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Arizona Bankruptcy Court Denies Confirmation of Saguaro Ranch's Plan of Reorganization for Second Time

On June 1, 2011, Judge Eileen Hollowell entered an opinion and an order denying confirmation of the third amended plan of reorganization proposed by Saguaro Ranch Development Corporation and four affiliated companies. This marks the second time this year that Judge Hollowell has denied confirmation of a plan of reorganization proposed by Saguaro Ranch - she denied confirmation of its second amended plan in February. The companies own over 1,000 acres of land located in the Tortolita Mountains near Tucson, Arizona. They planned to "create a master planned luxury community with maximal open space and minimal impact on the environment" by developing and selling 180 four to five acre lots for custom homes. The community was also planned to include amenities such as restaurants, a spa, tennis courts, and horse stables.

The debtors were not able to reach a settlement to gain the support of their pre-petition secured lenders for the proposed third amended plan. The lenders, Kennedy Funding, Inc. and Anglo-American Financial, LLC, lent the debtors \$50 million in 2005 to develop the project. After the court's denial of confirmation of the second amended plan, the court granted the lenders relief from the automatic stay. The debtors appealed that order, but there was no stay of the order pending appeal. A trustee sale was set for later this week.

The court's opinion denying confirmation of the third amended plan of reorganization focuses primarily on the proposed treatment of the lenders' claims, which the debtors asserted were \$28 million and the lenders asserted were \$40 million. The plan proposed to pay the lenders' section 1111(b)(2) claim by paying \$17.25 million over five years with six percent interest. The debtors asserted that the lenders' claims would be paid by the end of the seventh year after effectiveness of the plan, with the payments to the lenders being funded primarily by the sale of 131 home lots. The plan was also to be funded by a \$3 million cash infusion and assignment of a partnership interest asserted to be worth \$4 million, both from the family which owns controlling interests in the debtors.

Judge Hollowell first addressed the issue of feasibility. In determining that the plan was not feasible, the court determined that the appropriate standard was whether the debtors had established that the plan had "a reasonable probability of success." However, she also stated that "the oft-quoted language of In re Pizza of Hawaii, 761 F.2d 1374, 1382 (9th Cir. 1985), which warns against the confirmation of 'visionary schemes,' applies here." Among the issues that the court considered in determining that the debtors had not carried their burden of demonstrating the plan's feasibility were:

- The plan assumed an average lot sale price of \$500,000 in year one with 5% annual increases thereafter. While that was less than half of what lots had sold for before the bankruptcy filing in 2009, the lenders presented evidence that "lots have recently been listed or sold at the [Saguaro Ranch project] in the mid-\$300,000 range." The opinion states that "in the current [real estate] environment, the court cannot simply ignore comparable sales and listings" despite the debtors' argument that the prices were



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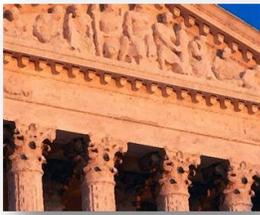
artificially depressed because "many of those lots are bank owned and not the same quality as the lots in escrow."

- The plan assumed that lots would be sold at a rate of 20 lots in year one and 15 lots per year in years two through eight. While the debtors provided evidence that they had 10 lots currently in escrow (with closings predicated on confirmation of the plan), the court noted that "many of the parties to the contracts have a strong personal relationship with [Steven Phinny] or with individuals who already own property at the project" and that all of the contracts "are subject to 'free look' periods which permit the proposed buyers to cancel the contract for any reason." Therefore, the court described the debtors' having so many lots currently in escrow as "impressive, and probably unsustainable" particularly because the plan's projections are "well above the pre-petition sales figures for the project of slightly more than nine lots per year."
- Finally, the court noted that there would "have to be additional sources" of funding for the debtors post-emergence which the court assumed would be "members of the Phinny family, who have invested over \$30 million in the project and who have advanced \$850,000 to keep the debtors operating post-petition." However, the plan did not contain any provisions requiring the Phinnys to provide additional financing and the court therefore determined that expected funding from the family did "not assure performance under the third plan."

In addition, Judge Hollowell also determined that the third plan of reorganization did not provide "fair and equitable" treatment to non-consenting, impaired secured creditors - to wit, the lenders - under section 1129(b) of the Bankruptcy Code. She found that the only alternative offered by section 1129(b)(2)(A) which the plan could even possibly meet would be 1129(b)(2)(A)(iii), which requires that the lenders "receive the 'indubitable equivalent' of [their] claim." In the opinion, the court held that "even if the debtors had demonstrated that the third plan was feasible, the third plan still falls short of meeting the indubitable equivalent standard because it deprives [the lenders] of significant bargained-for rights without compensating [the lenders] for the loss of those rights."

The "crux" of the debtors' failure to meet the indubitable equivalent standard was that the third plan required the lenders to release their liens on lots for "a flat lot release price well below the loan's requirement that [the lenders] receive 70% of the sale proceeds." According to the opinion, "where, as here, an undersecured creditor is required to release a portion of its collateral before receiving payments equal to its full value, it is effectively impossible for a debtor to propose a plan that will guarantee that the creditor is fully protected because the creditor's collateral base is being eroded." In that scenario, the court held that "the creditor must be protected with some form of substitute collateral" for the plan to meet the indubitable equivalent standard. The third plan did not provide the lenders with any substitute collateral, however.

In closing her opinion, Judge Hollowell made several final acknowledgements. First, she addressed the application of section 1129(b)(2)(A) of the Bankruptcy Code on real estate developers. After recognizing "the difficulties" that the section presents in such cases, she states that "Congress has decided that debtors must bear the risk of reorganization by contributing additional capital and/or pledging additional collateral to their undersecured creditors before debtors may enjoy the benefits of a confirmed plan." Second, she



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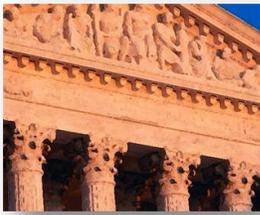
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acknowledged that confirmation of the plan could have many benefits, including "the continued employment of people who work at the project" and the continuation of the project "as an environmentally sensitive development in some of the most beautiful desert in Southern Arizona." She noted that these benefits, which were offered by the Creditors' Committee at the confirmation hearing, were "compelling, but not sufficient."

On Friday, the debtors filed a motion seeking "an emergency stay of any proceedings against the property secur[ing] creditor[s] Kennedy Funding, Inc. and Anglo-American Financial, LLC's lien" pending the debtors' appeal of the court's opinion and order denying confirmation, which was also filed on Friday. Therein, the debtors asserted that they are "likely to succeed on the merits" of their appeal, but even if "the court does not make such a finding, the court should" still grant the stay pending appeal because "the balance of hardship weighs heavily" in the debtors' favor, the lenders would not "be substantially harmed by a stay, and a stay protects the public interest." As noted above, the lenders have set a trustee's sale of the debtors' assets for Thursday, June 9, 2011. Earlier today, the lenders filed an objection to the debtor's request for a stay pending their appeal. A hearing is scheduled for Tuesday morning at 11:30 a.m. at the courthouse in Tucson.

Copies of the court filings referenced in this article can be accessed from the following links:

- [Third Amended Chapter 11 Plan and Exhibits filed by ERIC SLOCUM SPARKS of ERIC SLOCUM SPARKS PC on behalf of SAGUARO RANCH DEVELOPMENT CORPORATION \(Attachments: # \(1\) Exhibit A - Schedule of Lot Sales Pending Plan Confirmation# \(2\) Exhibit B - Map of Casita Lot# \(3\) Exhibit C - Cash Flow Projection# \(4\) Exhibit D - Sources and Uses of Cash# \(5\) Exhibit E - Schedule of Payments to Class 5 Creditor\)](#)
- [Supplemental Disclosure to Second Amended Disclosure Statement for Debtor's Third Amended and Modified Plan of Reorganization filed by ERIC SLOCUM SPARKS of ERIC SLOCUM SPARKS PC on behalf of PCC INVESTMENTS, LLC, SAGUARO GUEST RANCH MANAGEMENT CORPORATION, SAGUARO RANCH DEVELOPMENT CORPORATION, SAGUARO RANCH INVESTMENTS, LLC, SAGUARO RANCH REAL ESTATE CORPORATION](#)
- [Kennedy Funding and Anglo-American Financial's Objection to Debtors' Third Amended and Modified Plan of Reorganization Dated March 16, 2011 filed by GEORGE O. KRAUJA of FENNEMORE CRAIG, PC on behalf of ANGLO-AMERICAN FINANCIAL LLC, KENNEDY FUNDING, INC.](#)
- [Memorandum Re: Release Price Provided in Third Amended and Modified Plan Dated March 26, 2011 filed by ERIC SLOCUM SPARKS of ERIC SLOCUM SPARKS PC on behalf of PCC INVESTMENTS, LLC, SAGUARO GUEST RANCH MANAGEMENT CORPORATION, SAGUARO RANCH DEVELOPMENT CORPORATION, SAGUARO RANCH INVESTMENTS, LLC, SAGUARO RANCH REAL ESTATE CORPORATION. \(Attachments: # \(1\) Exhibit 1# \(2\) Exhibit 2# \(3\) Exhibit 3# \(4\) Exhibit 4# \(5\) Exhibit 5# \(6\) Exhibit 6# \(7\) Exhibit 7# \(8\) Exhibit 8\)](#)



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- [Kennedy Funding and Anglo American Financial's Objections to Debtors' Declarations and Exhibits filed by GEORGE O. KRAUJA of FENNEMORE CRAIG, PC on behalf of ANGLO-AMERICAN FINANCIAL LLC, KENNEDY FUNDING, INC.](#)
- [Kennedy Funding's Response to Debtors' Memorandum Re: Release Price Provided in Third Amended and Modified Plan \[DN 665\] filed by GEORGE O. KRAUJA of FENNEMORE CRAIG, PC on behalf of ANGLO-AMERICAN FINANCIAL LLC, KENNEDY FUNDING, INC.](#)
- [Kennedy Funding and Anglo-American Financial's Supplemental Brief in Support of Objection to Debtors' Third Amended and Modified Plan of Reorganization Dated March 16, 2011 filed by GEORGE O. KRAUJA of FENNEMORE CRAIG, PC on behalf of ANGLO-AMERICAN FINANCIAL LLC, KENNEDY FUNDING, INC.](#)
- [Memorandum on Release Prices and Other Issues filed by ERIC SLOCUM SPARKS of ERIC SLOCUM SPARKS PC on behalf of SAGUARO RANCH DEVELOPMENT CORPORATION](#)
- [Memorandum Opinion Denying Confirmation of Third Plan of Reorganization signed on 6/1/2011](#)
- [ORDER Denying Confirmation of Third Plan of Reorganization signed on 6/1/2011](#)
- [Emergency Motion for Stay Pending Appeal filed by ERIC SLOCUM SPARKS of ERIC SLOCUM SPARKS PC on behalf of SAGUARO RANCH DEVELOPMENT CORPORATION](#)
- [Emergency Motion to Set Hearing on Debtors' Motion for Stay Pending Appeal filed by ERIC SLOCUM SPARKS of ERIC SLOCUM SPARKS PC on behalf of SAGUARO RANCH DEVELOPMENT CORPORATION](#)
- [Kennedy Funding and Anglo-American Financial's Objection to Debtors' Motion for Emergency Stay Pending Appeal filed by GEORGE O. KRAUJA of FENNEMORE CRAIG, PC on behalf of ANGLO-AMERICAN FINANCIAL LLC, KENNEDY FUNDING, INC.](#)