Honorable Mike K. Nakagawa
United States Bankruptcy Judge

Entered on Docket
October 05, 2015

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

* * * * * *

In re:	)	BK-S-10-29932-MKN
	)	Chapter 11
CAREFREE WILLOWS, LLC,	)	
	)	Date: August 19, 2015
Debtor.	)	Time: 9:30 a.m.
	)	

ORDER ON MOTION FOR ORDER DIRECTING SALE OF PROPERTY, OR IN THE ALTERNATIVE, FOR CONVERSION[1]

On August 19, 2015, the court heard the Motion for Order Directing Sale of Property, Or in the Alternative, for Conversion ("Conversion Motion"), brought by AG/ICC Willows Loan Owner, L.L.C. ("AG"). The appearances of counsel were noted on the record. After arguments were presented, the matter was taken under submission.

BACKGROUND

Debtor owns and operates Carefree Willows, a 300-unit senior apartment complex located on approximately eleven acres of real property at 3250 S. Town Center Drive, Las Vegas, Nevada ("Property").[2] Debtor filed a voluntary Chapter 11 petition ("Petition") on

[1] All references in this Order to "ECF No." are to the numbers assigned to the documents filed in the bankruptcy case as entered on the docket maintained by the Clerk of the Court. All references to "AECF No." are to the documents filed in any adversary proceedings referenced in this Order. All references in this Order to "Section" are to the provisions of the Bankruptcy Code, 11 U.S.C. § 101 et seq.

[2] Debtor is a single-asset real estate ("SARE") entity; its sole asset is the Property and improvements comprising the age-restricted apartment complex. See Order on Motion for Order Determining that Debtor is a Single Asset Real Estate Entity ("SARE Order"). (ECF No. 118). Debtor also is a limited liability company owned primarily by Carefree Holdings, L.P.

October 22, 2010, to which was attached its schedules of assets and liabilities ("Schedules") and Statement of Financial Affairs ("SOFA"). (ECF No. 1). The Property is subject to a fully matured construction loan in the original principal mount of approximately $31,536,646.93 ("Construction Loan"). AG holds the Construction Loan as successor in interest to the original lender, Union Bank.[3]

Debtor's Schedule "D" identifies three creditors holding secured claims. In addition to Union Bank's claim secured by the Property, Debtor lists the Clark County Treasurer as having a statutory lien against the Property in the amount of $98,448.84, the entire amount of which the Debtor maintains is secured. Id. Debtor also lists "Service 1st Bank" as having a secured claim in the amount of $38,438.21, that is fully secured by a 32-passenger bus. Id.

On January 14, 2011, Debtor filed a motion ("Valuation Motion") seeking to establish the value of the Property at $30,000,000 "for purposes of confirmation." (ECF No. 88). On February 2, 2011, AG filed opposition requesting an evidentiary hearing to determine the value of the Property. (ECF No. 123). On February 8, 2011, Debtor filed a reply (ECF No. 129) accompanied by the Declaration of Kenneth Templeton (ECF No. 130) attesting that a confirmable plan could be proposed if the court establishes a value of the Property of at least $30,000,000. On February 15, 2011, AG withdrew its opposition to the Valuation Motion after reviewing the two appraisal reports that accompanied the motion. (ECF No. 134).

On February 28, 2011, AG filed a proof of claim that was assigned Claim No. 10-1 ("POC 10-1"). The total amount of the claim was for $32,562,189.24. Of the amount, the proof

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("Carefree Holdings") which has 96.3933% of membership interest in the company along with Willows Investment Group having the remaining percentage interest. See SOFA at Item 21. Carefree Holdings is a limited partnership that apparently has approximately 160 limited partners. See Application to Employ Attorney for Debtor Nunc Pro Tunc at 2. (ECF No. 195). The senior apartment complex is operated by Ken Templeton Realty & Investment, Inc. ("KTRI") pursuant to a management agreement between KTRI and Carefree Holdings. The management agreement is signed by Ken Templeton as the President of KTRI and as the manager of MLPGP, LLC ("MLPGP"), which is the entity that manages Carefree Holdings.

[3] The Construction Loan is personally guarantied by a number of parties, including Kenneth Templeton, Carefree Holdings, LP, the Templeton Family Trust, and the Ken II Trust (collectively, "Guarantors").

of claim states that $30,000,000 is secured based on a value of $30,000,000 for the Property and that the remaining amount of $2,562,189.24 is unsecured. Although POC 10-1 was filed on February 28, 2011, it did not include any interest that might have accrued postpetition pursuant to the underlying loan documents.

On February 28, 2011, AG also filed a proposed plan of reorganization (ECF No. 138) along with a proposed disclosure statement (ECF No. 137).[4]

On March 2, 2011, Debtor filed its proposed plan of reorganization (ECF No. 145) accompanied by a proposed disclosure statement (ECF No. 146).

On March 14, 2011, an order submitted by Debtor's counsel was entered on the Valuation Motion stating that the value of the Property "for purposes of the Debtor's proposed Plan of Reorganization is at least Thirty Million Dollars ($30,000,000)." (ECF No. 156).

On March 17, 2011, an amended order was entered on the Valuation Motion stating that the value of the Property "for purposes of plan confirmation is Thirty Million Dollars ($30,000,000)" ("Valuation Order"). (ECF No. 163).[5]

On March 25, 2011, Debtor filed an objection to POC 10-1. (ECF No. 178). On May 3, 2011, AG filed a response. (ECF No. 268). On May 10, 2011, Debtor filed a reply. (ECF No.

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[4] Debtor filed its voluntary Chapter 11 petition on October 22, 2010. Under Section 1121(b), it had a 120-day exclusive period of time to be able to propose a Chapter 11 plan. No extension of the exclusivity period was sought or obtained by the Debtor pursuant to Section 1121(d), and the exclusivity period ended on February 21, 2011. Termination of the plan exclusivity period allowed AG or any other party in interest, including the Debtor's equity security holders, to file a proposed plan.

[5] As both the Debtor and AG had filed proposed Chapter 11 plans, the language of the amended Valuation Order was not limited to the Debtor's proposed plan of reorganization. There was a disconnect, however, between the language of the Valuation Order and the language of the Debtor's initial plan of reorganization. While the Valuation Order specified that the value of the Property was $30,000,000 for purposes of plan confirmation, Debtor's proposed plan provided that payment of AG's secured and unsecured claims would be adjusted postconfirmation based on a revaluation of the Property proposed by the revested Debtor or as determined by the court. Because the Guarantors were to be the source of payment for the unsecured portion of AG's claim, a postconfirmation revaluation would have reduced or increased the amount the Guarantors would have had to pay within 15 days after any revaluation. The parties provided no indication whether the language in the Valuation Order was intended to supplant the language in the Debtor's initial Chapter 11 plan.

279). On May 24, 2011, an order was entered overruling Debtor's objection to POC 10-1. (ECF No. 323).

On March 25, 2011, AG commenced an action in the Eighth Judicial District Court, Clark County, Nevada, against the Guarantors, in addition to MLPGP. Through that litigation ("Guarantor Lawsuit"), AG seeks to enforce its claims against the defendants for the full, unpaid amount of the Construction Loan.

On April 8, 2011, Debtor filed a motion to designate the claim of AG pursuant to Section 1126(e) ("Debtor Designation Motion"). (ECF No. 219). On May 3, 2011, AG filed opposition. (ECF No. 269).

On August 26, 2011, summary judgment was granted in favor of AG in the Guarantor Lawsuit on the issue of liability.

On September 9, 2011, Debtor commenced Adversary Proceeding No. 11-01262-MKN, seeking to enjoin AG from pursuing the Guarantor Lawsuit during the pendency of the Debtor's Chapter 11 proceeding ("Guarantor Adversary Proceeding").

On November 29, 2011 and December 1, 2011, an evidentiary hearing was conducted on the Debtor's motion for preliminary injunction in the Guarantor Adversary Proceeding ("Preliminary Injunction Hearing"). Live testimony on behalf of the Debtor was presented by its chief operating officer, Kevin Close, and its principal, Kenneth Templeton.[6]

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[6] On the first day of the Preliminary Injunction Hearing, Mr. Templeton testified that he knew only one of the principals of an entity known as Willows Account, LLC ("Willows Account"), that being a person named Edward Erganian. He testified that Mr. Erganian had played basketball with Mr. Templeton for many years, that Mr. Erganian has a small office in Mr. Templeton's office building, and that Mr. Erganian has no direct or indirect relationship with Mr. Templeton or any of Mr. Templeton's entities other than a landlord-tenant relationship. On the second and last day of the Preliminary Injunction Hearing, Mr. Templeton testified in response to questions from Debtor's counsel that he also had conversations with Mr. Erganian that led to Mr. Erganian purchasing an obligation of the Debtor in excess of $4.6 million from an entity known as PSACP Investors, LLC ("PSACP"). Mr. Templeton also testified that in 2008 or 2009 he sold to Mr. Erganian an interest in a $500,000 promissory note made by an entity known as IFA, see note 39, infra, for the amount of $1,000. Mr. Templeton further testified that around the same time, he also sold to Mr. Erganian an interest in a $2.7 million promissory note made by IFA for the amount of $1,000. In response to redirect examination by AG's counsel, Mr. Templeton then testified that he had no relationships with Mr. Erganian other than the ones

On February 10, 2012, the court entered a memorandum decision ("Preliminary Injunction Decision") (AECF No. 122) and accompanying order (AECF No. 124) denying the preliminary injunction request.

On February 29, 2012, Debtor filed a proposed Fourth Amended Disclosure Statement ("Debtor Disclosure Statement") (ECF No. 577) along with its proposed Fourth Amended Plan ("Plan") (ECF No. 578).

On April 3, 2012, an order was entered conditionally approving the disclosure statements filed by both AG and the Debtor, and scheduling a confirmation hearing on both plans to commence on May 31, 2012. (ECF No. 599). That order also provided that any modifications to the proposed plans or proposed disclosure statements must be filed before April 27, 2012.

On April 26, 2012, AG filed a proposed Second Amended Plan ("AG Plan") (ECF No. 617) along with a Second Amended Disclosure Statement Describing the Second Amended Plan ("AG Disclosure Statement") (ECF No. 618).

On April 30, 2012, AG filed a motion to recharacterize as equity the alleged claim of Willows Account. (ECF No. 623). On May 21, 2012, Willows Account filed opposition. (ECF No. 713). On May 30, 2012, AG filed its reply. (ECF No. 763).

On April 30, 2012, AG also filed a motion to designate the claim of Willows Account pursuant to Section 1126(e) ("AG Designation Motion"). (ECF No. 625). On May 21, 2012, Willows Account filed opposition. (ECF No. 717). On May 30, 2012, AG filed its reply. (ECF No. 767).

On May 26, 2012, Debtor filed its First Amendment to Fourth Amended Plan. (ECF No. 745).

On May 31, 2012, a combined evidentiary hearing ("Confirmation Hearing") was commenced encompassing the competing plans of reorganization, the Debtor Designation Motion, the AG Designation Motion, and the AG Recharacterization Motion. The hearing was

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he had just testified to. Still later in his redirect examination by AG's counsel, Mr. Templeton also testified that Mr. Erganian had obtained many loans from a bank in which Mr. Templeton was the chairman, and that Mr. Templeton had personally loaned up to $800,000 to Mr. Erganian.

conducted on May 31, June 1, July 12, July 13, July 23, July 24, August 13, August 14, and August 27, 2012. The following individuals testified in open court and were subject to cross-examination: Alex Roudi, Edward McDonough, John White, Edward Erganian, Edward Burr, Deron Bocks, Grant Lyon, Elliott Burrell, Claudia Widhalm, Glenn Anderson, Thomas Anderson, Beverly Elrod, Harry Kogan, Kevin Close, Stanley Paher, Phillip Aurbach, and Kenneth Templeton. More than 100 exhibits were admitted into evidence. After the evidentiary record was closed, closing briefs were filed and closing arguments were presented. All of the matters were taken under submission as of October 9, 2012.

Even after all of the matters were taken under submission, the parties still attempted on many occasions to introduce additional issues or materials after the record was closed. On October 17, 2012, the Guarantors filed a motion to redact portions of the transcripts of the evidentiary hearing on the Debtor's preliminary injunction request that had been held in November and December of the prior year, which were already a part of the public record. (ECF No. 914). On December 21, 2012, Debtor objected to an amended proof of claim ("POC 10-2") that had been filed by AG based on certain valuation evidence submitted by the Debtor and Willows Account at the Confirmation Hearing. (ECF No. 939).[7] On February 11, 2013, Debtor filed a request for judicial notice regarding the status of certain appellate matters in the Guarantor Lawsuit. (ECF No. 955).

On March 6, 2013, AG filed a notice of "supplemental authority" regarding a decision reached by the Seventh Circuit Court of Appeals that allegedly supported AG's objection to confirmation of the Debtor's proposed Plan. (ECF No. 959). On May 30, 2013, AG filed another notice of "supplemental authority" regarding a decision reached by the Ninth Circuit Court of Appeals relevant to the AG Recharacterization Motion. (ECF No. 973). On June 12, 2013, Debtor filed a supplemental opposition to the AG Recharacterization Motion. (ECF No. 975). On December 10, 2013, AG filed a request for judicial notice regarding a loan payoff demand that it had received from the Carefree Holdings. (ECF No. 1013). On December 27,

[7] Debtor's objection to POC 10-2 ("Claim Objection") was heard on January 23, 2013 and taken under submission.

2013, Debtor filed a request for judicial notice regarding AG's purchase of various senior living facilities in Southern Nevada. (ECF No. 1017). Finally, on February 5, 2014, AG filed an application to reopen the evidentiary record regarding the matters addressed at the Confirmation Hearing. (ECF No. 1040). Debtor filed opposition to AG's reopening motion (ECF No. 1049) and AG filed a reply (ECF No. 1052). AG's reopening motion initially was noticed to be heard on March 5, 2014, but the hearing was continued to March 20, 2014.

On March 14, 2014, March 17, 2014, and March 18, 2014, separate memorandum decisions and accompanying orders were entered, denying the Debtor Designation Motion, granting the AG Recharacterization Motion, and granting the AG Designation Motion, respectively. (ECF Nos. 1058, 1060, 1063, 1064, 1067, 1068).[8] As a result of the disposition of those motions, AG withdrew its application to reopen the evidentiary hearing.[9]

Debtor appealed the order denying the Debtor Designation Motion. (ECF No. 1078). Willows Account appealed the AG Recharacterization Order. (ECF No. 1085). Debtor and Willows Account appealed the AG Designation Order. (ECF Nos. 1088 and 1090).[10] All of the appeals were directed to the United States District Court for the District of Nevada ("District Court"). Willows Account further filed a motion seeking a stay pending appeal of the AG

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[8] Where necessary, portions of the memorandum decisions will be referred to hereafter as "Debtor Designation Decision," "AG Recharacterization Decision," and "AG Designation Decision." The orders granting the AG Recharacterization Motion and the AG Designation Motion will be referred to, respectively, as the "AG Recharacterization Order" and the "AG Designation Order."

[9] AG's reopening motion delayed the resolution of the matters under submission. As a result of the withdrawal of AG's reopening motion, the record of the Confirmation Hearing remained closed.

[10] Willows Account was the subject of both the AG Recharacterization Motion and the AG Designation Motion due to the importance of its claim in the Debtor's confirmation strategy. Willows Account had acquired from PSACP a claim against the Debtor in the amount of $4,654,150.09. In turn, PSACP previously had obtained that claim against the Debtor from Carefree Holdings, which owns over 96 percent of the membership interest in the Debtor. During the course of the Chapter 11 proceeding, it was revealed that PSACP is owned by Phillip S. Aurbach, a long-time acquaintance of and attorney for Ken Templeton. See AG Designation Decision at 12 n.31.

Recharacterization Order. (ECF No. 1114). An order denying the motion for stay pending appeal was entered on May 20, 2014. (ECF No. 1174).

On June 4, 2014, Debtor then filed a further amended proposed plan of reorganization. (ECF No. 1186). An order was entered staying proceedings ("Stay Order") on the further amended plan on July 18, 2014. (ECF No. 1219). Debtor appealed the Stay Order. (ECF No. 1226). Debtor then sought a stay of the Stay Order. An order was entered denying that requested stay on August 15, 2014. (ECF No. 1254). Apparently, Debtor then sought from the District Court leave to appeal the Stay Order. On October 23, 2014, the District Court entered an order denying leave to appeal the Stay Order. (ECF No. 1284). On October 28, 2014, Debtor then appealed to the Ninth Circuit Court of Appeals the District Court's order denying leave to appeal the Stay Order. (ECF No. 1285).

On October 29, 2014, Debtor then filed in the bankruptcy court a motion seeking clarification of the Stay Order even though the Debtor had already appealed the order. (ECF No. 1287). Debtor also filed an ex parte motion for an order shortening time to have its clarification motion heard on an expedited basis. (ECF No. 1288).

On November 17, 2014, Debtor then filed a motion to reopen the evidentiary record on plan confirmation to establish that the Property had significantly increased in value. (ECF No. 1295). That motion was accompanied by a declaration of another valuation expert. (ECF No. 1296). Debtor noticed the reopening motion to be heard on January 7, 2015. (ECF No. 1297).

On November 20, 2014, Debtor noticed its request for clarification of the Stay Order to be heard on January 7, 2014. (ECF No. 1299).

On December 10, 2014, Debtor filed a motion to modify a prior order authorizing use of cash collateral (ECF No. 1304)[11] supported by the declaration of its chief financial officer (ECF

[11] On November 12, 2010, an order was entered approving a stipulation between the Debtor and Union Bank for the interim use of the proceeds of Union Bank's security interest in the Debtor's assets ("cash collateral"). (ECF No. 34). On February 8, 2011, an order was entered approving a further stipulation between the Debtor and AG, as successor in interest to Union Bank, for use of cash collateral under certain terms on an ongoing basis, and authorizing both parties to file motions seeking to modify its terms any time after May 1, 2011 ("Cash Collateral Order"). (ECF No. 128).

No. 1305). Debtor noticed the cash collateral modification motion to be heard on January 7, 2015. (ECF Nos. 1306 and 1312).

On December 12, 2014, an order was entered approving a stipulation continuing the hearings on Debtor's clarification motion, reopening motion, and cash collateral modification motion to January 14, 2015. (ECF No. 1317).

On December 31, 2014, AG timely filed its responses to all three motions. (ECF Nos. 1321, 1322, 1323 and 1324).

On January 7, 2015, Debtor timely filed its replies. (ECF Nos. 1326, 1327 and 1328).

On January 14, 2015, Debtor's clarification motion, reopening motion, and cash collateral modification motion were heard by the court and taken under submission.

On March 9, 2015, orders were entered granting Debtor's clarification motion (ECF No. 1350), denying Debtor's reopening motion (ECF No. 1344),[12] and denying Debtor's cash collateral modification motion ("Cash Collateral Modification Order"). (ECF No. 1348).

On March 9, 2015, an order was also entered overruling in part and sustaining in part the Debtor's Claim Objection regarding AG's POC 10-2 ("Claim Objection Order"). (ECF No. 1346).

On March 18, 2015, Debtor appealed the Claim Objection Order. (ECF No. 1361).

On March 25, 2015, Debtor filed a motion requesting the court to order the parties to participate in a settlement conference encompassing all pending matters between the parties. (ECF No. 1374). Debtor noticed the settlement participation motion to be heard on April 29, 2015. (ECF No. 1375).

On April 15, 2015, AG filed an opposition to the settlement participation motion. (ECF No. 1391). On April 22, 2015, Debtor filed its reply. (ECF No. 1401).

On April 29, 2015, a hearing was held on the Debtor's settlement participation motion. Counsel for the Debtor and AG appeared, but the parties' respective positions had not changed.

[12] Debtor's reopening motion further delayed the resolution of the competing plans of reorganization. As a result of the denial of the Debtor's reopening motion, the record of the Confirmation Hearing remained closed.

On May 4, 2015, an order was entered denying Debtor's request to require AG to participate in a settlement conference. (ECF No. 1405).

On May 13, 2015, upon application of AG (ECF No. 1407), a status hearing was conducted. At the hearing, the court was advised that no stays pending appeal of the two designation orders or the AG Recharacterization Order, or other matters on appeal, have been entered by the District Court or any other court.

On May 20, 2015, Debtor commenced Adversary Proceeding No. 15-1086-MKN, allegedly seeking a determination of the validity, priority or extent of AG's POC 10-2. (ECF Nos. 1414, 1415).

On July 20, 2015, AG filed a motion to dismiss that adversary proceeding ("Adversary Dismissal Motion"). (AECF No. 11). A hearing on that motion was noticed for August 19, 2015. (AECF No. 12).

On July 22, 2015, AG filed the instant Conversion Motion. (ECF No. 1424). A hearing on the Conversion Motion was noticed for August 19, 2015. (ECF No. 1423). On August 5, 2015, Debtor filed an opposition ("Debtor Opposition"). (ECF No. 1430). On August 5, 2015, a joinder in the Opposition was filed on behalf of the Guarantors ("Guarantor Opposition"). (ECF No. 1429). On August 12, 2015, AG filed a reply ("Reply"). (ECF No. 1436).

On August 19, 2015, the court held a hearing on both the Conversion Motion and the Adversary Dismissal Motion. After arguments were presented, the matters were taken under submission. During the hearing, the court also indicated, in accordance with Section 1112(b)(3), that a written decision on the Conversion Motion would be entered no later than August 26, 2015. The court also indicated that written decisions on the competing Chapter 11 plans, if necessary, would be entered no later than August 28, 2015, and that a written decision on the Adversary Dismissal Motion would be entered no later than September 4, 2015.

Despite the closure of the record and the matters being taken under submission, on August 21, 2015, AG filed a document entitled "Clarification and Waiver of Election under Plan in Light of August 19, 2015 Hearing." (ECF No. 1440). Thereafter, Debtor filed a response to that document on August 25, 2015 (ECF No. 1442), as well as an errata on August 26, 2015

(ECF No. 1443). AG then filed a reply on August 27, 2015. (ECF No. 1445).

DISCUSSION

In its Conversion Motion, AG now seeks either an order compelling a sale of the Property, or, an order converting the case to a Chapter 7 liquidation. As discussed at the hearing, a sale of the subject property essentially accomplishes the second alternative treatment set forth in AG's proposed Plan, i.e., a sale of the Property to the highest bidder. Also as discussed at the hearing, a conversion of the case will likely lead to the same result, i.e., a sale of the Property by a Chapter 7 trustee.[13] A possibility of reconverting the case to a Chapter 11, perhaps with the appointment of a Chapter 11 trustee, was also acknowledged. But AG insists that conversion of the case is required under Section 1112(b).

Section 1112(b)(1) provides that on request of a party in interest, a court "**shall** convert... or dismiss" a Chapter 11 case, "whichever is in the best interests of creditors and the estate, **for cause unless** the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate." 11 U.S.C. § 1112(b)(1) (Emphasis added). See In re Sullivan, 522 B.R. 604, 612 (B.A.P. 9th Cir. 2014). The burden of proof rests with the party seeking conversion or dismissal. See In re Warren, 2015 WL 3407244 at *4 (B.A.P. 9th Cir. May 28, 2015).

Section 1112(b)(4) sets forth various examples of "cause" within the meaning of Section 1112(b)(1). The examples of cause include: "(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation; (B) gross mismanagement of the estate; (C) failure to maintain appropriate insurance that poses a risk to the estate or to the public; (D) unauthorized use of cash collateral substantially harmful to 1 or more creditors; (E) failure to comply with an order of the court; (J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court." 11 U.S.C. § 1112(b)(4)(A, B, C, D, E, J). A sufficient evidentiary record must exist to support a

[13] There also seems to be no doubt that if the case is converted to Chapter 7, a trustee would seek authority under Section 721 to operate the Debtor's business rather than to shut it down.

finding of any of these examples of cause. See, e.g., In re Grego, 2015 WL 3451559 at *4-5 (B.A.P. 9th Cir. May 29, 2015) (insufficient evidence early in the Chapter 11 case to support a finding of gross mismanagement).

Even if cause is established under Section 1112(b)(1), however, the court may not convert or dismiss a Chapter 11 case "if the court finds and specifically identifies unusual circumstances" establishing that conversion or dismissal is not in the best interests of creditors, "**and the debtor or any other party in interest establishes**" that: "(A) there is a reasonable likelihood that a plan will be confirmed . . . within a reasonable period of time; and (B) the grounds for converting or dismissing the case include an act or omission of the debtor other than under paragraph (4)(A) - (i) for which there exists a reasonable justification for the act or omission; and (ii) that will be cured within a reasonable period of time." 11 U.S.C. § 1112(b)(2)(A and B) (Emphasis added). This language squarely shifts the burden to the respondent to provide evidence that the Chapter 11 proceeding should not be dismissed or converted. See Warren, 2015 WL 3407244 at *4. To avoid conversion or dismissal after cause is established, the bankruptcy court first must find that such relief is not in the best interests of creditors, and then the debtor or some other party in interest must establish: (1) a reasonable likelihood of timely plan confirmation, and (2) that the acts or omissions constituting cause were both justifiable and susceptible to timely cure.

AG argues that cause exists under each of the above-referenced non-exclusive examples in Section 1112(b)(4), see Conversion Motion at 15:22 to 23:7, as well as under all of the circumstances of this case, including bad faith. Id. at 15:2-3; Reply at 7:6-11. Assuming that cause exists, AG further maintains that the Debtor has failed to meet its burden of establishing that its acts and omissions were justifiable.[14] Debtor, of course, maintains that AG has not made

[14] Apparently conceding that the misleading testimony of its principal and its efforts to manipulate the confirmation process cannot be justified under Section 1112(b)(2)(A)(i), Debtor's fallback position is that a plan is proposed in good faith as long as it meets the objective of paying creditors in full. The equivalent of an "ends justify the means" argument, Debtor's rationalization effectively substitutes the good faith inquiry under Section 1129(a)(3) with the feasibility requirement under Section 1129(a)(11), while completely ignoring the principle that bankruptcy relief is typically available only to honest but unfortunate debtors. But Debtor's

a threshold showing of cause under Section 1112(b)(1)[15] that would shift the burden of

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position also conflates lack of good faith as an independent cause for dismissal or conversion under Section 1112(b)(1), with the good faith requirement for confirming a plan under Section 1129(a)(3). See 7 COLLIER ON BANKRUPTCY, ¶ 1112.07[1]-[7] (Alan N. Resnick and Henry J. Sommer, eds., 16th ed. 2009) ("At bottom, the general doctrine of good faith is designed to stop abusive chapter 11 cases at any stage of the case . . . . [T]he fact that a debtor may be able to reorganize is not a sufficient shield to defeat application of the doctrine, although a court certainly may, in its discretion, refuse to dismiss the case if the interests of creditors would be better served by declining to grant relief [under section 1112(b)(1)]. In contrast, . . . the good faith requirement in section 1129(a)(3) is more narrowly focused, and tests directly whether the debtor's conduct in formulating, proposing and confirming *a plan* displays the requisite honesty of intention. For example, if a debtor engages in fraudulent conduct in procuring confirmation, the plan may not be confirmed for lack of good faith under section 1129(a)(3)."). Thus, the Debtor in the instant proceeding is incorrect on both counts: an ability to reorganize does not preclude the dismissal or conversion of a case for lack of good faith, nor does it preclude denial of plan confirmation.

[15] As part of its view that good faith has no independent significance, Debtor remarkably argues as follows: "The mantra of 'bad faith' and 'conflict of interest' chanted by AG centers around one primary event: the testimony of Ken Templeton in connection with the preliminary injunction hearing which occurred on December 1, 2011. The Court found that testimony to be evasive and contradictory concerning Mr. Templeton's relationship to Ed Erganian . . . . The testimony of Ken Templeton at the preliminary injunction hearing has been referenced in virtually every brief filed by AG, and has been mentioned in most orders issued by this Court. That testimony occurred, and history cannot be changed. In denying the Debtor's Motion to Reopen Record, the Court again referenced the misleading manner in which Ken Templeton testified at the preliminary injunction hearing . . . . However, the Debtor does not accept that Mr. Templeton's testimony absolutely precludes the Debtor from ever confirming any plan whatsoever, and deprives the Debtor of all rights under the Bankruptcy Code, as is argued by AG. So far this Court has ruled against the Debtor on every motion, primarily based on Ken Templeton's testimony almost four years ago. This issue has been repeated so often, exaggerated by AG so repeatedly, that the reality of the situation is no longer recognizable. Mr. Templeton's testimony should not be allowed to become a cancer that ultimately destroys the Debtor." Debtor Opposition at 3:10-26 (Emphasis added).

It is not surprising that the Debtor does not accept the impact of Mr. Templeton's testimony inasmuch as the Debtor is managed by the same Mr. Templeton. It is not surprising that the Debtor would rather forget the deception attempted in Mr. Templeton's testimony at the Preliminary Injunction Hearing. See Preliminary Injunction Decision at 26:6 to 28:1. It is not surprising that the Debtor would ignore the subsequent testimony of Mr. Erganian at the Confirmation Hearing which detailed a much larger picture of deception. This appears to be the very type of conflicted judgment that AG complains about. Debtor also ignores entirely the role of Mr. Erganian as the principal of Willows Account, the primary unsecured creditor in the case, who voted in favor of the Debtor's proposed Plan and against the proposed AG Plan. Moreover, even when the Debtor attempted to compel AG to attend a settlement conference (ECF No. 1374) upon a representation that an individual named Steven Kalb would attend on behalf of the

justification to the Debtor under Section 1112(b)(2)(A).

I. The Existence of Cause under Section 1112(b)(1).

A. Loss and Diminution of the Estate/Failure to Confirm a Plan.

AG maintains that the positive cashflow reflected in the monthly operating reports ("MORs") filed by the Debtor, as well as the appreciation in the value of the Property, does not accurately reflect the impact of the interest accumulating on its secured claim nor the professional fees incurred by both AG and the Debtor. See Conversion Motion at 15:28 to 18:1. Moreover, AG argues that the Debtor's proposed Plan is unconfirmable as a matter of law. Id. at 18:3-15.

In response, Debtor argues that the Property has appreciated to a value substantially more than creditor claims, including AG's, thereby rendering moot any claims of either loss or diminution in value. See Debtor Opposition at 10:8-18. It disputes the reasonableness of the fees asserted by AG under Section 506(b), see id. at 9:17-22,[16] and reiterates that the fees of Debtor's counsel are being paid by Carefree Holdings, rather than the debtor in possession. Id. at 9:23-28.[17] Debtor further maintains that AG has ignored the postpetition payments of more

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Debtor with authority to settle (ECF No. 1401), no declaration or affidavit under penalty of perjury from Mr. Templeton or Mr. Kalb was ever submitted confirming such authority. Not surprisingly, AG adamantly opposed participation in a settlement conference that might be controlled by Mr. Templeton. (ECF No. 1391). Debtor's request to compel AG to attend a settlement conference was denied. (ECF No. 1405). After the court found Mr. Templeton's testimony to be untrustworthy in December 2011, Debtor could have substituted a new manager but its existing manager apparently took no steps to do so. After the court concluded on March 18, 2014 that Mr. Templeton had undertaken to manipulate and skew the bankruptcy voting process, see AG Designation Decision at 27, Debtor could have installed management insulated from Mr. Templeton's control but the same Mr. Templeton has taken no steps to do so. Thus, contrary to the Debtor's self-pitying portrayal, some cancers thankfully are treatable, and Debtor's effort to paint itself as the victim in its own bankruptcy proceeding is not persuasive.

[16] In its reply, AG maintains that any comparison of its attorneys fees to that paid to the Debtor's counsel is misleading because the Debtor's principal has also paid or continues to pay 10 other law firms to represent the Debtor, its equity holders, Guarantors, and other parties. See Reply at 11:6-20. Even if relevant, however, no evidence to support this assertion has been provided by AG.

[17] The Guarantors maintain that AG is responsible for counsel being paid by Carefree Holdings rather than the bankruptcy estate, because AG objected to the use of cash collateral to

than $9,155,847 to AG that has resulted in the lower net cumulative receipts in the monthly operating reports. Id. at 9:6-16, 10:1-7. Finally, it argues that it is possible for the Debtor to confirm a plan as a result of the appreciated value of the Property[18] and that no deadline to confirm a plan has ever been ordered. Id. at 10:21 to 11:6.

The parties' agreement that the Property has appreciated in value, as well as the postpetition adequate protection payments made by the Debtor, minimizes the significance of this example of cause under Section 1112(b)(4)(A). As previously indicated in the Claim 10-2 Objection Order, the calculation of postpetition interest cannot be made without establishing the date, if any, when AG became an oversecured creditor entitled to interest under Section 506(b). Similarly, AG has not demonstrated that the accrual of attorney's fees on its claim outstrips the rate of appreciation or has not been offset by the adequate protection payments.

The failure to confirm a plan of reorganization likewise has little significance in circumstances where the plan exclusivity period has expired. In this instance, AG has proposed a competing plan of reorganization which, if confirmed, would preclude the Debtor from further attempts to reorganize in this case. Under these circumstances, this ground for cause under Section 1112(b)(4)(J) has not been established.

B. Gross Mismanagement of the Estate.

AG also argues that the bankruptcy estate has been grossly mismanaged because of the Debtor's conflicts existing with its insiders, and because of the related manipulation of the plan confirmation process. See Conversion Motion at 19:17 to 21:19.

Debtor responds by flatly denying the existence of any conflicts or breaches of fiduciary

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pay for the Debtor's bankruptcy counsel. See Guarantor Opposition at 3:7-11. This is a somewhat baffling argument given that it was the Debtor that originally agreed in the Valuation Order that the Property was worth less than the alleged amount of AG's claim, thereby permitting AG to argue that payment of counsel's fees from its cash collateral would jeopardize AG's secured position.

[18] The Guarantors favor allowing the Debtor to propose another plan that revalues the Property rather than transferring the Property to AG. See Guarantor Opposition at 3:17-23.

duty, see id. at 11:8-11,[19] and apparently argues that any mismanagement occurred prior to the Plan Confirmation Hearing, and therefore cannot be the basis for relief beyond what was requested at the time of that hearing. Id. at 11:12-17. It maintains that mismanagement, in fact, has not occurred because the Debtor has met all reporting requirements and the Property has increased in value. Id. at 11:18-24.[20]

There appears to be no dispute that the Property has increased in value since the Valuation Order was entered on March 17, 2011. The extent to which any increase in value is attributable to the Debtor's operation of the senior apartment complex or the improvement of the real estate market generally, however, has not been established. Neither the Debtor nor AG has offered evidence with respect to this issue. Thus, Debtor's assertion that an increase in value

[19] The Guarantors apparently argue that conflicts are inherent when a principal is involved in the management of a debtor in possession, but that its consequences are excusable in this case because AG was aware of the conflict. See Guarantor Opposition at 3:1-6. A similar argument is made by the Debtor. See Debtor Opposition at 3:3-9. The more important question, however, is whether the debtor in possession has breached its fiduciary duty to creditors of the bankruptcy estate by acting primarily to protect the interests of the principal or other equity interest holders. See Woodson v. Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610, 614 (9th Cir. 1988) ("As [Chapter 11] debtor in possession he is the trustee of his own estate and therefore stands in a fiduciary relationship to his creditors."); Everett v. Perez (In re Perez), 30 F.3d 1209, 1219 (9th Cir. 1994) (fiduciary responsibility also rests with bankruptcy counsel for Chapter 11 debtor in possession). See also In re Count Liberty, LLC, 370 B.R. 259, 280 (Bankr. C.D. Cal. 2007) (collecting cases). Debtor asserts that the fiduciary obligation also encompasses the interests of the shareholders, citing, e.g., Pepper v. Litton, 308 U.S. 295 (1939), Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343 (1985); and In re Bellevue Place Assocs., 171 B.R. 615 (Bankr. D. Ill. 1994). See Debtor Opposition at 7:13-20. Debtor is correct, but it ignores the following key language from the Supreme Court's opinion in Commodity Futures Trading: "Perhaps more importantly, respondents' position ignores the fact that bankruptcy causes fundamental changes in the nature of corporate relationships. One of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors." 471 U.S. at 355.

[20] The Guarantors seem to reiterate this argument and assert without providing evidence that Debtor's principal has not diluted the other owners of Carefree Holdings, while also arguing that AG has provided no evidence to the contrary. See Guarantor Opposition at 4:7-10. As there is no evidence either way on the issue of dilution of ownership interests in Carefree Holdings, neither side prevails and the alleged fact simply has not been established.

constitutes evidence of proper management is a nonsequitur.[21]

Debtor's additional argument that mismanagement cannot be raised in connection with the Conversion Motion because it was not raised at the Confirmation Hearing is equally nonsensical. Until it filed the instant Conversion Motion, AG has never sought relief from the debtor in possession's reorganization efforts on the basis of gross mismanagement, whether through conversion, dismissal, or appointment of a Chapter 11 trustee.[22] The question remains then, whether AG has met its burden to establish the existence of gross mismanagement of the estate.

In a Chapter 11 proceeding, management of a debtor in possession is not the same as the prebankruptcy management of the debtor entity. Rather, a bankruptcy estate is created upon the commencement of the case and a Chapter 11 debtor remains in possession of its assets as long as it performs most of the duties of a Chapter 7 trustee. See 11 U.S.C. § 1107(a)(1). Like a bankruptcy trustee, a Chapter 11 debtor in possession, therefore, has a fiduciary duty to its creditors. As previously discussed at note 19, supra, a non-individual Chapter 11 debtor also has a fiduciary duty to its equity holders, but that duty is subordinate to its duties to its creditors.

In this instance, AG maintains that the conflicts between the Debtor's primary owner and manager, Mr. Templeton, and the equity security holders, the Guarantors, the affiliated entities, and their counsel, have resulted in a Chapter 11 debtor in possession that primarily serves the interests of equity holders rather than creditors of the estate. In support of that position, AG references the portion of the AG Designation Decision where the court concluded:

> The credible evidence of record supports a finding that, immediately prior to filing its bankruptcy, the Debtor created the Receivable and then directed its sale, sequentially, to two different individuals, each of whom would do the Debtor's bidding by supporting the Debtor's plan and rejecting AG's plan. Such intent and actions were undertaken to manipulate and skew the bankruptcy voting process in order to ensure that Debtor's plan could be confirmed and, potentially, that AG's

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[21] Debtor's assertion that it has met all Chapter 11 reporting requirements is addressed below.

[22] Surprisingly, even after Mr. Templeton's testimony on December 2011 during the Preliminary Injunction Hearing, see discussion at note 6, supra, AG never requested the appointment of a Chapter 11 trustee under Section 1104(a)(1).

> plan could not be confirmed. Such actions were not taken in good faith and evince the type of ulterior motive for which designation is appropriate under Section 1126(e).

AG Designation Decision at 26:28 to 27:7. (Emphasis added).[23]

Debtor has appealed the AG Designation Order and any of its challenges to the court's conclusions will be resolved by the District Court. Debtor did, however, seek to reopen the evidentiary record of the Confirmation Hearing solely to introduce evidence that the Property has increased in value, see discussion at 8, supra, but has never sought to introduce additional evidence disputing the efforts by Mr. Templeton to manipulate the voting process. Rather, Debtor continues to maintain that the bankruptcy estate has increased in value notwithstanding any improprieties by Mr. Templeton.

Because Section 1112(b)(4)(B) specifically refers to gross mismanagement of the bankruptcy estate rather than mismanagement of the bankruptcy proceeding, the court looks to

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[23] In its response to the Conversion Motion, Debtor argues that the voting process in fact was not skewed because the vote of Willows Account was not needed for the Debtor to have an impaired accepting class under Section 1129(a)(10) necessary to permit cramdown under Section 1129(b). See Debtor Opposition at 10:26-28. Debtor apparently does not quibble with the court's conclusion that the debtor in possession had attempted to manipulate the vote, but only now asserts that the attempt was unnecessary because the Debtor "did have a consenting class as the unsecured creditors voted unanimously to accept the plan." Id. at 10:24-25. It is undisputed, however, that until the time of the Confirmation Hearing, the Valuation Order still provided that the Property would have a value of $30,000,000 for purposes of confirming either plan. That value meant that under Section 506(a), AG would have an allowed secured claim of $30,000,000 and the balance of its claim would be allowed as unsecured. As of the Confirmation Hearing, AG's POC 10-1 reflected an unsecured amount of $2,562,189.24, and Debtor's previous objection to POC 10-1 already had been overruled. See discussion at 2-4, supra. Debtor's proposed Plan had placed AG's undersecured claim in a separate, allegedly unimpaired Class 2 in apparent violation of well-established law in this circuit. See In re Barakat, 99 F.3d 1520, 1526-27 (9th Cir. 1996). Debtor's then-proposed Plan placed the $4,654,000 unsecured claim of Willows Account, that it had obtained from PSACP, in impaired general unsecured Class 4. See Debtor Disclosure Statement at 6, 7, 12, 19 and 20. As the other claims in Class 4 totaled only approximately $168,000, the vote of Willows Account could entirely prevent or largely control acceptance of unsecured Class 4 pursuant to Section 1126(c). Acceptance by the general unsecured class was important, because cramdown under Section 1129(b)(2)(B) could be avoided, particularly application of the so-called "absolute priority rule" that would have prevented equity holders from retaining any property without contribution of money or value equivalent to what they would retain. That the ballot cast by Willows Account was disallowed as a result of the AG Designation Order and AG Recharacterization Order does not mean that the voting was not skewed. Simply casting the ballot skewed the process.

evidence of whether the operation of the senior apartment complex has been mismanaged.[24] Other than its prior concern over the management fees charged by KTRI, see Cash Collateral Modification Order at 9 n.11, AG has pointed to nothing in the Debtor's monthly operating reports inferring that the senior apartment complex has been mismanaged, much less grossly mismanaged. Mere disagreement over the rental rates and occupancy goals for the complex, as well as services and amenities provided to senior tenants, are insufficient. As AG has offered no evidence that the estate's only asset has been mismanaged, it has not met its burden of demonstrating the existence of this example of cause.

C. Failure to Maintain Insurance.

AG further asserts that the Debtor has failed to maintain insurance that is both adequate in amount and actually for the benefit of the Debtor. See Conversion Motion at 21:26 to 22:6. Debtor maintains that adequate insurance is in place and that AG simply could have asked for the information. See Debtor Opposition at 12:2-7. In reply, AG argues that it did ask for the information but the Debtor, through the Guarantors, refused to provide copies of the insurance policies. See Declaration of Janet Dean Gertz ("Gertz Declaration") at ¶ 5 and Exhibit "5" (ECF No. 1437). [25] More important, AG argues that a complete copy of the insurance policies may

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[24] Section 1112(b)(4)(A) couples continuing loss or diminution of the bankruptcy estate with the absence of a reasonable likelihood of rehabilitation. Both must be proven. Continuing loss or diminution does not look to the cause of the depletion of the estate. Moreover, the debtor's likelihood of rehabilitation and likelihood of reorganization are separate things: rehabilitation focuses on the reestablishment of a business, while confirmation of a reorganization plan can include liquidation of a business. See generally 7 COLLIER ON BANKRUPTCY, ¶ 1112.04[6][a][ii] (Alan N. Resnick and Henry J. Sommer, eds., 16th ed. 2011). Proof that the bankruptcy estate continues to suffer losses in value does not constitute cause if the moving party does not also demonstrate the absence of a likelihood of reestablishing the debtor's business. It simply does not focus on whether the debtor in possession is likely to confirm a Chapter 11 plan. Thus, when Sections 1112(b)(4)(A) and 1112(b)(4)(B) refer to losses to the estate and mismanagement of the estate, the focus is on the value of the estate rather than the debtor in possession's management of the bankruptcy reorganization process.

[25] Debtor's opposition is accompanied by the declaration of its insurance broker, Brad Rucker ("Rucker Declaration"). (ECF No. 1433). Attached to that declaration as Exhibit "A" is a copy of a letter dated August 3, 2015, addressed to Kevin Close, who is the chief financial officer of the Debtor. That letter is in response to a copy of the Conversion Motion that had been sent by the Debtor to the broker. Enclosed with the letter is a Memorandum of Property and

reflect that the Debtor's interest in the Property is not fully insured as the Debtor is left to compete with other named insureds affiliated with the Debtor's principal for full coverage of potential losses. See Reply at 13:18 to 14:16.[26]

On this record, the court concludes that a failure to maintain sufficient insurance simply has not been established. AG raises an important concern, perhaps one that the Office of the United States Trustee ("UST") should pursue, but has not produced sufficient evidence to establish the existence of what amounts to a negative. Debtor's apparent unwillingness to provide complete copies of the applicable insurance policies to AG in this contentious proceeding is not unexpected, but the court will require that complete copies be provided to the UST. The existence of cause under Section 1112(b)(4)(C) cannot be determined on this record.

D. Unauthorized Use of Cash Collateral/Failure to Comply with Orders.

AG argues that the Debtor failed to comply with the Cash Collateral Orders, or to abide by the prior rulings of the court. See Conversion Motion at 22:8 to 23:4. Debtor responds that the increase in its management and activity fees are appropriate based on the increase in rental income. See Debtor Opposition at 12:9-22. It also argues that its decision to commence an adversary proceeding challenging the amount of AG's claim is consistent with the court's prior ruling in connection with Debtor's objection to POC 10-2. Id. at 12:23-25.[27]

Liability Insurance ("Insurance Memorandum"), a copy of which is attached as Exhibit "B" to the Rucker Declaration. It appears that the Debtor's chief financial officer did not have the insurance information at the time the Conversion Motion was filed and had to contact the broker. It is therefore not clear who AG could have asked for the insurance information before raising the issue in the instant motion.

[26] Because the Insurance Memorandum does not include complete copies of the insurance policies, AG's counsel did an internet search for complete copies of standard policy forms prepared by the same vendor indicated on the Insurance Memorandum. See Gertz Declaration at ¶¶ 3 and 4. Copies of those forms are attached as Exhibits "1," "2," "3," and "4" to the Gertz Declaration. AG argues that if these standard forms are applicable to the Debtor's policies, then there may be coverage shared with non-Debtor entities that places the bankruptcy estate at risk.

[27] On the same date the Conversion Motion was heard, counsel also presented argument in connection with the Adversary Dismissal Motion. That motion is the subject of a separate order.

In arguing that it has not exceeded the Cash Collateral Budget, Debtor references the "last monthly operating report" showing total rents collected of $366,910, which allegedly would permit a 4 percent management fee in the amount of $14,676, as well as a 2 percent activities fee of $7,338, i.e., a total of $22,014. See Debtor Opposition at 12:16-18. Presumably, Debtor is referring to the MOR through June 30, 2015 that was filed on July 20, 2015. (ECF No. 1421). In the Statement of Cash Receipts and Disbursements, that report does show cash receipts of $366,923 on line 12, but the management fees shown on line 26 total $21,449, not the $22,014 total figure reflected in the Debtor's opposition. The $21,449 figure represents approximately 5.8 percent of the total cash receipts for June, not 4 percent. It is not clear whether the management fee figure on line 26 also includes a 2 percent activities fee, because line 33 consists of a separate cash outflow category labeled "Activities" but shows no expenditure in that category for the month of June.[28] The court has no idea whether this possible discrepancy is a function of the MOR format or an indicator of something more. On this record, however, the Debtor's explanation may be sufficient and AG has not met its threshold burden on this suggested basis for cause under Sections 1112(b)(4)(D and E).

E. Failure to Satisfy Reporting Requirements.[29]

Finally, AG maintains that the Debtor failed to disclose information regarding the value of the Property that should have been reflected in its MORs, as well as in the Debtor Disclosure Statement. See Conversion Motion at 23:9-23.[30] AG relies solely on language from the manual

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[28] Line 33 perhaps reflects the out-of-pocket expenses incurred for providing activities at the Debtor's senior housing complex, while the additional activities fees are included in the management fees set forth on line 26. The numbers alleged in the Debtor's Opposition, however, still do not add up to the amount shown on line 26.

[29] Section 1112(a)(4)(F) includes another example of cause: "unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter." Although AG appears to argue that the Debtor did not satisfy the financial reporting requirement by including the additional Property valuation information, its Conversion Motion does not cite this provision.

[30] On August 20, 2015, Debtor filed its most recent MOR for the period ending July 31, 2015, listing the market value of the Property at $45,300,000. (ECF No. 1439). Until January 8, 2015, all of the Debtor's MORs listed the value of the Property at $30,000,000. (ECF Nos. 70,

issued by the UST indicating that financial reports provided by a Chapter 11 debtor "are designed to provide the United States Trustee, the court, creditors, and other parties in interest with reliable information regarding the current status of a case." See Conversion Motion at 23:10-12, quoting U.S. Trustee Program Policy and Practices Manual ("UST Manual"), § 3-3.3 at 39 (January 2015).[31]

Debtor claims that its MORs properly reflected the stipulated value of the Property set forth in the Valuation Order, see Debtor Opposition at 13:3-8,[32] even though the Debtor was in possession of an appraisal setting forth a higher value. Additionally, Debtor maintains that it has attempted to reopen the evidentiary record to introduce new evidence of value of the Property but was not allowed to do so. Id. at 13:8-10.[33]

Neither parties' arguments are persuasive.

As an initial matter, AG's reference to the UST Manual is inappropriate.[34] The

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98, 136, 164, 241, 317, 372, 417, 463, 488, 534, 542, 558, 566, 576, 590, 610, 707, 803, 818, 867, 876, 917, 921, 938, 953, 958, 962, 965, 972, 980, 982, 984, 991, 992, 1003, 1015, 1031, 1051, 1070, 1145, 1173, 1209, 1222, 1271, 1275, 1281, 1300, 1320). On January 8, 2015, however, Debtor filed amended MORs for the periods ending July 31, 2014, through November 30, 2014, listing the value of the Property at $45,300,000. (ECF Nos. 1330, 1331, 1332, 1333, 1334). From January 20, 2015, forward, Debtor's unamended MORs for the periods ending December 31, 2014, through June 30, 2015, have listed the value of the Property at $45,300,000. (ECF Nos. 1335, 1340, 1370, 1394, 1413, 1419, 1421).

[31] The UST Manual is accessible on the website for the U.S. Trustee Program located at http://www.justice.gov/ust.

[32] Debtor asserts that the appraisals were provided to AG two months before the Confirmation Hearing. See Debtor Opposition at 13:6-8. This is incorrect. The existence of one of the appraisals was not disclosed until Debtor's valuation witness testified at the Confirmation Hearing.

[33] Debtor's motion to reopen the record was filed on November 17, 2014 (ECF No. 1295), after the District Court issued its order denying leave to appeal (ECF No. 1284) this court's order staying proceedings on the Debtor's additional Chapter 11 plan (ECF No. 1219). Prior to that ruling, AG had filed a motion to reopen the record (ECF No. 1040) on February 5, 2014, that Debtor vigorously opposed (ECF No. 1049).

[34] AG's reference to the sufficiency of the Debtor Disclosure Statement is the subject of the plan confirmation dispute between the parties. Whether the Debtor failed to include other valuation information in the Debtor Disclosure Statement is more appropriately addressed by the

introduction to the UST Manual clearly states that "[i]t is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable by law by any entity in any matter." UST Manual, Chapter 1-1: Introduction (February 2015). A Chapter 11 debtor in possession is required by Section 1107(a) to perform the duties of a Chapter 11 trustee under Section 1106(a). Under Section 1106(a)(1), a Chapter 11 trustee is required to perform the duties of a Chapter 7 trustee specified under Section 704(a)(8). Under Section 704(a)(8), a Chapter 7 trustee is required to file periodic reports for businesses that are authorized to be operated. These provisions make clear that the Debtor, as debtor in possession, is required to file monthly operating reports, but the language in the UST Manual cannot be cited as a point of reference.

Beyond this initial observation, the more important concern is the impact of the information that was not included in the MORs. No one disputes that the evidence in the Debtor's possession of a higher valuation of the Property first became an issue at the time of the Confirmation Hearing.[35] Until that time, all parties in interest had been given notice of the competing plans and the only adverse parties were the Debtor and its affiliates on one hand, and AG on the other. No committee of unsecured creditors had been formed and only an ad hoc committee of residents had appeared in the case. Only Willows Account and the Debtor initially sought to dispute the stipulated value set forth in the Valuation Order, and AG thereafter responded. The agreed value of the Property for purposes of plan confirmation was a non-issue until Willows Account, the Debtor, and the Debtor's expert witnesses made it an issue at the Confirmation Hearing. Except for the Guarantors and other insider parties, no additional parties in interest have disputed the value of the Property.

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adequate information standard under Section 1125(a).

[35] As previously discussed at note 5, supra, the language of the Valuation Order entered on March 17, 2011 appeared to conflict with the language of the Debtor's initial Chapter 11 plan filed on February 28, 2011. Other than this inconsistency, there was no apparent dispute prior to the Confirmation Hearing that the agreed value of $30,000,000 for the Property would be used in determining confirmation of both plans.

The record is also clear that until January 8, 2015, the Debtor's chief financial officer, Mr. Close, continued to sign MORs under penalty of perjury reflecting a $30,000,000 value for the Property, see note 30, supra, even though he was present during the Confirmation Hearing and was presumably aware of the testimony indicating a higher value.[36] The record also establishes that from January 8, 2015 forward, Debtor's chief financial officer has filed both amended and current MORs representing the value of the Property to be $45,300,000, see id., without the evidentiary record ever being reopened.[37]

Between AG's misreliance on the UST Manual and the Debtor's contradictory positions, the court sees no material impact upon or prejudice to the rights of any creditors as a result of the Debtor's failure to report the updated value of the Property. If the goal of requiring operating reports is to provide reliable information regarding the current status of a Chapter 11 proceeding, the goal appears to have been met in this case through the plethora of required, unrequired, solicited, unsolicited, invited, and uninvited materials submitted by the parties. Under these circumstances, the court concludes that the Debtor's previous failure to include available information as to an increased value of the Property is not a material default in its financial reporting obligations.

F. Lack of Good Faith.

Although not listed amongst the example of cause found in Section 1112(b)(4), a long line of cases has established that dismissal or conversion of a Chapter 11 proceeding is appropriate where a debtor in possession's bad faith, or lack of good faith, has been established. See generally 7 COLLIER ON BANKRUPTCY, supra, ¶ 1112.07; In re Sullivan, 522 B.R. at 614. See also In re Hayden, 2015 WL 2148949 at *3 (Bankr. C.D. Cal. May 6, 2015)(lack of good

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[36] Until January 8, 2015, the MORs continued to represent a $30,000,000 value for the Property even though the Debtor itself had been seeking to reopen the evidentiary record to state a higher value.

[37] This completely undercuts, of course, Debtor's current argument that it did not previously state a higher figure in its MORs because the court had denied its prior motion to reopen the evidentiary record.

faith may constitute cause for conversion or dismissal under Section 1112(b)(1)). A "totality of circumstances" or "amalgam of factors" analysis is used to determine good faith. See, e.g., In re Marsch, 36 F.3d 825, 828 (9th Cir. 1994); In re Grego, 2015 WL 3452559 at *6. Where a debtor in possession's lack of good faith is present, dismissal or conversion is not required, however, if the best interests of creditors otherwise would be served. The leading treatise has observed:

> For example, the debtor may be guilty of the most egregious bad faith in the handling of the case, and yet the reorganization might still be in the best interests of all concerned. In situations of this kind, the court might take a more surgical approach, and rather than dismiss the case, the court might simply appoint a chapter 11 trustee. Indeed, if it appears that creditors would be better off with a reorganization notwithstanding the debtor's bad faith, it might be an abuse of discretion for the court to order dismissal. On the other hand, if all of the creditors wish the reorganization to end, prompt dismissal may be in order.

7 COLLIER ON BANKRUPTCY, supra, ¶ 1112.07[4] (Emphasis added).

As previously discussed, AG has failed to demonstrate gross mismanagement of the estate within the meaning of Section 1112(b)(4), but egregious bad faith in the handling of the case is evident from the record. In this proceeding, the court previously determined that the Debtor's principal, Mr. Templeton, manipulated the voting process in an attempt to confirm the Debtor's proposed Plan and to prevent confirmation of the AG Plan.[38] In the Guarantor Adversary Proceeding, the court previously concluded that Mr. Templeton attempted to mislead the court concerning his relationship to the principal of Willows Account.[39]

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[38] In this Chapter 11 proceeding, the Debtor also sought authorization to employ the law firm of Marquis Aurbach Coffing as special counsel, without fully disclosing Mr. Templeton's personal, business and financial relationship with Mr. Aurbach, a named principal in that law firm. See note 10, supra.

[39] During the Confirmation Hearing, Mr. Templeton's extensive personal, professional, and financial relationship with the principal of Willows Account was explored more thoroughly through the testimony of Mr. Erganian. Because Mr. Erganian did not testify at the Preliminary Injunction Hearing, the full extent of his connections with Mr. Templeton and his related entities was not explored. Under direct and cross-examination at the Confirmation Hearing, Mr. Erganian revealed, for example, that Mr. Templeton had referred Mr. Erganian to counsel representing Willows Account, that the contact with such counsel was arranged through Debtor's chief financial officer, that Debtor's chief financial officer occasionally prepares documents for Mr. Erganian, that Mr. Templeton and Mr. Erganian are actually close friends, that Mr. Erganian views Mr. Templeton as a mentor, that Mr. Templeton grants Mr. Erganian concessions on his office rent, that Mr. Templeton has forgiven thousands of dollars of interest on certain loans

Under these circumstances, the record amply supports a conclusion that relief is appropriate due to the Debtor's bad faith. All of the litigious factions in this proceeding have expressed the view that the value of the Property, including the operation of the senior apartment complex, may be sufficient to pay AG and all other creditors in full. None of the parties to this proceeding support dismissal of the case, not even AG. As previously discussed at 11 & n.13, supra, if this Chapter 11 case is converted to Chapter 7, the assigned trustee likely would seek and obtain authorization under Section 721 to continue operation of the senior apartment complex until it could be sold. Alternatively, a Chapter 7 trustee or another party in interest could seek to reconvert the case to Chapter 11 so that the Debtor could be reorganized.

The court now turns to whether relief is precluded by the Debtor's showing in response to the Conversion Motion.

II. The Existence of Specifically Identified Unusual Circumstances under Section 1112(b)(2) that Conversion or Dismissal is Not in the Best Interests of Creditors.

Assuming that cause has been established, Section 1112(b)(2) requires a finding by the court of specifically identifiable unusual circumstances establishing that relief is not appropriate.

The court cannot independently identify in this case, however, circumstances where relief under Section 1112(b) is not in the best interests of creditors. The universe of creditors in this

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made to Mr. Erganian, that Mr. Templeton advised Mr. Erganian with respect to his default on certain loans issued by a bank for which Mr. Templeton was the chairperson, that Willows Account itself was formed for Mr. Erganian by the Debtor's chief financial officer, that Mr. Erganian reimbursed the Debtor's chief financial officer in cash for the cost of forming Willows Account, that Debtor's chief financial officer assisted Mr. Erganian as well as Mr. Aurbach in preparing the assignment of the PSACP claim, that it was Mr. Templeton who approached Mr. Erganian with the opportunity to purchase the PSACP claim for $10,000 rather than Mr. Aurbach whose entity owned the claim, that Mr. Erganian has frequent meetings with the staff at KTRI, that Mr. Erganian had a joint venture with KTRI regarding real estate work relating to Integrated Financial Associates, Inc. ("IFA"), that Mr. Templeton is a principal in IFA, that the Debtor's bankruptcy counsel is also counsel for IFA in its bankruptcy proceeding, that Mr. Erganian purchased from Mr. Templeton or a related party two promissory notes made by IFA, and that Mr. Templeton thanked Mr. Erganian for serving on the IFA creditors committee. This is anything but the arms length, financially distinct relationship that Mr. Templeton portrayed in his testimony at the Preliminary Injunction Hearing. Compare discussion at note 6, supra. Because Willows Account cast the largest vote in favor of Debtor's Plan and against the AG Plan, the court concluded that Debtor through its principal had attempted to manipulate and skew the voting process.

case is relatively small, consisting primarily of AG, and a handful of trade creditors. Willows Account purportedly was a creditor, but its claim has been recharacterized as equity. An entity known as Pause 1 has also filed a proof of claim in the case, but it appears that the owner of that entity also has connections with the Debtor's principal and even acquired that claim through both Mr. Templeton and Mr. Erganian.[40] While no request to recharacterize or designate the Pause 1 claim has been made, it may be that the transfer of the claim to Pause 1 suffers from the same defects as the transfer of the PSACP claim to Willows Account.

This Chapter 11 proceeding began primarily as a two-party dispute between the Debtor and Union Bank that came to a head when the Construction Loan matured. Debtor's failure to pay the Construction Loan exposed the Property to foreclosure under the deed of trust and also exposed the Guarantors to collection on their personal guaranties. Rather than pursuing a straightforward reorganization through Chapter 11, the Debtor's existing management has attempted to manipulate the process to assure confirmation of a plan of reorganization that would result in an immediate discharge of the Debtor under Section 1141(d)(1), while also serving to protect the Guarantors. These are the same parties that the Debtor tried to protect through its misleading evidentiary presentation in connection with the preliminary injunction requested in the Guarantor Adversary Proceeding.

An extraordinary amount of time has elapsed since this Chapter 11 proceeding was commenced. Whatever cooperation existed between the Debtor and Union Bank early in the case evaporated almost entirely after the Valuation Order was entered. Thereafter, virtually every issue has been contested. There was nothing extraordinary about a nine day trial on

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[40] At the Confirmation Hearing, Mr. Erganian testified that Mr. Templeton had offered to arrange a sale to him of a $150,000 promissory note made by the Debtor that Mr. Templeton had personally guarantied. Instead of purchasing that promissory note for himself, Mr. Erganian testified that he loaned funds to Timothy Deters, who is a former business partner of Mr. Erganian and who also worked for Mr. Templeton or KTRI. Mr. Deters then purchased the note in the name of his entity, Pause 1. Mr. Erganian testified that payments on the note are made to Pause 1 by Carefree Holdings, and then Pause 1 repays Mr. Erganian. He also testified that assignment of the promissory note to Pause 1 was prepared by the Debtor's chief financial officer. The proof of claim filed by Pause 1 in the bankruptcy case reflects that the original payee on the promissory note was Stanley Paher.

confirmation of competing Chapter 11 plans, but the parties' subsequent activities, including the submission of additional materials after the close of evidence and multiple appeals of even interlocutory orders, have delayed the completion of the case. The court's own caseload and procedural uncertainty also has contributed to prolonging the process.

Even assuming, however, that an extraordinary length of time, coupled with an undisputed increase in the value of the Property, is a sufficiently identifiable and unusual circumstance within the meaning of Section 1112(b)(2), the Debtor separately must meet the requirements of Sections 1112(b)(2)(A) and 1112(b)(2)(B).

III. A Reasonable Likelihood of Plan Confirmation and a Reasonable Justification for the Acts Constituting Cause.

As previously discussed at 12, if cause for relief under Section 1112(b)(1) is demonstrated, and the court specifically identifies the presence of unusual circumstances, the burden remains upon the debtor in possession to establish two separate requirements: (1) that there is a reasonable likelihood that a Chapter 11 plan will be confirmed within a reasonable period of time, and (2) that there exists a reasonable justification for the act or omission constituting cause for relief and that the act or omission will be cured within a reasonable period of time.

In the instant case, the Confirmation Hearing presented evidence in support and in opposition to both the Debtor's Plan and with respect to the AG Plan. In view of the court's determination of the AG Designation Motion and the AG Recharacterization Motion, not even the Debtor believes that the Plan currently under submission can be confirmed. See Debtor Opposition at 10-11. Consistent with its view that a Chapter 11 plan proponent's good faith is immaterial as long as creditors are paid, see discussion at note 14, supra, Debtor even proposed a different, Fifth Amended Plan after its prior Plan already was under submission and the evidentiary record was closed. See discussion at 8. In response to the instant Conversion Motion, Debtor maintains that it can expeditiously confirm a different Chapter 11 plan of reorganization that pays all creditors in full, including AG, based on the current value of the Property. See Debtor Opposition at 11. What it fails to address, of course, is how a plan

proponent previously found to have manipulated the confirmation process can propose another plan without a change in management. While the Debtor clearly is correct that Mr. Templeton's prior testimony occurred "and history cannot be changed," see Debtor Opposition at 3:17, supra, it is equally clear that the Debtor's management can be changed. Debtor's refusal to change management in this case leaves it unable to meet the good faith requirement of a plan proponent under Section 1129(a)(3).

But Section 1112(b)(2)(A) only requires evidence of a reasonable likelihood that a plan will be confirmed within a reasonable time; it does not require the plan be proposed by the debtor in possession. In this case, the plan exclusivity period under Section 1121(b) elapsed and AG filed a proposed plan even before the Debtor filed its initial plan. The proposed AG Plan does not suffer the same defects as the Debtor and provides for a liquidation of the Property as permitted by Section 1129(a)(11). Thus, without more, consideration of the entire record indicates that there is a reasonable likelihood of a plan being confirmed within a reasonable time, just not the Debtor's proposed plan.

But Section 1112(b)(2)(B) also requires that there be a reasonable justification for the debtor in possession's acts or omissions constituting cause. Perhaps consistent with its view that the requirement of good faith under Section 1129(a)(3) is unimportant when there is sufficient funds to pay creditors, Debtor apparently believes that the requirement of Section 1112(b)(2)(B) is unimportant because it makes no effort to justify its principal's attempt to mislead the court. As previously discussed at note 39, supra, it was the testimony of Mr. Erganian at the Confirmation Hearing that fully revealed the duplicity of Mr. Templeton's earlier testimony at the Preliminary Injunction Hearing. Not only was Mr. Templeton's first day of testimony at the Preliminary Injunction Hearing misleading, but his second day of testimony omitted even more details of his business, financial and social relationship with Mr. Erganian. Even when the breadth of Mr. Templeton's omissions was revealed through Mr. Erganian's testimony at the Confirmation Hearing, no effort was made through Mr. Templeton to explain or otherwise justify the prior testimony. Even when the consequences of those efforts were reflected in the AG Designation Order and the AG Recharacterization Order, the Debtor's arrogant response is to

treat Mr. Templeton's testimony as old news. In short, no reasonable justification for that misleading testimony has been offered in response to the Conversion Motion much as no explanation for those omissions was given at the Confirmation Hearing.

Under these circumstances, cause has been established under Section 1112(b)(1) due to the Debtor's lack of good faith in the management of the Chapter 11 proceeding. Even if specifically identifiable unusual circumstances exist suggesting that relief is not in the best interests of creditors, Debtor has failed its burden of establishing a reasonable justification for the lack of good faith of its principal. Accordingly, relief under Section 1112(b)(1) is appropriate.

Because a properly managed reorganization of the Debtor in Chapter 11 may well result in a successful rehabilitation, however, the court concludes that conversion to a Chapter 7 liquidation is not in the best interests of creditors or the equity holders of the Debtor. Instead, the court concludes that the appointment of a Chapter 11 trustee is more appropriate in this proceeding. As the appointment of a Chapter 11 trustee does not result in a dissolution of the Debtor, the Debtor's equity holders and former management are free to work with the appointed trustee in attempting to confirm a plan of reorganization.[41] If the appointed trustee concludes that confirmation of the AG Plan is in the best interests of creditors, the court will consider that recommendation.

IT IS THEREFORE ORDERED that the Motion for Order Directing Sale of Property, Or in the Alternative, for Conversion, brought by AG/ICC Willows Loan Owner, L.L.C., Docket No. 1424, be, and the same hereby is, **DENIED IN PART AND GRANTED IN PART AS PROVIDED HEREIN.**

IT IS FURTHER ORDERED that a sale of the assets of the Debtor as requested in the present Motion is **DENIED**.

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[41] Carefree Holdings apparently has in excess of 150 limited partners and owns in excess of 96 percent of the membership interest in the Debtor. Carefree Holdings is managed by MLPGP which in turn is managed by Mr. Templeton. See discussion at note 2, supra. Whether the appointed Chapter 11 trustee will have any dialogue with the other limited partners of Carefree Holdings may be problematic.

IT IS FURTHER ORDERED that relief under 11 U.S.C. § 1112(b)(1) is **GRANTED** though the appointment of a Chapter 11 trustee in this proceeding.

IT IS FURTHER ORDERED that the Office of the United States Trustee shall take steps forthwith to select and appoint a Chapter 11 trustee in this case.

IT IS FURTHER ORDERED that the Chapter 11 trustee appointed in this matter shall appear at a status conference in this proceeding on October 28, 2015, at 11:00 a.m. in Courtroom 2.

IT IS FURTHER ORDERED that the monthly payments required by the February 8, 2011, order authorizing use of cash collateral, Docket No. 128, shall continue to be made to AG/ICC Willows Loan Owner, LLC, by the appointed Chapter 11 trustee until further order of the court.

Copies sent to all parties via BNC

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