtor brought out through documentary and testimonial evidence that the building's tax expenses were apparently understated, and consequently, the net operating income and the resulting Cap Rate should have been lower. The accuracy of the 5% figure is highly suspect, and I will disregard it. Rounding up the average of the other six Cap Rates, I find that the appropriate Cap Rate is 4.1%.[FN11]

> FN11. The 4.1% Cap Rate also represents the average Cap Rate if I include 120 West 21st Street but use the 4.5% Cap Rate that the Debtor advocated for the sale of that building.

2. Rental Value per Square Foot

The assumptions regarding the rental value per square foot accounted for the biggest difference between the two appraisals. Mr. Ryan estimated a rental value of $65 per square foot, while Mr. Falsetta testified to a value of $72 per square foot. To illustrate the significance of this difference, an additional $7.00 per square foot of value multiplied by 93,691 square feet would increase the annual net operating income by $655,837. The 4.1% OAR would convert this additional income into roughly $16 million of additional value.[FN12]

> FN12. The spread was actually greater because Mr. Falsetta used a lower OAR and Mr. Ryan used a higher one.

Both experts calculated the square foot rental value by examining the rents in "comparable" buildings. Each used Silver Towers and MiMA in their analyses. Several other buildings appeared in one report but not the other. Two of the other buildings selected by Mr. Falsetta, the Continental and the Beatrice, are located on Sixth Avenue outside of Hell's Kitchen. Both buildings have superior amenities compared to the Building, and the residential units at the Beatrice start on the twenty-sixth floor while the residential units at the Continental start on the ninth floor. (*See Falsetta Report* at 62, 66.) In addition, the average overall rents are higher than the other comparables, (*see id.* at 67), and their inclusion raised the overall average rental value computed by Mr. Falsetta. The two remaining comparables, Longacre and Archstone West, are older and inferior in quality to the Building, (*id.* at 71), and it is unclear how much useful information they provide.

***8** Three of Mr. Ryan's other comparables—505 W. 37th Street, Townsend and Emerald Green—are located on side streets closer to the garment district and the entrance to the Lincoln Tunnel. The Archstone Clinton is an older building, erected in 1997. Mr. Ryan's remaining comparables, the Mercedes House (Phase 1) and the Platinum, provide better comparisons. In fact, the Platinum, a condominium, is located on 46th Street between Seventh and Eighth Avenues. (*Ryan Report* at 65.) Although Mr. Falsetta criticized the use of the Mercedes House in part because it is located three avenues west of the Building on Eleventh Avenue, Silver Towers, one of his comparables, is also located on Eleventh Avenue.

Based on the foregoing, I find that the appropriate comparables are Silver Towers, MiMA, the Platinum and the Mercedes House, although, the Mercedes House did not produce any rentals that satisfied the criteria described in the next paragraph. In addition to these buildings, the Orion, another condominium, is also a comparable. The Orion was completed in 2006 and is located at Eighth Avenue and 42nd Street, six blocks from the Building. (*Ryan Report* at 67.) Clifford Finn, the president of Citi Habitats Marketing Group provided testimony and documentary evidence regarding a number of recent rentals at that building. (*See* FMX S.)

As with the condominium analysis, the focus is on the one bedroom, one bathroom apartments between 700 and 800 square feet. The following rentals at Silver Towers and MiMA satisfy these criteria,[FN13] yielding an average per square foot rental of $72.58, and an average monthly rental of $4,445.53 for a 735 square foot apartment.

> FN13. In addition to the *Falsetta Report* and

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Falsetta Supplement, rental information also came from FMX S. Mr. Ryan reported ranges of rents but did not report the rents attributable to specific apartments.

Comparable	Floor	Sq. Ft.	$ per sq. ft.	Lease Date
MiMA	12	750	71.92	12/10/11
	14	775	70.06	12/10/11
	17	775	71.92	1/13/12
	25	775	74.71	1/13/12
	36	750	68.32	10/22/11
	42	720	68.25	9/30/11
	43	700	73.63	11/19/11
	46	700	76.29	12/10/11
Silver Towers	33	700	75.34	4/26/11
	33	700	75.34	5/5/11

Silver Towers and MiMA enjoy better amenities, (*see Falsetta Report* at 58, 60), comparable views but inferior locations—they are farther west and more distant from the main public transportation. Weighing superior amenities against an inferior location is a highly subjective exercise. As noted, the mean square foot rental at the two buildings is $72.58, which is rounded down to $72.

The Platinum and the Orion are condominiums, and they require a different consideration. Clifford Finn testified that there may be as much as a 10% variable in the way condominium and rental square footage is measured. (Tr. (2/21/12) at 72.) He did not specifically say how this affected value, but the implication of his testimony was that the variance tended to result in a lower per square foot rental calculation for condominiums. This does not make sense—a square foot is a square foot—but First Manhattan did not challenge this assumption, and I therefore accept it.

***9** Applying the same criteria outlined above produces the following information about rental activity at the Platinum and the Orion:

Comparable	Floor	Sq. Ft.	$ per sq. ft.	Lease Date
Platinum	3	751	62.32	8/23/11
	24	748	59.36	7/1/11
	12	750	57.60	3/16/11
	23	750	59.20	5/3/11
Orion	27	710	62.54	8/25/11
	51	794	60.45	8/17/11
	50	768	54.69	8/10/11
	23	712	54.78	7/21/11

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59	768	70.31	6/14/11
25	729	52.26	5/31/11
55	768	54.69	5/22/11
45	794	60.45	5/13/11
4	712	50.56	3/14/11

The average rental value of these thirteen apartments is $58.40, and the average monthly rental of a 735 square foot apartment would be $3,577.05. Mr. Finn implied that the average rental should be increased by as much as 10% or approximately $6 per square foot to roughly $64 to account for the variance in the measurement of square footage between a condominium and rental apartment.

Other considerations may also affect value. Both the Orion and the Platinum are slightly older than the Building. (*See Ryan Report* at 65, 67.) This suggests that the Building rental value should be higher. In addition, the Building has the advantage of "exclusivity"—typically three apartments per floor—and this feature adds value. The locations of the Platinum, the Orion and the Building are comparable. The Platinum and the Orion have superior amenities, superior apartment features and superior views compared to the Building, at least according to Mr. Ryan. (*See Ryan Report* at 65, 67, 77.) In fact, Mr. Ryan thought that the condominium sale value of the Platinum comparables should be adjusted downward by 25% and the Orion downward by 30% before using them to determine the square foot selling value of the units in the Building. (*Id.* at 77.)

While I accept the premise that these buildings are superior to the Building, applying the same downward adjustments, averaging 27.5%, to their grossed up aggregate rental value of $64 per square foot would lead to an extraordinary result. The adjustment would suggest that the average rent in the Building should be $46.48 per square foot, and the average monthly rent for a 735 square foot one bedroom, one bathroom apartment should be $2,842. Yet in the fourth quarter of 2011, the average per square foot rental for *all* buildings on the West Side of Manhattan was $55. (FMX H at 2.) Moreover, the average per square foot rental and monthly rent for *all* one bedroom apartments in Manhattan was $53.15 and $3,195, respectively. (*Id.)* In other words, the Building, brand new and located at 48th Street and Eighth Avenue, would skew toward the lower end of the West Side and Manhattan rental markets.

This result confirms the conservative nature of Mr. Ryan's adjustments, and I question them as I did when valuing the Building as a condominium. In addition, condominium units tend to rent at a lower rate because the rentals are generally handled by the unit owner or a broker rather than a professional leasing agent in charge of leasing every unit in the building. (*See* Tr. (2/15/12) at 91.) Furthermore, rates for one bedroom apartments in West Side rental markets have generally risen during 2011, (FMX H at 2; *see Ryan Report* at 55–57), and most of the Platinum and Orion comparable lease transactions occurred during the first half of 2011.

***10** Accordingly, I find that a straight average of the comparable rents at the Platinum and the Orion—plus roughly 10% or $64 per square foot—somewhat understates the current market for the Building, and supports an average adjusted rent of $66 per square foot, or a monthly rental of $4,042.50, for a 735 square foot apartment in the Building. Based on the foregoing, the rents at the four comparable buildings support a range of rents between $66 and $72 per square foot. The middle value of $69 per square foot, or a monthly rental of $4,226.25 for a 735 square foot one bedroom, one bathroom apartment, reflects the appropriate mark.

3. Other Reductions

a. Lost rent

Both sides recognize that it will take time to lease

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up the Building, and as a result, the owner will not receive rent from all of the apartments for the entire stabilized year. Ultimately, Mr. Ryan estimated that the lease up would take six months, (*Ryan Supplement* at 2), while Mr. Falsetta predicted it would take five months. (*Falsetta Report* at 83.) Selecting an intermediate range of 5.5 months means that the Building will lose 2.75 months, or approximately 23% of the total rent roll, during the first year. At $69 per square foot for 93,691 square feet, this translates into lost rent of $1,486,876.17.

b. Marketing and Lease-up Costs

The landlord will also incur marketing and other expenses during the lease up period, including rent concessions and brokerage fees. Mr. Ryan assumed a cost of completion of $500,000, and included some lease up expenses in his computation of net operating income. (*See Ryan Report* at 84.) Mr. Falsetta computed these additional expenses at $1,963,896. (*See Falsetta Report* at 83.) As noted earlier, he estimated the cost of completing the punch list and making minor repairs at $540,000, but it does not appear that this amount figured into his analysis. On the whole, however, his marketing and lease up costs are much greater than Mr. Ryan's. I find Mr. Falsetta's evidence more credible, as he had the benefit of input from Citi Habitats, an experienced leasing agent, and round up his other expenses to $2 million. Based on the foregoing, I find that the value of the Building as a rental is $91,719,773.83 (rounded to $91.7 million), as reflected in the following chart:

Rent per square foot	69.00
Effective Gross Rent ($69 x 93,691)	6,464,679.00
Retail income	432,450.00
Additional income	60,500.00
Total Income	6,957,629.00
Less: Vacancy & Credit Loss (4.5%)	(313,093.31)
Less: Operating expenses	(3,034,213.00)
Net Operating Income	3,610,322.69
Capitalized Value (NOI/4.1% Cap Rate)	88,056,650.00
Plus: Tax abatement	7,150,000.00
Less: Lost rent (2.75 months)	(1,486,876.17)
Less: Marketing & Lease up costs	(2,000,000.00)
Total Value	91,719,773.83

***11** Accordingly, the highest and best use for the Building is as a rental, and its value as a rental is $91.7 million. I have considered the parties' remaining contentions, and conclude that they do not alter my findings as set forth above. The foregoing constitutes the Court's findings of fact and conclusions of law.

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In re 785 Partners LLC
Slip Copy, 2012 WL 959364 (Bkrtcy.S.D.N.Y.)

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United States Bankruptcy Court,
D. Delaware.
In re PTL HOLDINGS LLC, Premier Trailer Leasing, Inc., Debtors.

No. 11–12676 (BLS).
Nov. 10, 2011.

Laura Davis Jones, Esquire, Pachulski Stang Ziehl & Jones, LLP, Wilmington, DE, Alan J. Kornfeld, Esquire, Pachulski Stang Ziehl & Jones, LLP, Los Angeles, CA, for Debtors.

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Related to Docket No. 13

OPINION[FN1]

FN1. This constitutes the Court's findings of fact and conclusions of law regarding confirmation of the pre-packaged Joint Plan of Reorganization. *See* Fed. R. Bankr.P. 7052, 9014(c).

BRENDAN LINEHAN SHANNON, Bankruptcy Judge.

***1** The matter before the Court is the request of PTL Holdings, LLC and Premier Trailer Leasing, Inc. (collectively, the "Debtors") for confirmation of their prepackaged Joint Plan of Reorganization (the "Plan"). The primary issue here is the value of the Debtors' business.[FN2] The Debtors and their first lien secured creditor contend that the business is worth less than the amount of the first lien debt. The second lien secured creditor, whose claims will be wiped out under the Plan, contends that it is in the money, and that because the Plan proposes to permit the first lien creditor to recover more than its allowed claims, the Plan cannot be confirmed. For the reasons that follow, the Court concludes that the Debtors have carried their burden to demonstrate that the total enterprise value of the Debtors' business is insufficient to provide for a recovery to the second lien secured creditor. Accordingly, the Court will confirm the Plan.

FN2. The office of the United States Trustee has also objected to the scope of certain exculpation provisions in the Plan. This objection is addressed *infra.*

I. BACKGROUND

The Debtors commenced these prepackaged Chapter 11 cases on August 23, 2011. The Debtors remain debtors and debtors-in-possession, and no trustee or official committee has been appointed.

The Debtors operate a trailer leasing company. Their business principally consists of purchasing semi-trailers and then leasing them to customers for long-term, short-term, or storage use. Long-term leases typically run between one and five years; short-term rentals about thirty days. As trailers age, they become less usable and command a lower price. Newly purchased trailers therefore primarily go to long-term lease customers, and are the most lucrative. Older, less-lucrative trailers go to rental customers. When trailers are no longer suitable for over-the-road use, the Debtors lease them out as storage space. The Debtors currently have about 1,500 to 1,800 customers and just over 11,000 trailers in their inventory.

The Debtors had been considering various restructuring alternatives since 2009, two years before they filed bankruptcy. The Debtors had to do so because by July 2009 they had defaulted under their pre-petition financing facilities, leading their lenders to deny them access to capital to purchase new trailers. Unable to meet customer demands for trailers, the Debtors' business—both in terms of revenue and EBITDA (earnings before interest, taxes depreciation and amortization)—shrank.

At first, the Debtors and their equity holders dis-

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cussed the possibility that the equity holders would invest more capital in the business. But those discussions led to a dead-end because the existing holders of secured debt would not agree to be partially subordinated as part of the deal. The Debtors next worked with their financial advisor, Lazard Middle Market LLC ("LMM"), to began a broad-based capital raising effort, FN3 marketing the company either for a sale or as an opportunity to invest equity capital. Although several bids were submitted, the lenders deemed them all inadequate. In late 2010 and early 2011, the Debtors explored a lender-supported restructuring in which the Debtors' existing lenders would supply new funding. But the lenders again balked. Finally, in response to increasing pressure from their secured lenders, the Debtors evaluated the prospects of an orderly liquidation of their assets. In the meantime, a new entity, Garrison Investment Group and its affiliates ("Garrison"), became the holder of all of the Debtors' first lien debt. That change ultimately allowed the Debtors to negotiate the terms of a comprehensive restructuring with Garrison that led to the filing of these cases and the proposed Plan.

FN3. It was in the context of this capital raise effort that the Debtors and LMM prepared a Confidential Information Memorandum ("CIM"), upon which Fifth Street now bases several of its objections to the Debtors' valuation.

***2** When they filed for bankruptcy, the Debtors had approximately $110.5 million of secured debt outstanding. Of that, roughly $84 million is first lien debt held by Garrison. The remaining $27 million is second lien debt held by Fifth Street Finance Corp. ("Fifth Street"). The amount and priority of those claims is undisputed. The Debtors also owe roughly $26 million to Stoughton, a trailer manufacturing company, for capital leases on a number of trailers (the "Stoughton Leases"). FN4

FN4. At trial, Fifth Street suggested that the fair market value of the trailers subject to the Stoughton Leases may actually be less than $26 million, meaning that Stoughton is an undersecured creditor who, by assumption of the leases, is nonetheless receiving full payment on it claims. Absent litigation on this issue or a consensual arrangement with Stoughton, however, the Court will not speculate as to the results of a hypothetical challenge to Stoughton's claims. For purposes of this analysis, therefore, the Court will assume the validity and value of the $26 million liability ascribed by the Debtors to the Stoughton Leases.

The Plan, which the Debtors filed along with their bankruptcy petitions, proposes to restructure and significantly deleverage the Debtors' capital structure. It would exchange Garrison's first lien debt for 100% of the equity in the reorganized business (subject to dilution from proposed equity and stock options to be provided to management). FN5 It further provides that the Debtors will have access to at least $20 million of new financing for working capital purposes. This financing is the crux of the Debtors' reorganization strategy, which is predicated on the high per-unit lease rates for new trailers that the Debtors will use the new money to purchase. The Plan also contemplates that the Debtors will assume the Stoughton Leases. The Plan does not, however, provide Fifth Street with a recovery.

FN5. Specifically, the Plan provides for a distribution to the Debtors' management of (i) direct equity equal to 7.5% of the common stock of the reorganized Debtors, and (ii) stock options that entitle management to acquire another 7.5% of the common stock of the reorganized Debtors.

The Plan's treatment of Fifth Street's second lien debt is based on an estimate of the reorganized Debtors' total enterprise value ("TEV") prepared by Andrew Torgove ("Torgove"), a managing director at LMM. Torgove's first report, dated August 12, 2011, estimated a TEV range for the reorganized Debtors of between $74 million and $99 million, with a midpoint of $86.5 million. After errors were discovered in that report, Torgove issued a "Valuation Report Supplement," dated September 27, 2011, and increased the TEV range to

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$76 million to $102 million, with a midpoint value of $89 million.

Fifth Street is entitled to a recovery only if the Court finds that the reorganized Debtors' TEV is greater than $110 million (the $26 million Stoughton Lease claim plus the $84 million Garrison first lien claim). If the Debtors' TEV surpasses that hurdle, then Fifth Street is in the money and the Plan is unconfirmable because it violates § 1129.

The Court conducted a three-day confirmation hearing on the Plan on October 3–5, 2011. The following witnesses appeared for the Debtors: Curtis Sawyer ("Sawyer"), the Debtors' chief financial officer; Scott Nelson ("Nelson"), the Debtors' chief executive officer; and Torgove. Seymour Preston Jr. ("Preston"), a managing director at Goldin Associates, Inc. ("Goldin"), testified for Fifth Street.[FN6] The parties also prepared and stipulated to the admission of nearly two hundred trial exhibits.[FN7]

FN6. Torgove and Preston each possess impressive academic and professional credentials and substantial experience. Both were qualified by the Court as experts in the field of valuation of companies in bankruptcy proceedings. (Tr. Trans.(10/4) at 115; (10/5) at 131–32.)

FN7. The Court again expresses its compliments and thanks to counsel on both sides for their courteous, professional and efficient approach to preparing this complex matter for trial on an expedited basis.

II. LEGAL ANALYSIS

As the plan proponent, the burden rests with the Debtors to demonstrate that the requirements of Bankruptcy Code § 1129 have been satisfied. *See Exide Tech.,* 303 B.R. 48, 58 (Bankr.D.Del.2003) ("The plan proponent bears the burden of establishing the plan's compliance with each of the requirements set forth in § 1129(a), while the objecting parties bear the burden of producing evidence to support their objections."); *In re Genesis Health Ventures, Inc.,* 266 B.R. 592, 598–99 (Bankr.D.Del.2001); *In re Great Bay Hotel & Casino, Inc.,* 251 B.R. 213, 221 (Bankr.D .N.J.2000). The objections raised by Fifth Street here go to both the good faith standard imposed by § 1129(a)(3) and the "fair and equitable" test under § 1129(b). The Debtors must prove by a preponderance of the evidence that the confirmation requirements have been met. *See In re DeLuca,* Case No. 95–11924, 1996 Bankr.LEXIS 1950, at *49–49 (Bankr.E.D. Va. April 15, 1996) (rejecting "clear and convincing" evidentiary standard in confirmation context).

A. The Business Plan and Projections

***3** The financial projections at the heart of this valuation exercise were prepared by the Debtors' management team. Fifth Street strongly criticizes those projections as being premised on unduly pessimistic and faulty assumptions, and contends that the projections were manufactured to produce a valuation that places Fifth Street out of the money. The Court finds, however, that the record developed at trial does not support Fifth Street's criticism.

As set forth below, the Debtors' projections anticipate substantial increases in both revenue and EBITDA (20% and 25%, respectively) over the next four years. Moreover, while the quality and integrity of projections are necessarily at issue in every valuation dispute, *see In re Nellson Nutraceutical, Inc.,* 356 B.R. 364, 374–78 (Bankr.D.Del.2006) (finding, after lengthy trial, that projections were unreliable and deliberately skewed to produce a predetermined valuation result), the parties have had a full and fair opportunity to test, in discovery and at trial, the assumptions and conclusions that underlie the projections. Following that exercise, and upon due consideration of the evidence and live testimony, the Court is satisfied that the projections were properly prepared and are sufficiently reliable to form the basis of the competing experts' analyses.

The credible evidence at trial established that the Debtors' business plan and projections were prepared primarily under the direction of the Debtors' experienced senior management, particularly Sawyer and Nelson. Both Sawyer and Nelson have been employed with the Debtors since 2009; both have also spent years in the transportation industry. Sawyer has a bachelor's de-

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gree in economics from Stanford University and a master's degree in business administration from the University of California at Berkeley. He has extensive experience in the leasing business generally and the trailer leasing business specifically. He also has a long professional history of developing business plans and projections for leasing companies, and has regularly done so for the Debtors.

Nelson has a bachelor's degree in industrial engineering from the Georgia Institute of Technology, and had gained extensive experience in the trailer leasing business before joining the Debtors. Over the last seven years, Nelson has been responsible for pricing approximately 25,000 units of trailer leasing opportunities. The record reflects that per-unit—that is, per-trailer—lease rates represent the single most important financial input in the Debtors' business. Nelson is responsible for setting the Debtors' lease rates and testified that he has substantial knowledge of competitors' pricing practices.

Both Sawyer and Nelson used their respective knowledge and experience to help develop the Debtors' current business plan, particularly with respect to lease rates and other key assumptions in the model that drive EBITDA during the projection period. The record reflects that the Debtors operate in a competitive marketplace, and that the rates they can charge their customers are directly tied to prevailing market rates and the age and quality of their trailer fleet. Nelson testified that the pricing incorporated in the business plan is competitive within the trailer leasing industry. (Tr. Trans.(10/4) at 14.). The Court found both Nelson and Sawyer to be credible witnesses.

***4** The Debtors' business plan is contained in an Excel computer model that stretches over 900 pages and contains 28 separate worksheets. (*See* Tr. Ex. 12.) The record reflects that the process and methodologies used by the Debtors' management in preparing the current projections and business plan are, in all material respects, consistent with their pre-bankruptcy practice.

The Debtors' business plan began with the Debtors' current trailer fleet and existing utilization rates and pricing as of June 2011. (Tr. Trans.(10/3) at 55–57, 69.) Management then projected the company's performance into the future based on a variety of factors that drive revenues, including utilization, price, fleet composition, the state of the economic environment generally, and the anticipated direction of the company's business. (Tr. Trans.(10/3) at 57, 62–65; Valuation Binder Ex. A at 4.) Capital expenditures ("CapEx") represents a critical component of the business plan because the plan assumes that all available capital will be deployed during the projection period to purchase new trailers. (Tr. Trans.(10/3) at 58.) That goes for all capital from external sources as well as all excess cash from the business. (Tr. Trans.(10/3) at 58; Tr. Trans. (10/4) at 31–32.) The plan contains projections for each of the thousands of new trailers the Debtors expect to acquire, including the cost to buy each trailer, the number of trailers that will be acquired, and the expected revenues from those trailers. (Tr. Trans.(10/3) at 57.)

The business plan assumes historically high utilization rates and competitive prices for the Debtors' business, but also takes into account factors such as seasonality and general economic conditions, which can have a significant impact on the Debtors' business, particularly short-term rents. (Tr. Trans. (10/3) at 40, 61; Valuation Binder Ex. A at 4.) Sawyer testified that, in his experience, when the economy dips rental revenues start to decrease. (Tr. Trans.(10/3) at 61.) He further testified that the state of the Debtors' business tends to slightly foreshadow the state of overall economy as represented through GDP. (Tr. Trans.(10/3) at 61, 73–74.)

The Debtors' project revenues to increase from $36.4 million to $43.7 million for the four-year span beginning in 2011 and ending in 2015, an increase of approximately 20%. (Tr. Trans.(10/3) at 58–59, 68; Tr. Ex. 219.) They likewise project EBITDA to grow during that period from $19.5 million to $26.3 million, an increase of approximately 35%. (Tr. Trans.(10/3) at 59, 68; Tr. Ex. 219.) There are, of course, risks that the business plan's projections will not be achieved—for instance, if the overall economy drops-off in the next two years. (Tr. Trans.(10/3) at 81–82.) There is also execution risk under the business plan in that the Debtors will have to find customers for the thousands of new trailers

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that they expect to acquire. (Tr. Trans.(10/3) at 82.)

Fifth Street challenges the projections on two fundamental grounds. First, that the Debtors' projections are unreasonably pessimistic both in terms of their own performance and the prospects for overall economic growth. Second, that the projections are fatally flawed due to management's bias toward undervaluing the business so as to maximize the post-confirmation upside of their equity interests.

***5** The Court starts from the basic proposition that preparing financial projections for a large operating business is equal parts science and art. *See* Peltz v. Hatten, 279 B.R. 710, 737 (D.Del.2002) ("[W]hen it comes to valuation ... reasonable minds can and often do disagree."). Indeed, "experts and industry analysts often disagree on ... appropriate valuation ... even when employing the same analytical tools.... This is because the output of financial valuation models are driven by their inputs, many of which are subjective in nature." *Id.* Moreover, according to one author, "projections may be difficult to make—and even more difficult to get two or more parties with different investment perspectives and transaction expectations to agree on." Shannon P. Pratt, et al., *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* 84 (4th ed.2000).

Put bluntly, these Debtors are in the business of moving and storing stuff; the more robust the economy, the more stuff there is to move and store, and the greater the demand for the Debtors' products and services. Thus, to develop the business plan and projections, the Debtors' management and its advisors used their understanding of the company's past performance, coupled with their predictions of economic conditions in the future, to estimate how the company will perform in the years to come. Fifth Street contends that the projections are inconsistent with other sources' more robust estimates of projected growth in domestic GDP; it quotes numerous industry sources that express optimism about strong demand in coming years. (Preston Reb. Rep. at 13.) FN8

FN8. "Preston Reb. Rep." refers to the Expert Rebuttal Report of Seymour Preston, Jr. that appears in the Valuation Binder at tab C.

The Debtors' projections reflect the Debtors' optimism that both revenue and EBITDA will grow through 2015, (Tr. Trans.(10/3/) at 58–59, 68; Tr. Ex. 219), though Fifth Street accuses the Debtors of not being optimistic enough. Sawyer testified regarding his expectations as to overall utilization rates, and acknowledged that there are substantial risks regarding the overall weak global and domestic economic recovery and the prospect of another (or prolonged) recession, as well as execution risk in the Debtors' effort to implement their business plan. (Tr. Trans.(10/3/) at 75–81.) These factors, considered in light of Sawyer's credible testimony, lead the Court to conclude that the Debtors' projections, which underlie Torgove's valuation, are not fatally flawed or otherwise materially unreliable. FN9

FN9. The Court notes that Fifth Street has also argued that the proposed stock distributions to management mean that the projections (and, ultimately, the Plan itself) are irretrievably tainted on account of management's self-interested bias toward a low valuation of the Debtors. The Court agrees with Fifth Street that the risk of self interest and bias mandates added scrutiny here. *See* *Exide Tech.,* 303 B.R. at 60, 65 (citing Gilson, Hotchkiss and Ruback, *Valuation of Bankruptcy Firms,* 13–1 Rev. of Fin. Stud. 43 (2003) (noting that management may see a direct economic benefit from undervaluing a company, where plan proposes equity grant in reorganized debtor)). However, given that, in the Court's experience, management's equity participation in a reorganized debtor is hardly unusual, and given further that there are sound, legitimate reasons that the new owners of a reorganized debtor may wish to ensure that management is invested in and incentivized to achieve success, it cannot be that an equity piece for management inevitably taints the process. When the Court considers the size and potential value of the proposed new equity distribution (7.5% outright, plus up to 7.5% more through options) in the context of these reor-

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ganization cases and weighs the credibility of management's testimony and the full body of evidence at trial, the Court is satisfied that the existence of the equity grant and the management options does not fatally undermine either the projections or the Plan here.

This conclusion is not materially altered by the distinctions that Fifth Street raises between the Debtors' current projections and the information contained in the Confidential Information Memorandum (the "CIM"), (Tr. Ex.1), prepared in early 2010 in connection with the Debtors' unsuccessful capital raising effort. First, the Court notes that the CIM was prepared as part of a marketing effort in hopes of encouraging new private investment in the Debtors. As such, the CIM was drafted to serve an entirely different purpose than the projections filed with the Disclosure Statement filed in this bankruptcy case. Moreover, while the Court notes that the CIM is somewhat more optimistic about the Debtors' prospects and overall value, the fact remains that the 2010 capital raise was a failure. To the extent the Court can derive any lessons from the CIM, it may be that the marketplace was unwilling to lend significant credence to a robust valuation for the Debtors.

B. Valuation Analysis

***6** Both experts, Torgove and Preston, used the Debtors' business plan and projections to testify about the Debtors' enterprise value. Both also testified about the three generally-accepted methodologies for valuing a business: discounted cash flow, comparable companies; and precedent transactions. FN10 Torgove prepared and filed the LMM Valuation and Preston filed a Rebuttal Report, but not a stand-alone valuation report. The Court begins with a brief discussion of Torgove's valuation analysis.

FN10. Additionally, the Debtors contend that the results of their unsuccessful prepetition capital raise effort in 2010 bolsters Torgove's conclusion that 5th Street is out of money. This argument is briefly addressed *infra.*

Torgove places the Debtors' TEV at between $76 million and $102 million, with a mid-point of $89 million. FN11 (Tr. Trans.(10/4) at 116.) Consistent with the business plan, Torgove's valuation assumes that the reorganized Debtors will have at least $20 million in new working capital financing available to them post-confirmation, substantially all of which will go to purchase new trailers. (Valuation Binder Ex. A at 3.) As noted above, Torgove used all three of the widely-accepted valuation methodologies, and compared the results of each approach to arrive at his opinion of the Debtors' TEV, as summarized in the chart below:

FN11. Torgove's valuation does not, however, take into account the additional $26 million liability in Stoughton Leases that the Debtor plans to assume, and which must be factored-in before Fifth Street can show that it is in the money.

METHODOLOGY	VALUATION RANGE
Discounted Cash Flow	$62,000,000–$100,000,000
Comparable Company:	
(2011P EBITDA)	$83,000,000–$103,000,000
(2012P EBITDA)	$78,000,000–$100,000,000
Precedent Transaction	$86,000,000–$105,000,000
Total Enterprise Value	$76,000,000–$102,000,000

(Tr. Trans.(10/4) at 116–117; Valuation Binder Ex. B at 2.)

As noted above, Fifth Street relies upon Preston's Rebuttal Report to challenge the various assumptions and determinations underlying the LMM Valuation.

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Preston testified that numerous adjustments should be made in each of the component methodologies utilized in the LMM Valuation, with the resulting TEV ranging from $119 million to $159 million and a midpoint of $139 million.

Valuation of an operating business is by definition an inexact science, hence the use of multiple methodologies, approximate ranges and midpoints. It has been "aptly observed that 'entity valuation is much like a guess compounded by an estimate.' " 7 Collier on Bankruptcy ¶ 1129.05[3][c] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.2011) (quoting Peter Coogan, *Confirmation of a Plan Under the Bankruptcy Code,* 32 Case W. Res. L.Rev. 301, 313 n. 62 (1982)). "Regardless of the method used, the result will rarely, if ever, be without doubt or variation." 7 Collier on Bankruptcy ¶ 1129.05[3][c]. As the United States Supreme Court has said:

> Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance.

***7** *Consolidated Rock Prods. Co. v. DuBois,* 312, U.S. 510, 526 (1941)).

The testimony of Torgove and Preston form the core of each side's valuation record. Each side has asked that the Court disregard, or at least discount, the opposing expert's testimony on the ground that it has been engineered to reduce or inflate value in furtherance of their respective clients' interests. As noted by Judge Carey recently in a valuation dispute, however, the Court is aware that "hired experts often approach their valuation task from an advocate's point of view." *In re Tribune Co.,* No. 08–13141, 2011 Bankr.LEXIS 4128, at *46 (Bankr.D.Del. Oct. 31, 2011); *accord In re Mirant Corp.,* 334 B.R. 800, 814–15 (Bankr.N.D.Tex.2005) ("that experts may be anxious to serve in the interests of the parties retaining them is neither startling nor enough reason to disregard their testimony.... It simply means the Court must be cautious itself ..."). The Court qualified Torgove and Preston as experts and each of them prepared diligently and testified credibly.

It is only after going through the multiple steps described by the Supreme Court in *Consolidated Rock,* and considering all of the evidence and testimony in proper context, that this Court can make an "informed judgment" as to the value of the Debtors. At bottom, in this case it is the Debtors' burden to demonstrate by a preponderance of the evidence that their valuation supports a Plan predicated upon TEV of less than $110 million.

i. Discounted Cash Flow

The discounted cash flow analysis is a "forward-looking" method that "measures value by forecasting a firm's ability to generate cash." *Exide,* 303 B.R. at 63 (citations omitted). "Discounted cash flow is calculated by adding together (i) the present value of the company's projected distributable cash flows (i . e., cash flows available to investors) during the forecast period, and (ii) the present value of the company's terminal value (i.e., the value of the firm at the end of the forecast period)." *Id.; see also Genesis,* 266 B.R. at 613 n. 19 ("discounted cash flow analysis determines the cash flows that would be available to a potential investor, based on a required rate of return, to determine net present value").

Here, Torgove's testimony reflects that he relied upon the Debtors' projections in the business plan in performing his discounted cash flow analysis. The projections assume year-over-year growth in revenues and EBITDA based in part on the anticipated acquisition of new trailers as part of the $20 million new working capital facility that will be made available to the Debtors under the Plan. (Tr. Trans.(10/3) at 59, 68; Tr. Ex. 219.)

In reliance upon the business plan and without any adjustments thereto, Torgove calculated a weighted average cost of capital of 11 .3.3 % and selected a range of exit multiples from 4.25x–6.25x under the terminal

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multiple method. (Valuation Binder Ex. B at 2.) Torgove's weighted average cost of capital: (a) includes a widely-accepted unsystematic risk premium of 3.0%, which captures unique risks specific to the Debtors, like the fact that the company has not had access to capital to invest in new trailers for two years and is emerging from bankruptcy with potentially strained relationships with customers and employees, (Tr. Trans.(10/4) at 154–56); (b) utilizes a size risk premium based on the 10(b) decile derived from Ibbotson, a standard valuation authority, that appropriately takes into account the Debtors' anticipated equity value, (Tr. Trans.(10/4) at 149–53; Tr. Ex. 205, 206); and (c) utilizes a risk-free rate based on the estimated 20–year U.S. Treasury yield that is the most commonly used and is the standard suggested by Ibbotson (Tr. Trans.(10/4) at 156). These assumptions result in a valuation range for the Debtors based on the discounted cash flow method in the range of $62 million to $100 million with a mid-point value of $89 million. (Tr. Trans.(10/4) at 158; Valuation Binder Ex. B at 2.)

***8** Preston recommended a wide range of adjustments to the discounted cash flow methodology in the LMM Valuation. Among other points, Preston contends that projected CapEx should be reduced and the rate of depreciation increased in determining the terminal value. (Preston Reb. Rep. at 25–26.) Also, in the context of calculating terminal value, Preston criticizes the use of 2015 as the terminal year (allegedly a "down-cycle" year), and a perpetual growth rate of only 2–4% applied to cash flows from that terminal year, for purposes of estimating the Debtors' value in perpetuity. Finally, Preston challenges the decisions and assumptions made by Torgove in calculating these Debtors weighted average cost of capital. Specifically, Preston (i) criticizes the use of the 10(b) Ibbotson decile in determining the size risk premium applied in the LMM Valuation, recommending the use of Ibbotson decile 10 (which includes a much broader sample size); and (ii) contends that the application of a 3% " bankruptcy premium" improperly inflates these Debtors' projected borrowing costs.

After making these and other adjustments, Preston has developed two separate valuation ranges for the Debtors using the discounted cash flow methodology. First, in applying the perpetuity method, Preston identifies a very broad range of $87 million to $222 million, with a midpoint of $154 million. Second, applying the exit multiple method, Preston calculates a somewhat tighter value range of $100 million to $145 million, with a midpoint of $122.5 million. (Preston Reb. Rep. at 33, 35.)

The Court has previously observed that the process of valuing an operating business requires a host of individual judgment calls by the valuator. In the present case, the record developed at trial reflects that Torgove's valuation is based upon the projections prepared by management and was prepared in accordance with standard and generally-accepted methodologies and assumptions. The Court recognizes and respects that Preston would have made a number of different decisions or assumptions, and the valuation exercise is sufficiently malleable or fluid to support those differing approaches. Nevertheless, having determined that the LMM Valuation is predicated upon reliable projections and generally-accepted valuation principles, the Court does not conclude that the differences of opinion and judgment between Preston and Torgove render the discounted cash flow analysis in the LMM Valuation flawed or materially unreliable.

ii. Comparable Company Analysis

The key components of a comparable company analysis are the Debtor's EBITDA and the selection of an appropriate multiple to apply to the EBITDA to arrive at enterprise value." *Exide,* 303 B.R. at 61. A subjective assessment is required to select the comparable companies. *Id.*

Torgove identified six publicly-traded companies that he deemed to be comparable to the Debtors. (Valuation Binder Ex. A at 19.) He considered, but ultimately excluded, eight other companies (originally identified in the CIM in 2010) as possible candidates for inclusion in the peer group with the Debtors. (Valuation Binder Ex. A at 19.) Preston's Rebuttal Report proposes to add four of these additional "comparable companies" to the six Torgove selected. (Valuation Binder Ex. C at

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16.) Preston strongly criticizes the LMM Valuation for choosing a skewed set of only six out of the fourteen companies that had been included in the CIM in 2010. Preston contends that without that broader pool of comparable companies identified in the CIM, Torgove's analysis artificially depresses the Debtors' TEV. (Preston Reb. Rep. at 7.)

***9** As a threshold matter, the Court reiterates its reservations about relying on the CIM as a tool to measure the accuracy or integrity of the LMM Valuation and the Debtors' current valuation. The CIM was a marketing piece created to support a fund-raising effort in the capital markets that ultimately failed. It was created in a somewhat different time frame and for a completely different purpose than the Debtors' Disclosure Statement and the LMM Valuation. Indeed, the CIM was presumably prepared to foster enthusiasm in the capital markets for the Debtors as an attractive investment opportunity. The Disclosure Statement and the LMM Valuation, on the other hand, were developed in the pursuit of confirmation of a proposed Plan that presumes that the value of the Debtors' business does not extend past the first lien debt (viz., $83.4 million plus the Stoughton Leases).

Case law teaches, of course, that courts considering competing valuations should always be wary (or at least cognizant) of the ultimate motives and economic interests of those proffering a particular position or analysis. *Mirant,* 334 B.R. at 815. Thus when the Court considers the CIM, LMM Valuation, and Preston Rebuttal Report, it remains cognizant of the context in which they were developed and the interests of the parties standing behind them. This recognition does not render the submissions invalid, it just means that the Court is obliged to cast a skeptical eye on all of the evidence, and to allow the adversarial process to run its course through trial.

As noted, the CIM identified fourteen companies in its comparable company analysis, and Torgove included six of these companies (and did not include the other eight) in his analysis. Preston contends that four of the excluded companies should have been included,[FN12] with a substantial upward effect on this component of the valuation analysis.

> FN12. Preston agreed that the last four of the fourteen were not good comparables and were properly excluded by Torgove. (Preston. Reb. Rep. at 15.)

Torgove testified to the difficulty in identifying appropriate candidates to include in his analysis due to the nature of the Debtors' business and the fact that other publicly traded companies in that business are significantly larger than the Debtors. (Tr. Trans.(10/4) at 192) For example, three of the six comparable companies used by Torgove are Ryder, United Rentals, and TAL International, with disclosed enterprise values of $5.6 billion, $3.3 billion and $2.9 billion, respectively—placing these companies between 30 and 50 times the size of these Debtors.

Preston contends that Cramo Oyj, Essex Rental, Touax SA and GATX Corp. all should have been included in Torgove's analysis. (Preston Reb. Rep. at 16.) Torgove testified, however, that he excluded both Cramo Oyj and Touax SA because those companies do almost no business in the United States. (Tr. Trans. (10/4) at 125–30.) The Court finds that to be a legitimate reason to exclusion them. As to GATX, Torgove testified that its enterprise value far exceeds that of the Debtors, and that he believed GATX's business operations are not fairly comparable to the Debtors. (Tr. Trans.(10/4) at 128; Tr. Ex 1 at 35) Among other things, GATX owns a fleet of ships and railroad locomotives. (Tr. Trans. (10/4) at 128; (10/5) 7–9.) Again, while reasonable valuators could differ on the appropriateness of including GATX (a company at least 40 times larger than these Debtors), the Court cannot find that Torgove's decision in this respect was unreasonable.

***10** Finally, and most importantly, Preston contends that Essex Rental should have been included. Essex Rental leases cranes and construction equipment. At approximately $300 million in enterprise value and a facially similar line of business, Essex Rental does appear a good candidate for comparison. However, Torgove identified several factors which led him to conclude that Essex Rental would not provide a good or informative

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comparison. (Tr. Trans.(10/4) at 126–28.)

Specifically, Essex's business differs materially from the Debtors in that the main products Essex offer for lease are large, mobile cranes made of high-quality steel alloys which enjoy usable lives in excess of 50 years and actually appreciate in value over time. More importantly, Essex Rental shows a trading multiple of 19 .5 x EBITDA, a multiple far outside the range of other companies in the analysis. Torgove concluded, and the Court agrees, that Essex Rental is an outlier and was properly excluded from the comparable companies analysis in the LMM Valuation.[FN13]

FN13. This determination is buttressed by the observation that the inclusion of Essex Rental in Preston's analysis serves to increase the estimated value by nearly $25 million.

Torgove focused on the TEV/EBITDA of the Debtors' peer group of comparable publicly traded companies. Given the Debtors have substantially lower revenues and growth prospects than the comparable companies—and hence greater risks—Torgove used the 25th percentile of the range of implied total enterprise value multiples of comparable companies. (Tr. Trans.(10/4) at 135; Tr. Trans. (10/05) at 11.) He considered comparable company projections for years 2011 and 2012, which yielded multiples of EBITDA in the range of 3.6x to 5.3x and a valuation range for the Debtors of $78 million to $103 million (Valuation Binder Ex. A at 24.)

iii. Precedent Transaction Analysis

"The [precedent] transaction analysis is similar to the comparable company analysis in that an EBITDA multiple is determined from recent merger and acquisition transactions ... and is then applied to the appropriate trailing twelve months of the Debtor." *Exide,* 303 B.R. at 62. Precedent transactions, however, are only comparable if similar market conditions existed when the precedent transaction occurred and the precedent is actually analogous. *Id.* at 61.

Torgove identified fourteen precedent transactions involving equipment-related rental businesses like the Debtors for the five-year period between March 2006 and May 2011. No transactions involving less than $10 million or more than $500 million of enterprise value were included in the analysis. (Tr. Trans.(10/4) at 141; Valuation Binder Ex. A at 27.) Based on the value of these transactions, Torgove implied a valuation multiple of 4.4x to 5.4x against the Debtors' last twelve months adjusted EBITDA, which resulted in a valuation range for the Debtors of $86 million to $105 million. (Valuation Binder Ex. A at 29.)

As with the comparable company analysis, the main bone of contention between the competing experts is in the decision to exclude several of the transactions identified in the CIM from the LMM Valuation. The Court has earlier observed that the decisions and judgments made in connection with preparation of the CIM are at best relevant to, but certainly not dispositive of, this valuation exercise. When those transactions are included as Preston recommends, the mean and median multiple would increase to 5.5%. Using this broader sample of transactions and a slightly higher multiple than Torgove, Preston contends that the precedent transactions methodology results in a valuation range for the Debtors stretching from $99 million to $188 million.

***11** The record developed at trial reveals relatively little information regarding the suitability of these three additional transactions and Torgove's rationale for excluding them from the LMM Report. Similarly, other than the fact that they were included in the CIM, Preston did not offer much guidance on why he believed they should be included in the LMM Report. However, the Court does struggle with the broad range of value calculated as a result of Preston's adjustments to the LMM Valuation: a range of $99–$188 million is sufficiently wide so as to impair its usefulness as a value metric.

iv. Conclusion on Valuation

The LMM Valuation posits a range of value for the Debtors of $76–$102 million, with a midpoint of $89 million. After making numerous changes or adjustments to the projections and the LMM Valuation, Preston posits a range of TEV from $119 million to $159 million. As noted above, starting with the first lien debt of $84

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million held by Garrison and taking into account the additional $26 million in liability on the Stoughton Leases, the TEV hurdle Fifth Street must overcome before it can show it is in the money is $110 million.

The Court has previously determined that the LMM Valuation was prepared according to widely-accepted methodologies and standards, and in reliance upon projections properly prepared by management. To the extent that the Preston Rebuttal Report identifies legitimate concerns with, or appropriate adjustments to, the LMM Valuation, they are not sufficient to materially affect or change the LMM Valuation. The Court thus concludes that the Debtors have carried their burden to demonstrate that the Debtors' TEV is below the $110 million threshold.

C. The United States Trustee Objection

The U.S. Trustee objects the Plan provision that proposes to exculpate a variety of parties from potential liability arising out of their participation in these proceedings. It is the position of the U.S. Trustee that the Plan's exculpation provisions go beyond what is contemplated and permitted under the Bankruptcy Code. The Plan's exculpation provision currently reads, in its entirely, as follows:

> As of and subject to the occurrence of the Effective Date, each of the Debtors, the Prepetition Agent, Holders of First Lien Credit Agreement Claims, Coda Capital Partners L.L.C. and its affiliates, Angel, Gordon & Co. LP and its affiliates, and each of their respective Agents, shall neither have nor incur any liability to any Person or Entity for any act taken or omitted to be taken, in connection with, or related to, the formulation, preparation, dissemination, implementation, administration, Confirmation or consummation of the Plan or any contract, instrument, waiver, release, or other agreement or document created or entered into, in connection with the Plan, or any other act taken or omitted to be taken in connection with the Cases; provided, however, that the foregoing provisions of this subsection shall have no effect on the liability of any Person or Entity that results from any such act or omission that is determined in a Final Order to have constituted gross negligence or willful misconduct.

***12** (Plan at 56.)

The U.S. Trustee argues that this provision goes too far because it would exculpate prepetition lenders—specifically, Garrison, Angelo, Gordon & Co., and Coda Capital—who are not estate fiduciaries or their professionals. As support for its view that the Court should limit the scope of the exculpation clause to cover estate fiduciaries, the U.S. Trustee cites to *In re Washington Mutual, Inc.,* 442 B.R. 314 (Bankr.D.Del.2011). In that case, the plan at issue proposed to exculpate and release parties, some of whom were fiduciaries, some not, for actions taken during the bankruptcy case. Because the court viewed the exculpation clause as "either duplicative of [the] releases ... or ... an effort to extend those releases" to non-fiduciaries, it found the exculpation clause "much too broad." *Id.* at 350. Such clauses, the court held, "must be limited to the fiduciaries who have served during the chapter 11 proceeding: estate professionals, the [c]ommittees and their members, and the [d]ebtors' directors and officers." *Id.* at 350–51.

The *Washington Mutual* court based its reasoning on the Third Circuit's decision in *In re PWS Holding Corp.,* 228 F.3d 224 (3d Cir.2000), which held that a plan may exculpate a creditor's committee, its members, and estate professionals for their actions in the bankruptcy case, except where those actions amount to willful misconduct or gross negligence. *Id.* at 246. In reaching its conclusion, the *PWS* court examined § 1103(c) FN14 and noted that the section "has been interpreted to imply both a fiduciary duty to committee constituents and a limited grant of immunity to committee members." *Id.* "This immunity," the court found, "covers committee members for actions within the scope of their duties." *Id.* The *PWS* court's reasoning thus implies that a party's exculpation is based upon its role or status as a fiduciary. That is why, as the *Washington Mutual* court pointed out, courts have permitted exculpation clauses insofar as they "merely state[ ] the standard to which ... estate fiduciaries [a]re held in a chapter 11 case." *Wash. Mut.,* 442 B.R. as 350. "That fiduciary standard, however, applies only to estate fiduciaries," no one else.

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Accordingly, the exculpation clause here must be reeled into include only those parties who have acted as estate fiduciaries and their professionals. *See Tribune,* 2011 Bankr.LEXIS 4128 at *160–61 (holding that exculpation provision must "exclude non-fiduciaries"). The U.S. Trustee's objection is therefore sustained.[FN15]

FN14. 11 U.S.C. § 1103(c) provides:

(c) A committee appointed under section 1102 of this title may—

(1) consult with the trustee or debtor in possession concerning the administration of the case;

(2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or the formulation of a plan;

(3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections to the plan;

(4) request the appointment of a trustee or examiner under section 1104 of this title; and

(5) perform such other services as are in the interest of those represented.

FN15. The Court is aware that sustaining the U.S. Trustee's objection is unlikely to have much practical effect because Garrison, which will hold or control any causes of action against Angelo, Gordon & Co. and Coda Capital, has already agreed not to pursue them. Even so, the Court cannot take a "no harm, no foul" approach to an exculpatory provision that exceed the authority provided under the Bankruptcy Code.

III. CONCLUSION

For the foregoing reasons, the Court concludes that the Plan has been submitted in good faith, and the Court further finds that the Debtors have carried their burden to demonstrate that the plan is fair and equitable, and otherwise sufficient to warrant confirmation of the Plan. Counsel for the Debtors shall promptly file a certification of counsel with an appropriate form of order confirming the Plan.

Bkrtcy.D.Del.,2011.
In re PTL Holdings LLC
Slip Copy, 2011 WL 5509031 (Bkrtcy.D.Del.), 55 Bankr.Ct.Dec. 206

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430 B.R. 99
United States Bankruptcy Court,
S.D. New York.

In re YOUNG BROADCASTING INC., et al., Debtors.

No. 09–10645 (AJG). | April 19, 2010.

Synopsis
Background: Confirmation hearing was held on competing plans of Chapter 11 debtors and creditors' committee.

Holdings: The Bankruptcy Court, Arthur J. Gonzalez, Chief Judge, held that:

[1] mere fact that, pursuant to Chapter 11 plan proposed by creditors' committee, current management would have more than 80%, by number, of voting stock of reorganized entity was insufficient to prevent plan from triggering incurable, non-monetary default under change-of-control provision in debtors' loan agreement, so as to prevent reinstatement of maturity of debtors' loan as specified under committee's plan;

[2] committee's plan lacked the requisite "feasibility" and could not be confirmed;

[3] committee, as plan proponent, failed to satisfy burden of showing that plan did not unfairly discriminate between noteholders and unsecured trade creditors; and

[4] committee failed to satisfy burden of showing that the 10% economic interest that debtors' principal received in reorganized entity was not "on account of" his existing equity interest in debtors, but in nature of compensation for services that he provided in connection with reinstatement of credit facility, and failed to establish that this distribution to principal, under plan which would result in less than a 100% distribution on unsecured claims, did not violate "absolute priority" rule.

Confirmation of committee's plan denied; confirmation of debtors' plan granted.

Attorneys and Law Firms

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Milbank, Tweed, Hadley & McCloy LLP By Linda Dakin–Grimm, Esq., Daniel M. Perry, Esq., Gregory A. Bray, Esq., Mark C. Scarsi, Esq., New York, NY, for Wachovia Bank, N.A., Agent for Senior Secured Lenders.

Opinion

CONFIRMATION OPINION

ARTHUR J. GONZALEZ, Chief Bankruptcy Judge.

Before this Court are two proposed plans of reorganization. The Official Committee of Unsecured Creditors (the

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"Committee") of Young Broadcasting, Inc. ("YBI" or the "Debtor") and its affiliated debtors and debtors in possession in the above-captioned cases (collectively, the "Debtors") move before this Court seeking confirmation of the Committee's Amended ***106** Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, dated November 4, 2009 (the "Committee Plan") pursuant to section 1129 of title 11 of the United States Code (the "Bankruptcy Code"). In the event that the Court denies confirmation of the Committee Plan, the Debtors[1] move for confirmation of the joint plan of Young Broadcasting, Inc. and its subsidiaries under chapter 11 of the Bankruptcy Code (as the same may be subsequently amended or supplemented and including all exhibits and supplements thereto, the "Debtors Plan"). For the reasons set forth below, the Court denies confirmation of the Committee Plan and grants confirmation of the Debtors Plan.

1 The Debtors in these cases are Young Broadcasting, Inc.; Young Broadcasting of Lansing, Inc.; Young Broadcasting of Louisiana, Inc.; Young Broadcasting of Nashville, LLC; Young Broadcasting of Albany, Inc.; Young Broadcasting of Richmond, Inc; Young Broadcasting of Knoxville, Inc.; Young Broadcasting of Green Bay, Inc.; Young Broadcasting of Davenport, Inc.; Young Broadcasting of Sioux Falls, Inc.; Young Broadcasting of Rapid City, Inc.; Young Broadcasting of San Francisco, Inc.; Young Broadcasting of Nashville, Inc.; Young Broadcasting of Los Angeles, Inc.; Young Broadcasting Shared Services, Inc.; Adam Young, Inc.; WKRN, G.P.; WATE, G.P.; KLFY, L.P.; YBT, Inc.; YBK, Inc.; LAT, Inc.; Winnebago Television Corporation; Fidelity Television, Inc.; and Honey Bucket Films, Inc.; Young Broadcasting Capital Corp.; and Young Communications, Inc.

Background

On February 13, 2009 (the "Commencement Date"), the Debtors filed before this Court a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. On September 16, 2009, Young Broadcasting Capital Corp. and Young Communications, Inc., two of the original Debtors' affiliates, each filed before this Court a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Pursuant to the Orders dated February 17, 2009 and October 29, 2009, these cases were jointly administered.[2]

2 Since the Commencement Date, the Debtors have continued to operate their businesses and manage their properties as debtors-in-possession ("DIP") pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

The Debtors' Business

YBI, a Delaware corporation that is currently headquartered in New York, was founded in 1986 by Vincent Young ("Young") and his father, Adam Young. Thereafter, affiliated entities were formed and acquired. The Debtors own and operate ten television stations in geographically diverse markets[3] and a national television sales representation firm, Adam Young, Inc.[4]

3 The stations are: Lansing, Michigan (WLNS—a CBS network affiliate); Green Bay, Wisconsin (WBAY—an ABC network affiliate); Lafayette, Louisiana (KLFY—a CBS network affiliate); Nashville, Tennessee (WKRN—an ABC network affiliate); Knoxville, Tennessee (WATE—an ABC network affiliate); Albany, New York (WTEN—an ABC network affiliate); Richmond, Virginia (WRIC—an ABC network affiliate); Davenport, Iowa (KWQC—an NBC network affiliate); Sioux Falls, South Dakota (KELO—a CBS network affiliate); and San Francisco, California (KRON—a MyNetworkTV network affiliate). The Debtors also operate satellite stations that rebroadcast programming from primary stations.

4 The Debtors' television broadcasting stations reach 6% of the total U.S. television households and are ranked first in news broadcasting in a majority of their geographic markets. The Debtors employ approximately 1,107 employees nationwide and their primary customers are local, regional, and national advertisers. The broadcasting industry is cyclical. Revenue of the Debtors' business generally is higher during even-numbered election years due to spending by political candidates and supporters of ballot initiatives, with spending usually the highest in the fourth quarter. Revenue from political advertising spending is particularly higher during presidential election years (i.e., years divisible by four).

***107** YBI is the borrower under a Fourth Amended and Restated Credit Agreement, dated as of May 3, 2005 (as subsequently amended and supplemented, and together with related loan and security documents, the "Credit Agreement"),

among YBI, the Lenders (the "Lenders") from time to time party thereto, Wachovia (as administrative agent, collateral agent and issuing bank), Lehman Commercial Paper Inc., and Merrill Lynch, Pierce, Fenner & Smith Incorporated (as syndication agents), BNP Paribas (as documentation agent), and Wachovia Capital Markets, LLC, Lehman Brothers Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated (as joint lead arrangers and joint lead book-runners). The Credit Agreement originally provided for a $300 million term loan that matures in November 2012. Subsequent amendments increased the term loan to $350 million.[5] The YBI's obligations under the Credit Agreement are secured by a first priority security interest in and liens upon substantially all of the Debtors' assets. As of the Commencement Date, the allowed amount of secured obligations owed to the Lenders was $338,451,923.85.[6]

5 Under the Credit Agreement, the secured obligation as amended bears a floating interest rate of LIBOR plus 2.5%. The Credit Agreement also requires that, so long as any amounts remain outstanding under Credit Agreement, the Debtor must maintain at least $10 million in cash reserve.

6 This amount consists of outstanding principal in the amount of $338,125,000, plus unpaid prepetition fees, costs, and expenses as of the Commencement Date.

On March 1, 2001, YBI completed a private offering of $500 million of 10% senior subordinated notes due 2001. On December 23, 2003, YBI completed another private offering of $140 million of 8 ¾ % senior subordinated notes due 2014. These two series of notes are collectively referred to as the "Senior Subordinated Notes" and have an aggregate face amount of $640 million. The Senior Subordinated Notes are general unsecured obligations of the YBI, subordinated in right of payment to all senior debt, including all of the YBI's indebtedness under the Credit Agreement. The Senior Subordinated Notes are guaranteed by each of the Debtors. As of December 31, 2008, the principal amount outstanding under the Senior Subordinated Notes was approximately $484.3 million.

Events Leading Up to the Debtors' Chapter 11 Filing

During the years leading up to the Commencement Date, the Debtors were burdened with debt and suffered a decline in revenue as a result of the general decrease in advertising budgets in the current recession. The Debtors also encountered increased competition from other television stations as well as alternate advertising vehicles such as newspapers, radio stations, magazines, cable networks, and internet portals. In particular, the Debtors' largest station, KRON–TV ("KRON"), suffered severe cash flow losses. The Debtors explored various options prior to filing Chapter 11, including cost savings initiatives, attempts to sell KRON, and discussions of out-of-court restructuring with the holders of the Senior Subordinated Notes (the "Noteholders"). These efforts were unsuccessful at solving the Debtors' dire financial problems. In February 2009, the Debtors' board of directors appointed David Pauker of Goldin Associates, LLC as the Debtors' Chief Restructuring Officer ("CRO") to effect a recapitalization and deleveraging through a Chapter 11 plan or a section 363 sale.

108 *The Auction, the Credit Bid, and the Competing Plans

When the cases were first filed, the Debtors pursued a dual track process, exploring a sale of substantially all of their assets while attempting to reach a consensual "stand alone" plan with their major constituents. At the time, the Debtors believed that a section 363 sale would best suit the Debtors' situation and maximize value for the estate. In April 2009, this Court approved the Debtors' bidding procedures for the sale of substantially all of their assets, and after an extensive marketing process, the Debtors received three qualified bids, all seeking to purchase substantially all of the Debtors' assets, and an expression of interest from a potential purchaser who had not participated in the sale process or conducted due diligence.[7] The Lenders were selected as the stalking horse bidder and offered to credit bid $200 million of their secured debt towards the purchase of the Debtors' assets and to cause the purchasing entity to assume all allowed administrative costs and cure claims, resulting in a bid value of approximately $219.9 million (the "Credit Bid").[8] After consultation with the Committee and the Lenders, the Debtors deemed the Credit Bid as the prevailing bid and the auction was canceled.[9]

7 During the Debtors' marketing process, sixty-nine potential bidders were contacted, twenty-nine of which negotiated confidentiality agreements entitling them access to due diligence information. The potential purchaser, who set forth a bid of $215

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million, did not qualify to participate in the auction because the bid was not accompanied by a deposit and it was subject to additional due diligence that the bidder estimated would take two to three weeks to complete.

8 The other two qualified bids offered to purchase the assets for $120 million.

9 The other two qualified bidders indicated that they would not raise their bids to the level of the Credit Bid, did not intend to attend the auction, and demanded prompt return of their deposits. Both the Lenders and the Committee declined to give more time to the non-qualified bidder to conduct due diligence. The Debtors' financial advisor believes that the bids at the auction accurately reflect the market perception that the then current value of the Debtors' assets was less than the Credit Bid.

By this time, however, the Debtors' business had improved and had produced sufficient cash flow to operate until at least the end of 2009. Consequently, this Court found that the emergency conditions required to authorize a sale of substantially all of the Debtors' assets outside the plan process were not satisfied and ruled that it would only consider approval of a sale as part of a plan. The Court then entered an order authorizing the Debtors to execute the Asset Purchase Agreement (the "APA") with the Lenders, subject to a further order confirming a plan of reorganization. Meanwhile, the Debtors began negotiating with the Committee to develop an alternative plan of reorganization.

Further, after the Court denied the Debtors' request to approve the sale, the Debtors moved to extend exclusivity, at which time the Committee objected and sought a lifting of exclusivity to file the Committee Plan.[10] The Debtors, with the consent of the Lenders, agreed to a lifting of exclusivity to permit the Committee to propose a plan, provided that the Committee Plan remained on the same timeline towards confirmation as the Debtors Plan. On August 12, 2009, this Court entered an order extending exclusivity with a carve-out to allow the Committee to file a competing ***109** plan. The Debtors filed the joint plan of the Debtor and its debtor subsidiaries on September 24, 2009, an amended joint plan on November 4, 2009, and their Disclosure Statement for that plan on October 9, 2009. On October 9, 2009, the Committee filed its Disclosure Statement Supplement. On November 5, 2009, the Court approved both the Committee's Disclosure Statement Supplement for the Committee Plan and the Debtors' Disclosure Statement for the Debtors Plan. On November 6, 2009, the Court entered an order approving solicitation and voting procedures (the "Solicitation Order"). According to the Solicitation Order, the Debtors would solicit votes for the Debtors Plan and the Committee Plan on a single ballot. Creditors entitled to vote would receive a single ballot. On the ballot, creditors could vote for or against either plan and, if voting in favor of both plans, indicate a preference for one plan over the other. In November 2009, pursuant to the Solicitation Order, the Solicitation Package was mailed to creditors.

10 At this time, the Committee also committed to make a cash infusion of $38 million to fund the Committee Plan. That commitment was later increased to $45.6 million in order to provide an additional working capital cushion to the Company.

In December 2009, after a presentation of both plans to the Debtors' board of directors, it decided, exercising its fiduciary duties and business judgment, that it preferred the Committee Plan over the Debtors Plan. As a result, it seeks confirmation of the Debtors Plan only if the Court does not confirm the Committee Plan.

The Debtors Plan

The Debtors Plan, (1) fully compensates allowed administrative expenses, allowed priority claims, and secured claims other than the Lenders' claims; (2) creates a new company, New Young Broadcasting Holding Co., Inc. ("NewCo"), which would receive all of the common stock of the Reorganized Debtors (the "Company"), and in which the Lenders would receive all of the equity interests in complete satisfaction of their secured claims totaling $338 million as of the Commencement Date; (3) provides general unsecured creditors with their pro rata share of $1 million in the aggregate; (4) provides equity warrants in NewCo to the Noteholders if they voted to accept the Debtors Plan; and (5) provides no distribution to holders of equity interests in the Debtors. The Debtors Plan completely deleverages the Debtors as both the Senior Subordinated Notes and the Lenders' claim under the Credit Agreement are discharged and extinguished.

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The Committee Plan

The treatment of allowed administrative expenses, allowed priority claims, secured claims, and general unsecured claims are the same under the Committee Plan as they are under the Debtors Plan. Likewise, holders of equity interests will also receive no distribution.[11]

[11] In an effort to address certain change of control provisions in the Credit Agreement, the Committee Plan provides that Mr. Young will receive all of the Class B shares of common stock of the Company, which converts to 10% of the Class A common stock upon full repayment of the Debt. The Court will subsequently address whether this provision adequately addresses the change of control provisions.

However, under the Committee Plan, all $338 million of the debt owed to the Lenders under the Credit Agreement as of the Commencement Date, including accrued post petition interest and principal amortization payments, will be reinstated.[12] If the Credit Agreement is reinstated under the Committee Plan, at the time of the loan's maturity in November 2012, assuming ***110** timely payment of interest and quarterly principal amortization payments, a principal balance of $325,000,000 (the "Debt") will become due. The Committee Plan further provides the Noteholders with a pro rata share of 10% of the Company's common stock and the opportunity to participate in a rights offering under which the Noteholders can purchase a pro rata share of $45.6 million of preferred stock plus 80% of the common stock in the Company. A Plan Support Agreement filed by certain backstop parties (the "Backstop Parties") in support of the Committee Plan provides for a cash investment in the amount of $45.6 million, which will pay all monetary defaults under the Credit Agreement, fund payments under the Committee Plan, and meet the working capital and general corporate needs of the Debtors. In addition, Young will receive all of the Class B shares of common stock of the Company, which converts to 10% of the Class A common stock upon full repayment of the Debt in November 2012.

[12] The Lenders' other rights under the Credit Agreement remain the same as required by sections 1123(d) and 1124 of the Bankruptcy Code.

Balloting Results

On January 18, 2010, the Declaration of Jane Sullivan Regarding Voting on, and Tabulation of, Ballots Accepting and Rejecting (I) The Debtors' Joint Plan Under Chapter 11 of the Bankruptcy Code and (II) the Official Committee of Unsecured Creditors' Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code ("Ballot Declaration"), containing balloting results, was filed. Below are the balloting results for both plans:

Vote on Debtors Plan	Amount Accepting (% of Amount Voted)	Amount Rejecting (% of Amount Voted)	Number Accepting (% of Amount Voted)	Number Rejecting (% of Amount Voted)
Lender Claims (Class B/Class 2)	$295,448,513.35 (95.21%)	$14,871,077.94 (4.79%)	57(81.43%)	13 (18.57%)
Noteholder Claims (Class D/Class 6)	$197,281,000.00 (58.29%)	$141,163,000.00 (41.71%)	26 (27.96%)	67 (72.04%)
General Unsecured Claims	$7,499,225.45 (88.68%)	$957,656.85 (11.32%)	33 (43.42%)	43 (56.58%)

(Class E/Class 7)

Vote on Committee Plan	Amount Accepting (% of Amount Voted)	Amount Rejecting (% of Amount Voted)	Number Accepting (% of Amount Voted)	Number Rejecting (% of Amount Voted)
Lender Claims (Class B/Class 2)	N/A (deemed accept)	N/A (deemed accept)	N/A (deemed accept)	N/A (deemed accept)
Noteholder Claims (Class D/Class 6)	$338,291,000.00 (99.95%)	$153,000.00 (0.05%)	90 (96.77%)	3 (3.23%)
General Unsecured Claims (Class E/Class 7)	$2,663,436.08 (31.49%)	$5,793,446.22 (68.51%)	52 (68.42%)	24 (31.58%)

Preference Election	Amount Preferring Debtors Plan (% of Amount Voted)	Amount Preferring Committee Plan (% of Amount Voted)	Number Preferring Debtors Plan (% of Amount Voted)	Number Preferring Committee Plan (% of Amount Voted)
Lender Claims (Class B/Class 2)	$222,808,122.34 (78.26%)	$61,908,799.41 (21.74%)	22(39.29%)	34 (60.71%)
Noteholder Claims (Class D/Class 6) 13	$58,123,000.00 (31.47%)	$126,551,000.00 (68.53%)	8 (38.10%)	13 (61.90%)
General Unsecured Claims (Class E/Class 7)	$918,422.90 (92.73%)	$72,018.52 (7.27%)	6 (60.00%)	4 (40.00%)

See JX–56, Ex. A.

FN13. These calculations only include the preference elections of those holders that voted to accept both plans.

*111 On December 30, 2009, the Lenders filed a motion *in limine* (the "Daubert Motion") seeking an order from the Court to

exclude (1) the expert report and testimony of Tom Kuhn ("Kuhn") of Allen & Company ("A & C") on the issues of the Company's ability to sell or refinance in November 2012, and (2) Kuhn's expert report and testimony on the Debtors' valuation. On January 11, 2010, the Committee filed an opposition to the Daubert Motion.

On January 19, 2010, a hearing (the "Confirmation Hearing") commenced on the issues of whether the Debtors Plan and the Committee Plan can be confirmed pursuant to Bankruptcy Rule 3017 and 3018 and sections 1126, 1128, and 1129 of the Bankruptcy Code.[14] The Confirmation Hearing continued on January 20, 2010, January 21, 2010, and concluded on January 25, 2010. As instructed by the Court, the parties filed post-hearing briefs, proposed findings of fact and conclusions of law, and post-trial reply briefs. The record of these proceedings was closed as of February 16, 2010.[15]

[14] The parties also made oral arguments with respect to the Daubert Motion at the Confirmation Hearing on January 19, 2010.

[15] The Lenders filed an Evidentiary Objections and Motion to Strike numerous statements in Kuhn's Declaration on the basis that they violate Federal Rules of Civil Procedure 26(a)(2)(B) and 37(c)(1) as containing statements of purported fact and opinion that were not included in Kuhn's expert report. Courts have held that where an expert affidavit " 'expound[ed] a wholly new and complex approach,' " as opposed to " 'merely support[ing] an initial position,' " the expert's affidavit should be stricken. *Point Prods. A.G. v. Sony Music Entm't, Inc.*, No. 93 Civ 4001, 2004 U.S. Dist. LEXIS 2676, at *32 (S.D.N.Y.2004). However, where an expert's affidavit provides evidentiary details for an opinion expressed in his expert report, those portions of his or her affidavit can be considered. *Id.* Kuhn's statements in ¶¶ 3, 6, 10, 22, 25, 26, 27, 30, 32, 33, and 34 are not new opinions; they consist of details and explanations of statements he made in his expert report that are entirely consistent with and substantially similar to opinions expressed in his expert report. Thus, the Lenders' Evidentiary Objections and Motion to Strike with respect to ¶ ¶ 3, 6, 10, 22, 25, 26, 27, 30, 32, 33, and 34 are OVERRULED. Lenders' objection to ¶ 12 of Kuhn's Declaration is SUSTAINED because Kuhn cannot rely on the qualifications of his colleagues at A & C to buttress the reliability of his expert opinion. *See Chartwell Litig. Trust v. Addus Healthcare, Inc., (In re Med Diversified, Inc.),* 334 B.R. 89, 96 (Bankr.E.D.N.Y.2005). To rule otherwise would deprive the Lenders of their ability to cross-examine witnesses who are not testifying before the Court. The Lenders' also object to ¶ 24 of Kuhn's Declaration that "Based on current closing prices, public company comparables are trading at 6.6x–9.2x average 2009/2010 BCF, excluding any control premium." The Lenders' objection to ¶ 24 is SUSTAINED because Kuhn was making a statement about current trading prices of public company comparables, information that he did not possess at the time he submitted his expert report. This statement constitutes new opinion and new information and is, therefore, excluded from the record.

Discussion

Reinstatement of the Credit Agreement

[1] The Lenders argue that the Committee Plan cannot be confirmed because it is premised upon an impermissible reinstatement of the Debt. In that regard, the Lenders contend that the Committee's proposed allocation of voting rights would trigger an immediate change of control ***112** default under the Credit Agreement. The Lenders further argue that because that default is not being cured, the loan cannot be reinstated pursuant to section 1124(2).

The Committee contends that its proposed plan, as structured, complies with the Credit Agreement in all respects, including the provision that no event triggering a change of control occur. Alternatively, the Committee argues that if the Court determines that the primary structure for selecting directors for the board as set forth in the Committee Plan, contravenes the Credit Agreement, the secondary proposed structure, set forth in a footnote in the Supplemental Disclosure Statement, conforms to the Lenders' interpretation of the terms of the Credit Agreement. The Committee maintains that the alternative board structure is a technical fix and would not require re-solicitation under Bankruptcy Code section 1125 or Bankruptcy Rule 3019 because it does not alter any economic interest as it is neither material nor adverse to the only class (i.e., Noteholders) that had previously accepted Plan.

With respect to the alternate proposed board structure, the Lenders argue that the description of that proposal in the footnote of the Supplemental Disclosure Statement provides insufficient information to determine whether Mr. Young would retain the requisite percentage of Voting Stock or otherwise conform to the requirements of the Credit Agreement. The Lenders further argue that, to the extent the Committee seeks to further supplement its description of the structure, such modification would constitute a material change in the Committee Plan concerning the Backstop Parties' control of the board. Thus, it