

  
Honorable Mike K. Nakagawa  
United States Bankruptcy Judge



Entered on Docket  
June 01, 2016

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF NEVADA

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In re:	)	Case No.: 11-14973-MKN
	)	Chapter 11
R & S ST. ROSE LENDERS, LLC,	)	
	)	Date: May 18, 2016
Debtor.	)	Time: 11:00 a.m.
	)	

**ORDER ON MOTION OF UNITED STATES TRUSTEE, PURSUANT TO 11 U.S.C. § 1112(b) AND FEDERAL RULES OF BANKRUPTCY PROCEDURE 1017(f) AND 9014, TO CONVERT OR DISMISS CHAPTER 11 CASE<sup>1</sup>**

On May 18, 2016, the court heard the Motion of United States Trustee, Pursuant to 11 U.S.C. § 1112(b) and Federal Rules of Bankruptcy Procedure 1017(f) and 9014, to Convert or Dismiss Chapter 11 Case. (“Conversion Motion”). The appearances of counsel were noted on the record. After arguments were presented, the matter was taken under submission.

**BACKGROUND**

On April 4, 2011, R&S St. Rose Lenders, LLC (“Lenders”) commenced the above-captioned Chapter 11 proceeding. Its voluntary Chapter 11 petition was accompanied by its schedules of assets and liabilities (“Schedules”) in addition to its statement of financial affairs.

<sup>1</sup> All references to “Section” or “§” are to the provisions of the Bankruptcy Code, 11 U.S.C. §§ 101-1532. All references to “ECF No.” are to the number assigned to the documents filed in the above-captioned case as they appear on the docket maintained by the clerk of the court. Documents filed in other cases will be similarly identified.

1 (Lenders ECF No. 1). Lenders’s Schedule “A” listed no real property assets. Lenders’s personal  
2 property Schedule “B” listed two checking accounts totaling \$574.38, a claim in the amount of  
3 \$12 million against R&S St. Rose, LLC, and a “judgment against Branch Banking and Trust  
4 Company” in the amount of \$41,000.

5 On the same date, R&S St. Rose, LLC (“St. Rose”) commenced a separate voluntary  
6 Chapter 11 proceeding, denominated Case No. 11-14974-MKN. Its voluntary Chapter 11  
7 petition was accompanied by its schedules of assets and liabilities (“Schedules”) in addition to  
8 its statement of financial affairs. (St. Rose ECF No. 1). St. Rose’s Schedule “A” listed a fee  
9 simple interest in approximately 38 acres of raw land located on St. Rose Parkway in Henderson,  
10 Nevada (“the Property”).

11 On July 22, 2011, Branch Banking and Trust Company (“BB&T”) filed in the Lenders  
12 proceeding an unsecured proof of claim in the amount of \$38,539,707.47. The claim is based on  
13 a 2007 loan (“Construction Loan”) between Colonial Bank, N.A. (“Colonial Bank”) and St.  
14 Rose, secured by a deed of trust against the Property. The rights under the loan and deed of trust  
15 allegedly had been obtained by BB&T from the Federal Deposit Insurance Corporation  
16 (“FDIC”) as receiver for Colonial Bank. The claim asserts that BB&T’s lien against the  
17 Property is senior to that of Lenders and references an action previously commenced in state  
18 court by Colonial Bank.

19 On July 26, 2011, Commonwealth Land Title Insurance Company (“Commonwealth”)  
20 filed in the Lenders proceeding a separate unsecured proof of claim in an amount to be  
21 determined. The claim asserted that it has an estimated value of \$43,980,000 based on certain  
22 consolidated litigation that had begun in state court in 2008. In connection with the previously  
23 described Construction Loan, Commonwealth, through Nevada Title Company, issued a title  
24 insurance policy in the amount of \$43,980,000 for the benefit of Colonial Bank. In completing  
25 the Construction Loan, however, a deed of trust that had been recorded against the Property in  
26 2005 in favor of Lenders was never conveyed, nor was it subordinated to Colonial Bank’s later

1 recorded deed of trust securing the Construction Loan in 2007. As a result, the consolidation  
2 litigation mentioned in Commonwealth's proof of claim was commenced in state court.<sup>2</sup>

3  
4 <sup>2</sup> The consolidated litigation consisted of a first action brought by Robert E. Murdock  
5 ("Murdock") and Eckley M. Keach ("Keach") and a second action brought by Colonial Bank.  
6 The first action brought by Murdock and Keach was commenced in November 2008 in the  
7 Eighth Judicial District Court for Clark County, Nevada ("State Court"). That action was  
8 brought against Saiid Forouzan Rad ("Rad"), R. Phillip Nourafchan ("Nourafchan"), Forouzan,  
9 Inc. ("Forouzan"), RPN, LLC ("RPN"), as well as Lenders and St. Rose, entitled Murdock, et al.  
10 v. Rad, et al., Case No. 08-A574852-C. In April 2009, Colonial Bank Group Inc. and R&S  
11 Investment Group ("RSIG") were also added as named defendants.

12 In July 2009, Colonial Bank, Commonwealth's insured, commenced the second action in  
13 the State Court against St. Rose, and others, denominated Case No. 09-A-594512-C. Both  
14 Colonial Bank and Lenders were secured creditors of St. Rose. Colonial Bank's primary  
15 assertion was that Lenders had improperly obtained a lien against the subject Property ahead of  
16 Colonial Bank's deed of trust. Shortly after the second action was commenced, Colonial Bank  
17 was placed into receivership by which the FDIC became the receiver. Subsequently, BB&T, as  
18 the alleged purchaser from the FDIC of the assets of Colonial Bank, filed an amended cross-  
19 complaint, again asserting various claims against St. Rose, Lenders, and others. Lenders  
20 counterclaimed, seeking a declaration that its deed of trust had priority over Colonial Bank's  
21 deed of trust. That second action subsequently was consolidated with the first action that had  
22 been commenced by Murdock and Keach. (In this Order, the consolidated action is referred to  
23 as the "State Court Action.")

24 On January 8, 2010, a ten-day trial of the State Court Action was commenced and  
25 concluded on or about April 14, 2010, resulting in a variety of rulings by the State Court. A  
26 foreclosure of the Property by Lenders under its deed of trust was scheduled to be conducted on  
June 1, 2010, and BB&T's request to stay the foreclosure was denied by the State Court.

On May 13, 2010, to prevent the foreclosure by Lenders, BB&T commenced an  
involuntary Chapter 7 proceeding against St. Rose, denominated Case No. 10-18827-MKN  
("Involuntary Proceeding"). As a result of the involuntary Chapter 7 petition filed by BB&T, the  
foreclosure of the Property, as property of the St. Rose bankruptcy estate, was prevented by the  
automatic stay under Section 362(a).

On May 25, 2010, a motion to dismiss the Involuntary Proceeding was filed by Rad and  
Forouzan (Involuntary Proceeding ECF No. 9) and later joined by Lenders. (Involuntary ECF  
No. 25).

On June 23, 2010, the State Court entered Findings of Fact and Conclusions of Law  
determining, inter alia, that Lenders's deed of trust has priority over the Colonial Bank deed of  
trust.

On July 13, 2010, the State Court entered an initial judgment against Lenders in favor of  
Murdock in the amount of \$166,741.83 and in favor of Keach in the amount of \$1,009,163.61,  
resulting in a total judgment of \$1,175,905.44.

On October 29, 2010, an order was entered by the bankruptcy court dismissing the  
Involuntary Proceeding. (Involuntary ECF No. 37).

1 On May 1, 2012, BB&T filed a motion to substantively consolidate the two bankruptcy  
2 estates (“Consolidation Motion”). (St. Rose ECF No. 116; Lenders ECF No. 135). On June 11,  
3 2012, St. Rose filed opposition to the Consolidation Motion. (St. Rose ECF No. 128). Lenders  
4 joined in the opposition. (Lenders ECF No. 153). On the same date, Commonwealth joined in  
5 the Consolidation Motion. (Lenders ECF No. 155). A consequence of substantive consolidation  
6 of the separate bankruptcy estates would be to eliminate Lenders’s claim against St. Rose,  
7 thereby leaving BB&T with the only claim secured by the Property.

8 On September 4, 2012, this court entered an order denying the Consolidation Motion  
9 (“Consolidation Order”). (St. Rose ECF No. 168; Lenders ECF No. 172). On September 12,  
10 2012, BB&T filed a notice of appeal to the United States District Court (“USDC”) for the  
11 District of Nevada. (St. Rose ECF No. 173; Lenders ECF No. 175). On September 18, 2012,  
12 Commonwealth also filed an appeal from the Consolidation Order to the USDC. (St. Rose ECF  
13 No. 183; Lenders ECF No. 190).

14 On August 2, 2013, St. Rose filed a proposed Chapter 11 liquidating plan (“St. Rose  
15 Plan”). (St. Rose ECF No. 242).

16 On November 8, 2013, in the St. Rose Chapter 11 proceeding, an order was entered on  
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18 On or about November 5, 2010, a final judgment was entered in the consolidated State  
19 Court Action granting judgment in favor of Murdock and Keach against Lenders, granting  
20 judgment in favor of Lenders against BB&T as to the priority of Lenders’s deed of trust, and  
21 dismissing all other claims not previously resolved in the action. BB&T appealed that judgment  
22 to the Nevada Supreme Court.

23 On or about March 31, 2011, Murdock and Keach assigned to Commonwealth their  
24 rights under the judgment in the consolidated State Court Action.

25 On April 4, 2011, Lenders and St. Rose voluntarily commenced their separate Chapter 11  
26 reorganization proceedings.

On May 31, 2013, the judgment reflected by the State Court Order was affirmed by the  
Nevada Supreme Court. On September 26, 2013, a petition for rehearing was denied. On  
February 21, 2014, the Nevada Supreme Court denied BB&T’s petition for rehearing en banc.  
BB&T then petitioned for writ of certiorari to the United States Supreme Court. On October 6,  
2014, the certiorari petition was denied. See Branch Banking and Trust Co. v. R&S St. Rose  
Lenders, 135 S.Ct. 85 (U.S. 2014).

1 confirmation of the St. Rose Plan. (St. Rose ECF No. 291). On November 21, 2013, in the St.  
2 Rose proceeding, an order was entered approving a sale of the subject Property (“Sale Order”) in  
3 accordance with the confirmed St. Rose Plan. (St. Rose ECF No. 302).<sup>3</sup> On November 21,  
4 2013, BB&T filed a notice appealing to the USDC the confirmation of the St. Rose Plan. (St.  
5 Rose ECF No. 306). On November 22, 2013, Commonwealth also filed an appeal of the plan  
6 confirmation order. (St. Rose ECF No. 312). On December 13, 2013, an order was entered  
7 denying BB&T’s request to stay the plan confirmation order pending appeal. (St. Rose ECF No.  
8 353).<sup>4</sup>

9 On March 27, 2014, an order was entered by the USDC vacating the bankruptcy court’s  
10 Consolidation Order and remanding the matter to the bankruptcy court for further proceedings  
11 (“Remand Order”). (St. Rose ECF No. 378; Lenders ECF No. 312).

12 On July 15, 2014, a stipulation was filed regarding further substantive consolidation  
13 proceedings after remand on the Consolidation Motion. (Lenders ECF No. 421). Discovery and  
14 supplemental briefing deadlines were established.

15 On August 7, 2014, an order was entered by the USDC affirming the bankruptcy court’s  
16 order confirming the St. Rose Plan. (St. Rose ECF No. 446).

17 On October 27, 2014, an evidentiary hearing commenced on the renewed Consolidation  
18 Motion as required by the Remand Order.

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21 <sup>3</sup> Under the Sale Order, the Property was sold for the purchase price of \$13,500,000, with  
22 the liens in favor of Lenders and Colonial Bank attaching to the proceeds of sale (“Sale  
23 Proceeds”).

24 <sup>4</sup> Pursuant to Article III of the St. Rose Plan, the Sale Proceeds were to be distributed to  
25 Lenders up to the allowed amount of its claim. After the close of the sale, those proceeds were  
26 distributed to Lenders over the objection of BB&T. See Motion to Return Funds to Debtor that  
were Improperly Disbursed under the Chapter 11 Plan, filed April 28, 2014 (St. Rose ECF No.  
381); Opposition to Motion to Return Funds, etc., filed May 21, 2014 (St. Rose ECF No. 389).  
The motion was withdrawn by BB&T upon the agreement of counsel that Lenders would not  
disburse the funds absent a confirmed Chapter 11 plan.

1 On November 21, 2014, the evidentiary hearing on the Consolidation Motion was  
2 completed.

3 On January 9, 2015, BB&T submitted its closing brief. (Lenders ECF No. 598).  
4 Commonwealth submitted its closing brief. (Lenders ECF No. 600). St. Rose submitted its  
5 closing brief (“St. Rose Closing”). (Lenders ECF No. 599). Joinders in the St. Rose Closing  
6 brief were filed by RSIG (Lenders ECF No. 601), the Creditor Group (Lenders ECF No. 604),  
7 and Lenders (“Lenders Closing”). (Lenders ECF No. 602). Because the Lenders Closing brief  
8 included additional legal arguments, an additional joinder in that brief was filed by RSIG.  
9 (Lenders ECF No. 603).

10 On January 26, 2015, closing arguments on the renewed Consolidation Motion were  
11 presented.

12 On April 24, 2015, proposed findings of fact and conclusions of law were submitted by  
13 all parties. (Lenders ECF Nos. 652 and 653).

14 On March 15, 2016, the UST filed the instant Conversion Motion. (Lenders ECF No.  
15 748). The Dismissal Motion was noticed to be heard on April 13, 2016. (Lenders ECF No.  
16 749).

17 On March 15, 2016, an order was entered denying the renewed Consolidation Motion  
18 (“Second Consolidation Order”) (Lenders ECF No. 751; St. Rose ECF No. 601), accompanied  
19 by a memorandum decision (“Memorandum Decision”). (Lenders ECF No. 750; St. Rose ECF  
20 No. 600).

21 On March 29, 2016, BB&T appealed the Second Consolidation Order. (Lenders ECF  
22 No. 762; St. Rose ECF No. 605).

23 On April 1, 2016, an order was entered continuing to May 18, 2016, the hearing on the  
24 Conversion Motion. (Lenders ECF No. 772).

25 On April 6, 2016, Commonwealth separately appealed the Second Consolidation Order.  
26 (Lenders ECF No. 774; St. Rose ECF No. 618).

1 On April 18, 2016, Lenders filed its Third Amended Chapter 11 Plan (“Plan”) (Lenders  
2 ECF No. 794) along with its Sixth Amended Disclosure Statement (“Disclosure Statement”).  
3 (Lenders ECF No. 793).<sup>5</sup> A hearing to approve the Disclosure Statement was noticed for May  
4 18, 2016. (Lenders ECF No. 795).

5 On April 19, 2016, Commonwealth filed a notice (Lenders ECF No. 797) scheduling a  
6 hearing for May 18, 2016, on various claim objections (Lenders ECF No. 264) that it previously  
7 filed in the Lenders Chapter 11 proceeding.

8 On April 27, 2016, BB&T filed a motion seeking to stay the Second Consolidation Order  
9 as well as portions of the Chapter 11 proceeding, pending resolution of the appeals of the Second  
10 Consolidation Order (“Stay Motion”). (Lenders ECF No. 804).

11 On April 29, 2016, an order was entered shortening time so that the Stay Motion could be  
12 heard on an expedited basis. (Lenders ECF No. 808).

13 On May 3, 2016, Commonwealth joined in the Stay Motion. (Lenders ECF No. 811).

14 On May 4, 2016, opposition to the Conversion Motion was filed by Commonwealth  
15 (Lenders ECF No. 813) and BB&T (Lenders ECF No. 816). On the same date, Commonwealth  
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17 <sup>5</sup> Previous plans and disclosure statements were filed by Lenders. On April 2, 2014,  
18 Lenders filed an initial Chapter 11 plan of liquidation that was attached as an exhibit to an initial  
19 disclosure statement. (Lenders ECF No. 316). On April 24, 2014, Lenders filed a first amended  
20 disclosure statement to which it attached the Chapter 11 plan of liquidation. (Lenders ECF No.  
21 330). On May 16, 2014, Lenders filed a second amended disclosure statement (Lenders ECF  
22 No. 347) along with a separate first amended plan of liquidation. (Lenders ECF No. 348). On  
23 May 30, 2014, Lenders filed a third amended disclosure statement. (Lenders ECF No. 362). On  
24 June 6, 2014, Lenders filed a fourth amended disclosure statement. (Lenders ECF No. 371). On  
25 July 3, 2014, an order was entered approving the fourth amended disclosure statement and  
26 scheduling a plan confirmation hearing to take place on October 14, 2014. (Lenders ECF No.  
403). The hearing on confirmation of Lenders’s first amended Chapter 11 plan was continued  
numerous times pending the outcome of the renewed motion for substantive consolidation.

On April 18, 2016, Lenders filed a fifth amended disclosure statement (Lenders ECF NO.  
790) along with a second amended Chapter 11 plan (Lenders ECF No. 791), which were rejected  
by the court clerk as nonconforming entries. Later on April 18, 2016, Lenders filed the instant  
Disclosure Statement (Lenders ECF No. 793) along with the third amended Chapter 11 plan of  
liquidation. (Lenders ECF No. 794).



1 also filed its objection to the Disclosure Statement (Lenders ECF No. 812) and BB&T did so as  
2 well. (Lenders ECF No. 815).

3 On May 6, 2016, Lenders filed opposition to the Conversion Motion. (Lenders ECF No.  
4 819).

5 On May 9, 2016, St. Rose, the Creditor Group, and Double E Family, LLC, separately  
6 joined in the Lenders's opposition to the Conversion Motion. (Lenders ECF Nos. 820, 821, and  
7 822).

8 On May 10, 2016, RSIG joined in the Lenders's opposition to the Conversion Motion.  
9 (Lenders ECF Nos. 823). On the same date, an opposition to the Stay Motion was filed on  
10 behalf of St. Rose ("Stay Opposition") (Lenders ECF No. 824), and Lenders and the Creditor  
11 Group joined in that opposition. (Lenders ECF Nos. 825 and 826).

12 On May 11, 2016, RSIG and Double E Family, LLC, also joined in the Stay Opposition  
13 that was filed on behalf of St. Rose. (Lenders ECF Nos. 827 and 828).

14 On May 12, 2016, the UST filed a reply in support of its Conversion Motion ("UST  
15 Reply"). (Lenders ECF No. 829).

16 On May 13, 2016, BB&T filed a reply in support of its Stay Motion ("Stay Reply").  
17 (Lenders ECF No. 830).

18 On May 16, 2016, a hearing was conducted on the Stay Motion.

19 On May 17, 2016, an order was entered denying the Stay Motion. (Lenders ECF No.  
20 831).

## 21 **DISCUSSION**

22 The court having considered the written and oral arguments of the parties, together with  
23 the record in this proceeding, concludes that the Conversion Motion must be denied.

24 The UST seeks to end the Chapter 11 proceeding by converting the case to a liquidation  
25  
26



1 proceeding under Chapter 7. See Conversion Motion at 8:7.<sup>6</sup> The UST seeks conversion under  
2 Section 1112(b)(1) for “cause” as defined in Section 1112(b)(4)(A). Id. at 4:22 to 5:9.

3 Section 1112(b)(1) provides as follows:

4 Except as provided in paragraph (2) and subsection (c), on request of a party in  
5 interest, and after notice and a hearing, the court shall convert a case under this  
6 chapter to a case under chapter 7 or dismiss a case under this chapter, whichever  
7 is in the best interest of creditors and the estate, for cause unless the court  
8 determines that the appointment under section 1104(a) of a trustee or an examiner  
9 is in the best interests of creditors and the estate.

10 (Emphasis added.) 11 U.S.C. § 1112(b)(1). Section 1112(b)(4) provides a non-exclusive list of  
11 circumstances constituting “cause,” including the circumstance suggested by the UST in the  
12 Conversion Motion:

13 “substantial or continuing loss to or diminution of the estate and the absence of a  
14 reasonable likelihood of rehabilitation.”

15 (Emphasis added.) 11 U.S.C. § 1112(b)(4)(A). The burden of establishing cause rests with the  
16 party seeking relief under Section 1112(b)(1). See Lebankoff v. U.S. Trustee (In re Labankoff),  
17 2010 WL 6259969, at \*3 (B.A.P. 9th Cir. June 14, 2010); see generally 7 COLLIER ON  
18 BANKRUPTCY, ¶ 1112.04[4] (Alan N. Resnick and Henry J. Sommer, eds, 16th ed. rev. 2016).  
19 Because Section 1112(b)(1) provides the alternatives of conversion or dismissal, the moving  
20 party also should demonstrate why the alternative it requests is in the best interests of creditors  
21 and the estate. See generally 7 COLLIER ON BANKRUPTCY, supra, ¶ 1112.04[4] at n.31, citing,  
22 e.g., In re Helmers, 361 B.R. 190, 198 (Bankr.D.Kan. 2007).

23 The operative command in Section 1112(b)(1) that the court shall convert or dismiss a  
24 Chapter 11 proceeding is subject to the exception set forth in Section 1112(b)(2). The exception  
25 sometimes is referred to as a “defense” to conversion or dismissal because the burden of  
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24 <sup>6</sup> In its response to the various oppositions filed by all parties in interest, the UST  
25 suggested that the case should be converted to Chapter 7 or that a Chapter 11 trustee should be  
26 appointed. See UST Reply at 6:26 to 7:1. Although the title of the Conversion Motion includes  
the words “or Dismiss Chapter 11 Case,” the prayer to the Conversion Motion as well as UST  
Reply does not request dismissal of the Chapter 11 proceeding.

1 establishing its requirements rests upon the respondent. Under Section 1112(b)(2), if the moving  
2 party establishes the existence of cause under Section 1112(b)(1), then the opponent can prevent  
3 conversion or dismissal if four requirements are met: (1) the court identifies unusual  
4 circumstances establishing that such relief is not in the best interests of creditors and the estate;  
5 (2) the opponent establishes that there is a reasonable likelihood of confirming a plan in a  
6 reasonable amount of time; (3) the opponent establishes that the grounds for relief include an act  
7 or omission of the debtor for which there is a reasonable justification; and (4) the opponent  
8 establishes that the act or omission can be cured within a reasonable time. See 11 U.S.C. §  
9 1112(b)(2)(A and B). Where cause is based on Section 1112(b)(4)(A), however, the third and  
10 fourth requirements arguably can never be met because they apply only to acts or omissions  
11 “other than under [Section 1112(b)(4)(A)].” (emphasis added.) 11 U.S.C. § 1112(b)(2)(B).  
12 Because of this language, some courts have concluded that Section 1112(b)(2) cannot be used as  
13 a defense when there are continuing losses in a liquidating Chapter 11 proceeding. See In re  
14 Wallace, 2010 WL 378351, at \*6 & n.23 (Bankr. D.Idaho Jan. 26, 2010).<sup>7</sup>

15 The UST argues that both elements under Section 1112(b)(4)(A) are present in this case.  
16 First, it maintains that there is a substantial or continuing loss to or diminution of the estate  
17 because the Sale Proceeds have declined by more than \$814,000 in the last two years due to the  
18 payment of allowed administrative costs, primarily attorney’s fees. See Dismissal Motion at 6:6-  
19 8; UST Reply at 4:1-2 and 5:8-11. At the hearing, the UST argued that, according to the St.  
20 Rose opposition to the Stay Motion, an additional \$800,000 in attorney’s fees may be incurred in  
21 connection with the further appeals pursued by BB&T. See Stay Opposition at 10:15-20.<sup>8</sup>

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22  
23 <sup>7</sup> Because even liquidating plans are permissible under Chapter 11, the unstated premise  
24 behind this exclusion appears to be that a loss to or diminution of the estate is an act or omission  
that cannot be justified, nor cured by confirming a plan.

25 <sup>8</sup> The UST, as well as the responding parties, seem to ignore that all of the professional  
26 fees allowed in the Lenders proceeding to date have been on an interim basis only. All such  
professional fees are subject to the court’s final review and approval.

1 Absent any sources of income to offset these ongoing administrative expenses, the UST  
2 maintains the Lenders's estate continues to diminish with each passing day.<sup>9</sup>

3 Second, the UST maintains that no rehabilitation of Lenders is contemplated even if its  
4 proposed Plan is confirmed. The UST initially argued that there is no likelihood of rehabilitation  
5 because the Lenders Chapter 11 proceeding has been pending for nearly five years without a  
6 confirmed plan. See Dismissal Motion at 6:12-16. Because Lenders filed its current proposed  
7 Plan and proposed Disclosure Statement after the Dismissal Motion was filed, however, the UST  
8 subsequently argued that there is no likelihood of rehabilitation at all because Lenders has now  
9 proposed a liquidating plan.<sup>10</sup> See UST Reply at 4:20-25, citing In re Mense, 509 B.R. 269, 284-  
10 85 (Bankr. C.D.Cal. 2014) and 6:2-23, citing In re LG Motors, Inc., 422 B.R. 110, 117  
11 (Bankr.N.D. Ill. 2009) and In re Brutsche, 476 B.R. 298, 307 n.15 (Bankr. D.N.M. 2012).<sup>11</sup>

12 \_\_\_\_\_  
13 <sup>9</sup> A loss to or diminution of the estate, however, should surprise no one. From day one,  
14 Lenders disclosed in its Schedules that it had only \$574.38 in its bank accounts, with its only  
15 other assets consisting of a \$12 million claim against St. Rose and a \$41,000 judgment against  
16 BB&T. No income producing assets were listed. The MORs filed by Lenders throughout the  
17 Chapter 11 proceeding have not shown any income to the estate, other than interest accrued after  
18 the Property was sold and the proceeds deposited into a segregated debtor in possession account.  
19 Although Lenders for some reason changed to a much abbreviated format for its MORs starting  
20 in December 2012, compare Lenders ECF No. 219 (November 2012) with Lenders ECF No. 227  
(December 2012), the court's review of the MORs filed to date merely confirms the UST's  
21 unsurprising estimate of the amount of professional fees paid to date. In this respect, most  
22 liquidating Chapter 11 proceedings are similar to disputes involving "burning candle" insurance  
23 policies where the funds available for payment of claims are consumed by the legal costs of  
24 adjudicating the validity of the claims.

21 <sup>10</sup> The court does not understand why the liquidation proposed in Lenders's latest Plan  
22 seemingly comes as a surprise to the UST. Even the initial plan filed by Lenders on April 2,  
23 2014, see note 4, supra, was a liquidating plan. Because the MORs filed by Lenders have never  
24 disclosed actual income other than interest from the Sale Proceeds, the court is bumfuzzled why  
the UST waited nearly two years after the initial plan was filed to assert that the case should be  
dismissed or converted for cause under Section 1112(b)(4)(A).

25 <sup>11</sup> Although the cases cited by the UST suggest that confirmation of a liquidating plan  
26 cannot constitute rehabilitation within the meaning of Section 1112(b)(4)(A), other courts  
disagree. See, e.g., In re McTiernan, 519 B.R. 860, 866 (Bankr. D.Wyo. 2014)("In determining

1 None of the cases cited by the UST is controlling, and none are particularly useful or  
2 persuasive under the circumstances of the instant case. More important, none of the creditors in  
3 the Lenders's bankruptcy proceeding support conversion of the case to Chapter 7, nor dismissal  
4 of the Chapter 11 case.<sup>12</sup> It is not difficult to understand why.

5 What happens if Lenders's Chapter 11 proceeding is converted? A chapter 7 trustee  
6 would be appointed to administer the Sale Proceeds. Assuming those proceeds are  
7 approximately \$12,000,000, the trustee's compensation would be up to \$383,250 under Section  
8 326(a).<sup>13</sup> Right off the bat, the actual stakeholders in this case lose a significant portion of the  
9 Sale Proceeds without receiving any substantive benefit. But before any distributions even take  
10 place, a Chapter 7 trustee likely would obtain counsel to assist in assessing the competing claims  
11 between Lenders, BB&T, Commonwealth, the Creditor Group, and RSIG.<sup>14</sup> Any counsel  
12 employed by a Chapter 7 trustee would be required to expend considerable time becoming

13 \_\_\_\_\_  
14 whether the debtor can rehabilitate, the court does not find that an interpretation of  
15 'rehabilitation' precludes liquidation under a chapter 11 bankruptcy case.''). There is no  
16 controlling decision in the Ninth Circuit.

17 <sup>12</sup> Where there is an actual choice to be made between conversion or dismissal, the  
18 common view is that "the creditors are the best judge of their own best interests." Arkansas, Inc.  
19 v. United States Trustee (In re Camden Ordinance Mfg. Co. of Arkansas, Inc.), 245 B.R. 794,  
20 802 (E.D. Pa. 2000). In this Chapter 11 proceeding, no committee of unsecured creditors was  
21 ever formed. As a result, there was no official creditors committee for the UST to poll before the  
22 Conversion Motion was filed. It certainly would have been useful, however, to have ascertained  
23 whether the real parties in interest favor conversion of the case before the instant motion was  
24 filed. The net effect of most well-intended but ill-conceived requests in highly contested  
25 proceedings is simply to increase legal expenses to all parties.

26 <sup>13</sup> Under Section 326(a), a Chapter 7 trustee could seek compensation based on 25% of  
the first \$5,000 (\$1,250), 10% of the next \$45,000 (\$4,500), 5% of the next \$950,000 (\$47,500),  
and 3% of the next \$11,000,000 (\$330,000), totaling \$383,250.

<sup>14</sup> Unlike a simple personal injury or contract claim for which a debtor's existing  
attorneys might be employed as special counsel by a Chapter 7 trustee, the attorneys most  
familiar with this prolonged legal dispute likely could not be employed as bankruptcy counsel  
for a trustee.

1 familiar with the evidentiary record underlying the factual disputes that separate the parties, as  
2 well as the status of the multiple appeals pending in the case. Given Lenders's position that its  
3 deed of trust against the Property had priority over the deed of trust of BB&T's predecessor in  
4 interest, and BB&T's position that substantive consolidation is required and would eliminate  
5 Lenders's claim against St. Rose, a Chapter 7 bankruptcy trustee would be hard pressed to find a  
6 middle ground for negotiation. Although Chapter 7 trustees typically exercise greater  
7 supervision than Chapter 11 debtors in possession over the fees generated by their bankruptcy  
8 counsel, a significant savings in legal expenses is unlikely because any trustee appointed in the  
9 Lenders proceeding is not assured of any greater concessions from the relevant parties in  
10 interest. Nothing about the history or circumstances of this case suggests that conversion to  
11 Chapter 7 is in the best interests of any of the creditors.

12 And what happens if Lenders's Chapter 11 proceeding is dismissed? A judgment  
13 previously was entered in State Court that included findings determining Lenders's claim to have  
14 priority over BB&T. See note 2, supra. The judgment also included findings that BB&T lacked  
15 standing to seek relief. The judgment was affirmed by the Nevada Supreme Court en banc and  
16 certiorari was denied by the U.S. Supreme Court. The judgment is final. If the Lenders's  
17 bankruptcy proceeding is dismissed, BB&T and Commonwealth likely will commence  
18 additional litigation in State Court seeking to prevent Lenders from distributing the Sale  
19 Proceeds to the many individuals and entities who loaned their personal funds to Lenders.  
20 Unless the State Court requires a sufficient bond to be posted, another relatively risk-free  
21 litigation cycle will commence in State Court,<sup>15</sup> subject to disputes concerning the issue and  
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23 <sup>15</sup> The Stay Motion previously brought by BB&T, joined by Commonwealth, sought to  
24 prevent Lenders from proceeding towards confirmation of its proposed Plan as long as their  
25 appeals of the Second Consolidation Order was pending. In opposition, Lenders and St. Rose  
26 demanded that security of at least \$2,480,000 be posted by BB&T and Commonwealth as a  
condition to any stay. See Stay Opposition at ¶¶ 29-32. That figure represented legal fees  
already incurred and anticipated, as well as interest lost to creditors from a lengthy delay in

1 claim preclusive effects of the previous rulings entered by the Nevada trial and appellate courts,  
2 this bankruptcy court, and the federal appellate courts.<sup>16</sup> Moreover, because dismissal of  
3 Lenders's bankruptcy proceeding will not necessarily terminate the appeal of the Second  
4 Consolidation Order, the litigants' resources and judicial resources are not likely to be  
5 conserved.<sup>17</sup> Just like conversion to Chapter 7, nothing about the history or circumstances of this  
6 case suggests that dismissal of the bankruptcy is in the best interests of the creditors.

7 In this instance, the UST has not demonstrated why conversion of the Chapter 11  
8 proceeding to Chapter 7 is preferable to simply dismissing the case. Additionally, the UST has  
9 not demonstrated that the appointment of a Chapter 11 trustee is a better alternative to dismissal.  
10 In fact, the UST does not even address what would happen if the Lenders Chapter 11 proceeding

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12  
13 distributions. BB&T and Commonwealth opposed any security requirement. See Stay Reply at 6:9 to 7:2.

14 <sup>16</sup> Under Section 349(b)(2), none of the prior orders entered in the Lenders's Chapter 11  
15 proceeding, including the Second Consolidation Order and multiple claim objection orders,  
16 would be vacated if the case is dismissed. The State Court, of course, would determine whether  
17 those orders are entitled to preclusive effect. An issue might arise under Section 349(b)(3),  
18 however, to the extent it requires property of the estate to be revested "in the entity in which  
19 such property was vested immediately before commencement of" the bankruptcy case.  
20 (Emphasis added.) 11 U.S.C. § 349(b)(3). The Sale Proceeds, as well as the underlying  
Property, were never property of the Lenders bankruptcy estate as of the commencement of the  
Lenders Chapter 11 proceeding. While Lenders acquired the Sale Proceeds post-petition as a  
result of the St. Rose confirmed plan, the language of Section 349(b)(3) may require those  
proceeds to be returned to St. Rose in the event of a dismissal.

21 <sup>17</sup> It is well established that substantive consolidation can be ordered between a  
22 bankruptcy debtor and a party or entity that is not in bankruptcy. See, e.g., Alexander v.  
23 Compton (In re Bonham), 229 F.3d 750 (9th Cir. 2000)(substantive consolidation ordered nunc  
24 pro tunc of bankruptcy estate of individual Chapter 7 debtor with two non-debtor closely held  
25 corporations); Clark's Crystal Springs Ranch v. Gugino (In re Clark), 548 B.R. 246 (B.A.P. 9th  
26 Cir. 2016)(substantive consolidation ordered nunc pro tunc of bankruptcy estate of individual  
Chapter 7 debtor with nondebtor limited liability company and nondebtor family trust). Under  
the current state of the law, dismissal of the Lenders bankruptcy case may or may not prevent  
BB&T and Commonwealth from continuing to seek to consolidate the revested debtor estate of  
St. Rose with the resulting non-debtor entity Lenders.

1 is dismissed so as to provide a basis for comparison of the alternatives available under Section  
2 1112(b)(1).

3 Even if the UST addressed the actual impact of its request, however, the court concludes  
4 that neither conversion nor dismissal of the Lenders Chapter 11 proceeding is in the “best  
5 interests of creditors and the estate” as required by Section 1112(b)(1). Instead, the alternatives  
6 provided by Section 1112(b)(1) would increase the burdens on the parties who actually have a  
7 financial stake in this proceeding without providing any corresponding benefit. Moreover, none  
8 of the alternatives are supported by any of the creditors in the case. Because these threshold  
9 requirements for relief under Section 1112(b)(1) have not been met, it is unnecessary for this  
10 court to address whether the requirements under Section 1112(b)(2) can be satisfied.

11 **IT IS THEREFORE ORDERED** that the Motion of United States Trustee, Pursuant to  
12 11 U.S.C. § 1112(b) and Federal Rules of Bankruptcy Procedure 1017(f) and 9014, to Convert or  
13 Dismiss Chapter 11 Case, Docket No. 748, be, and the same hereby is, **DENIED**.

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15 Copies sent to all parties via BNC and via CM/ECF ELECTRONIC FILING

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