Honorable Mike K. Nakagawa
United States Bankruptcy Judge

Entered on Docket
January 11, 2022

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

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In re:	Case No.: 19-14796-MKN
	Chapter 11
GYPSUM RESOURCES MATERIALS, LLC,	
	Jointly Administered with
☐ Affects Gypsum Resources Materials, LLC	Case No.: 19-14799-MKN
☐ Affects Gypsum Resources, LLC	
☒ Affects All Debtors	
Debtors.	
GYPSUM RESOURCES, LLC, a Nevada limited liability company; and GYPSUM RESOURCES MATERIALS, LLC, a Nevada limited liability company,	Adv. Proc. No. 19-01083-MKN
	Date: December 13, 2021
	Time: 9:30 p.m.
Plaintiffs,	
vs.	
REP-CLARK, LLC, a Colorado limited liability company,	
Defendant.	

MEMORANDUM DECISION AFTER TRIAL[1]

[1] In this Memorandum Decision, all references to "ECF No." are to the number assigned to the documents filed in the above-captioned bankruptcy case as they appear on the docket maintained by the clerk of court. All references of "AECF No." are to the documents filed in the above-captioned adversary proceeding. All references to "Section" are to the provisions of the Bankruptcy Code. All references to "Bankruptcy Rule" are to the Federal Rules of Bankruptcy Procedure. All references to "Civil Rule" are to the Federal Rules of Civil Procedure. All references to "FRE" are to the Federal Rules of Evidence.

On December 13, 2021, a trial was conducted in the above-captioned adversary proceeding. The appearances of counsel were noted on the record. After the close of evidence and the presentation of final arguments by counsel, the matter was taken under submission.

This Memorandum Decision constitutes the court's findings of fact and conclusions of law pursuant to Civil Rule 52 and Bankruptcy Rule 7052. Any finding of fact determined to be a conclusion of law is deemed to be a conclusion of law; any conclusion of law determined to be a finding of fact.

BACKGROUND

On July 26, 2019, Debtors[2] filed a voluntary Chapter 11 petition in this bankruptcy court. (ECF No. 1).[3]

On August 9, 2019, Debtors filed a complaint commencing the above-captioned adversary proceeding ("Adversary Complaint"). (AECF No. 1). That complaint alleges a single claim seeking declaratory relief with respect to a certain "Mining Lease Agreement" executed on or about February 12, 2018, between the Debtors and defendant Rep-Clark, LLC ("Defendant"). That Mining Lease Agreement was executed pursuant to a "Gypsum Reserves Agreement and Joint Escrow Instructions" ("Reserves Agreement") between the same parties, that had been executed on or about February 8, 2018. Debtors seek a judgment declaring the Mining Lease

[2] A voluntary Chapter 11 proceeding was commenced by Gypsum Resources Materials, LLC ("GRM"), denominated Case No. 19-14796-MKN. A related Chapter 11 proceeding was commenced by Gypsum Resources, LLC, denominated Case No. 19-14799-MKN. The two cases are jointly administered but not substantively consolidated. Where appropriate in this Memorandum Decision, the two Chapter 11 debtors are referred to jointly as the "Debtors."

[3] Prior to the trial, Debtors had filed a proposed amended Chapter 11 plan of reorganization ("Proposed Plan") that addresses, *inter alia*, the claims of the Defendant in this adversary proceeding. (ECF No. 1662). A disclosure statement ("Disclosure Statement") in support of that Proposed Plan also was filed by the Debtors. (ECF No. 1664). Because the outcome of this adversary proceeding impacts the treatment of Defendant's claims under any proposed plan, a stipulated order was entered on November 19, 2021, continuing the hearing on the plan confirmation to March 28 and 29, 2022. (ECF No. 1747).

Agreement to reflect a secured financing transaction between the Debtors and the Defendant, rather than a true lease.[4]

On August 26, 2019, Debtors filed separate schedules of assets and liabilities, as well as separate statements of financial affairs ("SOFA"). (ECF Nos. 104, 105, 106, and 107). The Mining Lease Agreement was not scheduled by the Debtors as an unexpired lease of residential or non-residential real property.

On November 8, 2019, Defendant filed an answer to the Adversary Complaint. (AECF No. 22).

On October 14, 2021, Debtors filed a motion to determine the value of certain collateral securing the proofs of claim filed by the Defendant in the Chapter 11 proceeding ("Valuation Motion"). (ECF No. 1675).[5]

On November 8, 2021, an order was entered denying separate motions for summary judgment filed by the parties ("SJ Order").[6] (AECF No. 172).[7]

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[4] In the event that the Mining Lease Agreement is an unexpired lease or executory contract, Section 365 provides different rights and responsibilities, including the ability of a debtor in possession to assume or reject such a lease or executory contract. A rejection essentially relieves a debtor in possession from future performance but still requires the payment of rejection damages as a pre-bankruptcy unsecured claim. In the event the Mining Lease Agreement is part of a secured financing transaction, Section 506 will govern the allowance of secured and unsecured claims, and Section 1129 will govern the treatment of such secured and unsecured claims in a proposed Chapter 11 plan. Section 1111(b) permits certain creditors having secured and unsecured claims to elect specific treatment of their claims as long as the election is made by a specific deadline.

[5] The hearing on the Valuation Motion initially was noticed to be held on November 17, 2021, but has been continued on several occasions. As of the date of trial in this adversary proceeding, the hearing is scheduled for March 28 and 29, 2022, concurrently with plan confirmation. (ECF No. 1747).

[6] The same order also denied without prejudice the Debtors' related motion to strike the testimony and report of Defendant's proposed expert, Thomas P. Erwin ("Erwin"). The motion was not renewed prior to trial and neither party has objected to the court's consideration of Erwin's report, nor the rebuttal report of Debtor's expert, John C. Lacy ("Lacy").

[7] Denial of summary judgment required trial of any disputed issues of material fact. As the parties are familiar with the legal framework applicable in this adversary proceeding, the

On November 19, 2021, counsel for the parties filed a joint pretrial statement. (AECF No. 182).

On December 8, 2021, counsel for the parties filed an amended joint pretrial statement ("Pretrial Statement").[8] (AECF No. 187).

THE UNCONTESTED FACTS

In addition to agreeing to the court's jurisdiction to resolve this matter, the parties also agreed to a lengthy set of facts surrounding the Mining Lease Agreement and Reserves Agreement. The parties request that such facts be treated as established without further proof, and that request is granted. Because the parties are familiar with those facts, see Pretrial Statement at ¶¶ 1 through 56, they will not be repeated here.

The parties further identify as "disputed facts," however, the opinions articulated by their respective experts, Erwin and Lacy. The opinions of Erwin on behalf of the Debtors and Lacy on behalf of the Defendant are set forth in separate expert reports admitted as Trial Exhibits 18 ("Erwin Report") and 19 ("Lacy Report"), respectively.[9]

THE EVIDENCE ADMITTED AT TRIAL[10]

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discussion contained in the SJ Order is fully incorporated into this Memorandum Decision and will not be repeated here.

[8] Exhibit 2 to the Pretrial Statement is a list of joint exhibits that the parties stipulated to admit into evidence ("Trial Exhibit(s)").

[9] The opinions do not appear to be factual statements at all as both Erwin and Lacy acknowledge that they simply reviewed the allegations of the Adversary Complaint and various transactional documents. Lacy also reviewed Erwin's report. Neither were involved in the transaction and do not appear to have any personal knowledge. In other words, their differences of opinion are not factual disputes.

[10] Pursuant to FRE 201(b), judicial notice may be taken of any materials appearing on the docket of the Chapter 11 proceedings as well as the instant adversary proceeding. See U.S. v. Wilson, 631 F.2d 118, 119 (9th Cir. 1980); Lawson v. Klondex Mines Ltd., 2020 WL 1557468, at *5 (D. Nev. March 31, 2020); Bank of Am., N.A. v. CD-04, Inc. (In re Owner Mgmt. Serv., LLC Trustee Corps.), 530 B.R. 711, 717 (Bankr. C.D. Cal. 2015).

In addition to the aforementioned agreed set of facts, the parties also agreed to the admission of thirty-one separate Trial Exhibits, most of which were submitted in connection with the prior summary judgment motions. In addition to the Mining Lease Agreement (Trial Exhibit 4), the exhibits include the Reserves Agreement (Trial Exhibit 1), a certain Mining Claims Grant Bargain and Sale Deed and Deed of Trust ("Mining Deed") (Trial Exhibit 6), a Memorandum of Land Royalty Agreement,[11] and a separate Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing for three different types of payment required by the Reserves Agreement (Trial Exhibits 7, 8, and 9). Among those exhibits are additional trial declarations of the Debtors' principal, James M. Rhodes ("Rhodes") (Trial Exhibit 31) and Defendants' representative, Byron Levkulich ("Levkulich") (Trial Exhibit 30).[12]

The declarations of Rhodes and Levkulich were admitted into evidence as the direct testimony of each witness. Both were subject to live cross-examination at trial. No other witnesses were offered or called at trial, and no other live witness testimony was admitted.

DISCUSSION

The SJ Order describes the relief sought by the Debtors and is incorporated in this memorandum by reference. Debtors seek a declaration "that the purported mining lease be recharacterized as secured financing and thus not subject to election under Section 365(d)." SJ Order at 6:19-21; Pretrial Statement at 9:26-28.[13] Debtors seek to treat the Mining Lease

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[11] The Memorandum of Land Royalty Agreement is admitted into evidence as Trial Exhibit 5, but a copy of the Land Royalty Agreement itself was not attached to that exhibit. A copy of the entire Land Royalty Agreement was attached as Exhibit 15 to the Defendant's documents filed in connection with the summary judgment motions. (AECF No. 140). The court takes judicial notice of that copy.

[12] Like the prior summary judgment motions, scattered among the stipulated trial exhibits are excerpts from the transcripts of various depositions of certain party representatives and witnesses, including Lacy, Erwin, Levkulich and Rhodes. (Trial Exhibits 20, 21, 22 and 23). Certain other discovery-related materials are included. The record also consists of copies of various non-testimonial documents that contain statements and representations attributable to representatives of the parties as well as others.

[13] Section 365(d)(4) addresses the timing for a trustee or debtor in possession to elect to assume or reject an unexpired lease of nonresidential real property. If the Mining Lease

Agreement as a secured financing transaction giving rise to a secured claim allowed under Section 506(a),[14] rather than an executory contract or unexpired lease governed by Section 365.[15] As the party seeking the recharacterization remedy the burden of proof, of course, rests upon the Debtors. See, e.g., Duke Energy Royal v. Pillowtex Corp. (In re Pillowtex, Inc.), 349 F.3d 711, 716-17 n. 6 (3rd Cir. 2003) (energy-saving equipment lease as secured financing arrangement); Ford Motor Credit v. Lasting Impressions Landscape Contractors, Inc. (In re Lasting Impressions Landscape Contractors, Inc.), 579 B.R. 43, 51 (Bankr. D. Md. 2017) (master truck leasing agreement as secured financing arrangements); WorldCom, Inc. v. General Electric Global Asset

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Agreement constitutes secured financing rather than an unexpired lease, then Section 365 simply does not apply. Moreover, in the event the Mining Lease Agreement is recharacterized as secured financing, the parties have agreed that the deadline for Defendant to elect to treat its entire claim as secured under Section 1111(b)(2), if at all, expires ten days after entry of a final judgment in this adversary proceeding.

[14] Under Section 506(a), secured claims generally are allowed as secured in the amount of the value of the creditor's collateral, with the amount of the claim exceeding the value of the collateral allowed as unsecured. Generally, secured and unsecured claims must be classified separately in a proposed Chapter 11 plan, see 11 U.S.C. §1122(a), and must be treated differently in any proposed plan. See 11 U.S.C. §1123(a)(1). As previously mentioned in note 4, supra, secured creditors may elect to have their entire claim treated as secured even if they otherwise would have an allowed unsecured portion under Section 506(a).

[15] As previously suggested in note 4, supra, under Section 365(a), a Chapter 11 debtor in possession may, with court approval, assume or reject any executory contract or unexpired lease of the debtor. In approving a decision to assume or reject an executory contract or unexpired lease in Chapter 11, the bankruptcy court typically gives deference to the business judgment of management. See Mission Product Holdings, Inc. v. Tempnology, LLC, 139 S.Ct. 1652, 1658 (2019). Until a management decision is made, specific obligations are imposed by Sections 365(d)(3) and 365(d)(4) with respect to unexpired leases of nonresidential real property. In particular, Section 365(d)(4) requires management to make the decision within 60 days after the case is commenced or such additional time permitted by the court. Moreover, if the decision is not made before the deadline, the debtor in possession must surrender the property to the lessor. Under Section 365(g)(1), the rejection of an executory contract or unexpired lease of property constitutes a breach of the contract or lease immediately before the date of the filing of the bankruptcy petition. Under Section 502(g)(1), a claim arising from the rejection of an executory contract or unexpired lease is determined and allowed as if the claim had arisen before the date of filing the bankruptcy petition. Rejection of an executory contract or unexpired lease, however, does not result in a rescission or termination of such contract or lease. See Mission Product Holdings, 139 S.Ct. at 1661.

Mgmt. Svcs. (In re WorldCom, Inc.), 339 B.R. 56, 62 (Bankr. S.D. N.Y. 2006) (telecommunications equipment lease a disguised security agreement). See also Huntington Technology Finance, Inv. v. Neff, 2020 WL 1430092, at *10 (D. Conn. Mar. 24, 2020) (non-bankruptcy recharacterization of lease agreement for multimedia advertising sign). The standard of proof ordinarily applied in bankruptcy proceedings is the preponderance of the evidence. See generally Grogan v. Garner, 498 U.S. 279, 286 (1991).

Defendant opposes such relief and maintains that the Mining Lease Agreement is an unexpired lease of nonresidential real property that is subject to the assumption and rejection requirements of Section 365. In addition to the requirements applicable during the pendency of a Chapter 11 proceeding, secured claims and unexpired leases may be treated differently in Chapter 11 plans. See generally 7 COLLIER ON BANKRUPTCY, ¶¶ 1123.02[1] and 1123.02[2] (Richard Levin and Henry J. Sommer, eds., 16th ed. 2021).[16] Both sides agree that recharacterization of a pre-bankruptcy transaction is permitted by the Ninth Circuit's decision in City of San Francisco Market Corp. v. Walsh (In re Moreggia & Sons, Inc.), 852 F.2d 1179 (9th Cir. 1988), that was issued two years after the Second Circuit's decision in Liona Corp., N.V. v. PCH Associates (In re PCH Associates), 804 F.2d 193 (2nd Cir. 1986). The parties disagree, however, on whether the relief afforded in those two cases is appropriate under the facts of this case.

I. The Decisions in Moreggia & Sons and PCH Associates.

The Second Circuit's decision in PCH Associates was issued in 1986 and was discussed significantly by the Ninth Circuit two years later when it issued the Moreggia & Sons decision.

A. PCH Associates.

[16] For example, while a Chapter 11 case is pending, a secured creditor's interest in the property securing its claim typically constitutes "cash collateral" that is protected by Section 363(b) or which may be subject to adequate protection requirements by application of Section 362(d). Similarly, where a debtor is a party to an executory contract or an unexpired lease when a bankruptcy is commenced, Section 365 sets forth postbankruptcy performance requirements, assumption and rejection deadlines, and continuing obligations.

In PCH Associates, the bankruptcy debtor was a limited partnership that had a sale-lease-back arrangement for a hotel. Prior to filing for Chapter 11, the debtor sold the underlying land but leased the land to continue operation of the hotel. The contemporaneous "sale leaseback agreement" and "ground lease" were in effect at the time the bankruptcy petition was filed. In response to the lessor's efforts to compel the debtor to make rent payments pursuant to Section 365(d)(3), the debtor commenced an adversary proceeding to declare that the parties had a joint venture or financing transaction, rather than a lease of nonresidential real property. If the debtor was unable to retain possession of the underlying land pursuant to the ground lease, it would not be able to operate the hotel.

The bankruptcy court[17] and the district court on appeal concluded that the ground lease in PCH Associates was a joint venture to which the requirements of Section 365(d) did not apply. The Second Circuit panel also concluded that the requirements of Section 365(d) did not apply, but did not construe or recharacterize the transaction as a particular form of agreement. Instead, the circuit panel concluded only that the ground lease was not a "true" or "bona fide" lease to which Section 365(d) would apply. The Second Circuit observed that "Based on the circumstances of the negotiations and economic substance of the transaction, it was not error to conclude that the parties intended to impose obligations and confer rights significantly different from those arising from the ordinary landlord/tenant relationship." 804 F.2d at 200. The panel gave several reasons for its conclusion that a bona fide lease did not exist: (1) the amount of rent was structured to assure a return on investment rather than to compensate for the use of the land; (2) the sale price of the land was not based on market value but to obtain investors to finance the lessor's purchase from the debtor; (3) the debtor initiated the entire transaction rather than the lessor; (4) the debtor assumed the lessor's obligation to pay property taxes and insurance on the land; (5) both the debtor and the lessor could choose to refinance the existing obligations against the land and the hotel; and (6) the lessor would retain an interest only in the net profits from the hotel, rather than continue to be paid rent, in the event that landlord was paid its original

[17] The bankruptcy court decision in PCH Associates is reported at 55 B.R. 273 (Bankr. S.D. N.Y. 1985).

investment amount. Id. at 200-201. Based its conclusion that no true or bona fide lease existed, the Second Circuit held that Section 365(d) should not be applied to the transaction.[18]

B. Moreggia & Sons.

In Moreggia & Sons, the bankruptcy debtor was the assignee of a long-term lease of two retail spaces in a produce terminal. In addition to the debtor, the terminal included multiple businesses that had been displaced by a city-wide redevelopment project. The produce terminal was owned and operated by a non-profit corporation. Construction of the terminal was financed by the issuance of corporate bonds. Base rent for the retail spaces was calculated to pay off the bonds and the base rent obligation ceased when the bonds were retired. All of the businesses, including the debtor, were subject to a variety of common obligations. Those obligations included payment of parking, utility charges and taxes assessed against the non-profit corporation, payment of excess costs, preparation of yearly operating budgets, payment of repair and maintenance expenses, payment of association membership fees, and payment of applicable liability, property damage and worker's compensation insurance.

After its base rent obligation expired, the debtor in Moreggia & Sons filed for Chapter 11 but confirmation of its proposed plan of reorganization was denied. When the case was converted to Chapter 7, the bankruptcy trustee attempted to assume and assign the debtor's rights in the two retail spaces. The non-profit corporation argued that the two retail spaces were nonresidential real property leasehold interests that were subject to the requirements of Section 365(d)(4). Because the leasehold interests had not been assumed by the 60-day deadline set forth in Section 365(d)(4), the non-profit corporation asserted that the debtor's interest in the two retail spaces had elapsed and could not be assigned. As a result, the non-profit maintained that Section 365(d)(4) required the Chapter 7 trustee to surrender the two retail spaces. If the Chapter 7 trust

[18] The Second Circuit in PCH Associates declined to affix its own label to the transaction before it, but observed as follows: "It is unnecessary, therefore, to identify the transaction as a joint venture, security agreement, subordinated financing, or other investment scheme. Suffice it to say that it is not a bona fide lease for purposes of the Bankruptcy Code." 804 F.2d at 199. Reaching an "I know what it isn't" conclusion, of course, is no more instructive than applying an "I know it when I see it" test. Perhaps the term recharacterization itself is a misnomer when the outcome of the dispute does not even require a transaction to be given a different label.

was unable to retain the interest in the two retail spaces, he would not have been able to assume and assign the leasehold interests to a third party to generate funds to pay creditors.

The bankruptcy court, the district court on appeal, and the Ninth Circuit panel in Moreggia & Sons all concluded that the debtor's interest in the two retail spaces was not an unexpired lease of nonresidential real property subject to Section 365(d)(4). That conclusion was reached despite language in the subject agreement typical of a lease transaction, e.g., "lease," "landlord," and "rent."[19] In determining whether Section 365 should be applied to the parties' transaction regardless of the language they used, the Moreggia & Sons panel discussed four considerations: (1) the intention of the parties to enter into a typical landlord/tenant relationship, (2) whether executory burdens still existed, (3) whether Congress's purpose for the assumption or rejection deadline would be served, and (4) whether equitable considerations militate against a forfeiture of the debtor's interest through enforcement of the deadline. 852 F.2d at 1184-86. Based on these considerations, the Ninth Circuit concluded that the deadline under Section 365(d)(4) should not be applied to the debtor's interest in the two retail spaces.[20]

II. The Circumstances in PCH Associates and Moreggia & Sons Are Distinguishable From the Case Before This Court.

[19] As this court noted in the SJ Order, the pre-bankruptcy document at issue in Moreggia & Sons was labeled by the parties as a "Lease" but the parties apparently agreed that words in the document such as "landlord, lease and rent" were not "reflective of the true nature of the Agreement." 852 F.2d at 1180 n.1. There is no similar agreement between the Debtors and the Defendant in this dispute. In other words, the instant parties do not agree at all that the Mining Lease Agreement should be recharacterized.

[20] Like the Second Circuit in PCH Associates, the Ninth Circuit panel in Moreggia & Sons declined to actually label the transaction before it: "We interpret Section 365(d)(4) to apply only to true or bonafide lease situations. *See In re PCH Associates*, 804 F.2d 193, 198 (2nd Cir. 1986)…Simply because this interest is not easily characterized as a security arrangement, a joint venture, a sale and leaseback, or other common financing scheme, does not compel the conclusion that it is a lease subject to the strictures of section 365. *PCH Associates*, 804 F.2d at 198." 852 F.2d at 1186.

At trial, Debtors rely primarily on PCH Associates and Moreggia & Sons but neither decision involved facts that are substantially similar to the instant case.[21] Differences between the facts in those cases and the current case, however, are significant.

In the current case, the Debtors' business has included a gypsum mining operation on real property located in Clark County, Nevada. The business also includes the Debtors' desire to develop the surface of the same real property for residential units. The parties stipulate that in February 2018, pursuant to the Reserves Agreement, Debtors sold two assets to the Defendant: (1) the mining claims, i.e., sub-surface mineral rights underlying certain real property while reserving the surface rights in the same property to the Debtors[22]; and (2) a monetary interest in the form of royalties from the sale of parcels from the Debtors' development of certain real property. The parties also stipulated that these two assets were sold by the Debtors to the Defendant for a purchase price of $30 million.[23] As to the first asset, the parties entered into the Mining Lease Agreement so that the Debtors could continue to extract the minerals from the same real property, in exchange of the payment of royalties from the Debtors' sale of minerals obtained through the mining operation. The Mining Lease Agreement also includes a provision for a compensatory royalty to be paid in the event of the Debtors' early termination of mining

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[21] To a lesser degree, Debtors also referred to the bankruptcy court decision in In re Independence Village, Inc., 52 B.R. 715 (Bankr. E.D. Mich. 1985), which was cited in PCH Associates, 804 F.2d at 200, as well as in Moreggia & Sons, 852 F.2d at 1183. In the Independence Village decision, however, even the representatives of the ostensible landlord testified that it was never that party's intention to be a lessor of the subject property. 52 B.R. at 718.

[22] The mining claims are located on the following parcels of real property: Assessor's Parcel Nos. 175-05-601-001, 175-05-501-001, 175-05-101-001, 164-32-301-001, 164-32-701-001, 164-32-801-001, 164-32-201-001,164-32-201-002, 164-32-601-001, 164-32-501-001, 164-33-001-002, 164-31-201-001, 165-36-000-004, 165-25-000-004, 164-30-301-001, 165-25-000-003, 164-30-201-001, 165-24-000-003, 164-29-000-002, 164-29-000-001, and 164-20-000-002. See Exhibit "A" to Mining Deed. See also Valuation Motion at 3 n.2.

[23] The parties stipulated that Debtors' desire to sell the sub-surface rights to the real property was for the purpose of paying off old debts and to develop real property into residential housing.

operations that does not pay the full amount of the royalties contemplated by the agreement. The Mining Lease Agreement also includes a provision allowing the Debtors to request reconveyance of the remaining mining claims upon full satisfaction of royalty payments required by the agreement.[24] As to the second asset, the parties entered into the separate Land Royalty Agreement by which Defendant would be paid, as a royalty, a fixed percentage or minimum dollar amount per acre from the gross proceeds from the Debtors' development and sale of residential units. The obligation to pay the royalties under the Land Royalty Agreement was secured by specific parcels of real property.[25] The obligation apparently continues until the Debtors complete the sale of residential units on the real property securing the Land Royalty Agreement.[26]

The reasons articulated in PCH Associates are not present in the instant case. As discussed below, Debtors have offered limited evidence addressing the intention of the parties to the Mining Lease Agreement, while Defendant's evidence expressly rejects any suggestion that the parties intended to enter into a secured loan transaction as now requested by the Debtors. But beyond this threshold inquiry, no evidence suggests that the rent charged for the Debtors' extraction of minerals under the Mining Lease Agreement, in the form of royalty payments, is

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[24] If the Debtors extract all of the minerals encompassed by the mining claims that were sold, it appears that the Defendant would have no reason to retain the subject real property because the sub-surface rights it purchased would have little or no further remaining value. The reconveyance option under Mining Lease Agreement permits the Debtors to seek to reunite the sub-surface rights with the surface rights once the Defendant realizes the full investment value of the mining claims.

[25] Exhibit "C" to the Reserves Agreement designates 351.96 acres of real property as securing the obligations under the Land Royalty Agreement. Debtors acknowledge that those parcels of real property consist of Assessor's Parcel Nos. 164-30-201-001, 164-30-301-001, 164-30-301-003, 164-30-401-001, 164-30-401-003, 164-30-401-004, 164-30-401-005, 164-31-101-001, 164-31-101-003, 164-31-101-004, 164-31-201-001, 165-25-000-003, 165-25-000-004, 165-36-000-003, and 165-36-000-004. See Valuation Motion at 6:7-17.

[26] Assessor's Parcel Nos. 164-30-201-001, 164-30-301-001, 165-25-000-003, 165-25-000-004, and 165-36-000-004 apparently encompass the sub-surface mining claims sold to the Defendant, as well a part of the acreage securing the Debtors' obligation under the Land Royalty Agreement.

not designed as actual and reasonable compensation for the value of the Debtors' use of the real property. After all, no evidence is presented that the minerals removed from the real property somehow will regenerate, or that removal of the minerals will not diminish the value of the real property. Moreover, no one suggests that the Debtors were prevented from conducting mining operations on other properties where comparable mineral deposits might be found. While the Debtors may have been stuck between a rock and a hard place financially and figuratively,[27] no evidence suggests that they were required to continue their mining operation at all in lieu of devoting their efforts at residential development of real property surface rights. Debtors also have not demonstrated that the $30 million sale price was outside the expected range of market value at the time the real property was sold to the Defendant under the Reserves Agreement.[28] No one disputes that Defendant contacted the Debtors to explore a transaction rather than Debtors initiating the contact. Debtors offer no testimony or other evidence inferring that they agreed to pay property taxes and insurance on the understanding that it was required as part of a secured loan. Additionally, there is no mutual ability of the parties to refinance the obligations, if any, that encumber the surface rights or sub-surface rights to the real property. The minerals produced from the Debtors' operation under the Mining Lease Agreement are used to pay royalties to the Defendant that function as rent under a mining lease. By contrast, the royalties paid from the sale of residential units separately arise from the Land Royalty Agreement and are separate from the Mining Lease Agreement.

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[27] As referenced in note 23, supra, Debtors sold the sub-surface rights to pay off old debt and to retain the surface rights for potential residential development. It is not clear what "old debt" needed to be paid by the Debtors that led to their interest in a transaction with the Defendant. A bankruptcy filing preceded by obtaining substantial funds to pay old debt ordinarily raises questions as to whether such prepetition payments are recoverable from the transferees under Section 550 through the avoiding powers in bankruptcy. The two-year deadline for commencing avoidance actions would have commenced on the Debtors' petition date of July 26, 2019. Items 3 and 4 of the SOFA for GRM discloses numerous prepetition payments within 90 days and 1 year of the petition date made to both non-insiders and insiders of GRM. It is not clear whether such payments were made from the proceeds of the sale of the mining claims to the Defendant or from other sources.

[28] The trial court in PCH Associates found it undisputed that the value of the underlying land purchased by the lessor was unrelated to the amount of the investment. 55 B.R. at 276.

The considerations examined in Moreggia & Sons have limited application in this case. On its face, Moreggia & Sons simply did not involve the ownership of real property having severable components of value, i.e., surface rights that could be developed into marketable residential units, and separate rights to sub-surface minerals that could be extracted for sale. Both values can be realized by the respective owners of such rights unlike the occupants of two discrete retail spaces located in a common produce terminal. Debtors have offered little evidence addressing the mutual intentions of the parties to the Mining Lease Agreement, while Defendant's evidence expressly rejects any suggestion that the parties intended to enter into a secured loan transaction as now requested by the Debtors. Executory burdens still exist because the Debtors continue to conduct mining operations with attendant obligations going both ways. Congress' deadline for assumption or rejection of an unexpired lease of nonresidential real property is of limited relevance in a situation involving only two sophisticated parties rather than multiple tenants in a retail shopping complex. The legislative purpose for that deadline neither favors nor disfavors the relief requested. A forfeiture of the Debtors' interest in the Mining Lease Agreement has neither occurred nor is required to occur in light of the election to assume or reject that is still available to the Debtors. More important, Debtors have not suggested that forfeiture of the Mining Lease Agreement will prevent them from completing a successful Chapter 11 reorganization.[29]

While the facts of every case are different, the circumstances in Moreggia & Sons as well as PCH Associates are not similar enough to direct an outcome in the current case.

III. The Economic Substance of the Instant Transaction Does Not Warrant Recharacterization of the Mining Lease Agreement.

It is easy enough, of course, to distinguish virtually every case from a separate case on their facts. The instant case is no different. The court having considered the entire record,

[29] The same could not be said for the Chapter 11 reorganization efforts of the debtor in possession in PCH Associates, nor with respect to the Chapter 7 trustee's efforts in Moreggia & Sons to obtain value from the assignment of the two retail spaces.

including the live witness testimony, however, concludes that the Debtors have not met their burden of proof at trial in this particular case.

First, the weight of the percipient witness testimony favors the Defendant. In the SJ Order, the court previously indicated that evidence of the intention between the parties to the Mining Lease Agreement would be critical in determining whether the relief requested by the Debtors is appropriate. See SJ Order at 11:7-16.[30] At trial, Levkulich testified that he was the exclusive negotiator for the Defendant and the Defendant always intended to enter into an investment transaction. Lekvulich also testified that in negotiating the Mining Lease Agreement with the Defendant, Debtors were represented primarily by Jaron Lukasiewicz ("Lukasiewicz"), an officer of the Rhodes Corporation. Levkulich testified that he specifically rejected the Debtors' efforts to enter into a secured loan transaction. Although Rhodes was the ultimate decisionmaker for the Debtors, Levkulich testified that all of his primary communications took place through Lukasiewicz. Levkulich's description of the negotiation process was corroborated by Rhodes' testimony at trial. As to the parties' intentions when entering into the Mining Lease Agreement, Rhodes could not point to any written communications by email or otherwise inferring an intention to enter into a loan transaction.[31] When pressed in his prior deposition to

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[30] The integration clauses contained in the Mining Lease Agreement, Reserves Agreement, and Land Royalty Agreement previously were discussed by the court. See SJ Order at 7-8 ns. 12, 13, and 14. If this was strictly a question of Nevada law, parol evidence likely would not be admissible to contradict the terms of the agreements as written. See NetBank, FSB v. Kipperman (In re Commercial Money Center, Inc.), 350 B.R. 465, 481-82 (B.A.P. 9th Cir. 2006). The recharacterization analysis, however, appears to assume that the intentions of the parties not expressed in the four corners of the subject documents may be considered or surmised in determining whether to grant equitable relief in bankruptcy.

[31] An email from Lukasiewicz to Levkulich dated April 25, 2017, appears to confirm that Rhodes had agreed to enter into an investment transaction with the Defendant rather than a loan transaction: "On a positive note, I can tell you that Jim [Rhodes] would prefer to move forward on a royalty deal like the one we're discussing versus a debt deal." (Trial Exhibit 13). On cross-examination, Rhodes was specifically asked about this email sent by the Debtors' representative but had no recollection of it. As there was no re-direct examination, Rhodes offered no testimony that Lukasiewicz incorrectly represented the intentions or understandings of the Debtors.

identify any email or written communication supporting Debtors' interpretation of the transaction, Rhodes could not do so.[32] More important, Lukasiewicz was never called as a witness and never testified at trial. In other words, the preponderance of the evidence in the record only supports the intention of the Defendant consistent with the Mining Lease Agreement being part of an investment transaction rather than a secured lending transaction.[33] Debtors have failed to meet their burden of proving a contrary intention.[34]

Second, the weight of the expert testimony favors the Defendant. As previously mentioned, the Strike Motion was not renewed prior to trial and the parties agreed to the court's consideration of the expert reports of both Erwin and Lacy. Neither are percipient witnesses but the Debtors and Defendant apparently agree that both qualify as expert witnesses under FRE

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[32] Rhodes' deposition was taken on June 29, 2021, and the reporter's transcript was admitted into evidence. Both in the deposition and at trial, Rhodes attested that he does not use email. He also testified in his deposition that Lukasiewicz and the in-house counsel who worked on the transaction with the Defendant no longer work for the Debtors. Although email is a common and accepted means of communication in business and non-business matters, Rhodes frequently testified at trial and in his deposition that he had no recollection of the emails and other documents admitted into evidence. In his deposition, he also could not identify the date or details of conversations that he had with Levkulich where they might have agreed to a loan transaction in lieu of an investment transaction. By contrast, Levkulich testified without contradiction that he was the exclusive negotiator on behalf of the Defendant and he credibly addressed the context of each email communication admitted into evidence as well as the purpose of each provision in the transactional documents. Debtors' failure to present testimony from Lukasiewicz or their in-house counsel, or a contemporaneous record of Rhodes' involvement and communication in negotiating the transaction, seriously undermines their ability to meet their burden of proof.

[33] Levkulich testified that Defendant sought an investment acquisition rather than a loan transaction because of Rhodes' history of using bankruptcy to alter the treatment of creditors' secured claims. Because the Land Royalty Agreement results in a secured claim to which cramdown is requested in the Proposed Plan, however, Defendant's desire to entirely escape such treatment apparently has been thwarted.

[34] In connection with the summary judgment motions, the court previously noted the absence of affidavits or declarations from the parties' respective legal counsel who prepared the Mining Lease Agreement, Reserves Agreement, and other related documents. See SJ Order at 12 n.21. Thus, there is no evidence to suggest that legal counsel were aware of any intentions of the parties not expressed in the actual documents.

702. Neither do the parties object to consideration of such expert testimony to the extent it would assist in understanding the evidence otherwise before the court. See FED.R.EVID. 702(a) ("A witness who is qualified as an expert…may testify in the form of an opinion or otherwise if…the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue…"). As to whether the testimony assists in understanding the Mining Lease Agreement along with the related documents, however, Debtors' expert offers noncommittal testimony at best. Lacy's report states in pertinent part:

> My view is that the Reserves Agreement, the Mining Lease, the Royalty Agreement, the Deeds of Trust and the Guaranty of Mining Lease (referred to collectively in this report as the "Arrangement") are an integrated transaction that appears to be a form of investment with guarantees of return. It may also have been motivated by factors, not the least of which could be to secure favorable tax treatment to the parties. I would not disagree with the conclusion expressed in the Complaint for Declaratory Relief that the transaction could be characterized as a form of financing…

Lacy Report at 1-2 (emphasis added). An expert "not disagreeing" with what a transaction "could be characterized as" is of little if any assistance to the court in understanding the evidence in the record. By contrast, Defendant's expert addresses each challenged aspect of the transaction identified by the Debtors, see Adversary Complaint at ¶¶ 25(a) through (g), suggesting that none of them warrant relief from the provisions of the Mining Lease Agreement or any of the related agreements. See Erwin Report at 4-8.[35] Unfortunately, neither expert was called to testify at trial and were not available for cross-examination to explain their opinions. Obviously, the court cannot and does not give weight to their opinions as to any ultimate

[35] Erwin and Lacy differ in their opinions with respect to the interpretation of the Mining Lease Agreement in conjunction with all related agreements, the import of a certain compensatory royalty, and the purpose of a reconveyance option. See Exhibit "1" to Pretrial Statement. The compensatory royalty is an amount that the Debtors must pay the Defendant in the event that the Debtor does not complete mining of all the minerals contemplated by the Mining Lease Agreement. The reconveyance option arises when the Debtors complete the mining contemplated by the Mining Lease Agreement and the Debtors want the Defendant to reconvey the sub-surface rights previously sold to the Defendant under the Reserves Agreement.

conclusions of fact or law, nor as to any mixed questions of law and fact. Moreover, while the court cannot and does not give the opinion of Erwin more weight than the opinion of Lacy, the court is mindful that the burden of proof as well as the burden of persuasion rests with the Debtors. Looking for assistance from the competing expert testimony presented by the parties, the court concludes that this evidence tips more in favor of denying recharacterization of the Mining Lease Agreement.

Third, the economic substance of the transaction does not favor the Debtors over the Defendant. For reasons already explained, the economic substance of the instant transaction is significantly different from that which existed in the PCH Associates and the Moreggia & Sons proceedings. In absence of compelling evidence of the parties' actual intent in their favor, Debtors maintain that the economic substance of the instant transaction itself constitutes circumstantial evidence of the parties' intent.[36] But the Reserves Agreement accomplished sales of two separate assets in exchange for the $30 million in funds that the Debtors apparently wanted to achieve their goals. The economic value of both assets derived from the exploitation of real property: sub-surface rights to extract the mineral deposits and surface rights for residential development. Debtors originally owned both assets but apparently needed cash to realize both values.[37] While Debtors apparently do not dispute their financial needs at the time of the transaction, they do not explain why they could not have found a third party to mine the sub-surface minerals located on the subject property, while retaining the surface rights for themselves.

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[36] Debtors' legal position is that the parties' intent is not the sole factor nor the dispositive factor in determining whether to recharacterize the Mining Lease Agreement before the court. See Pretrial Statement at 10:5-11. The court agrees with one caveat: evidence of the parties' intent also cannot be ignored. The interrelationship between reformation of a contract under state law and the recharacterization remedy under bankruptcy law was previously addressed at length by the court. See SJ Order at 8:4 to 12:20. Both remedies seek a result that is consistent with the express or implied intention of the parties.

[37] The record indicates that Lukasiewicz informed Levkulich that the Debtors were exploring other sources of capital to meet their financial needs while also negotiating the transaction with the Defendant. (Trial Exhibit 12).

Defendant's business, on the other hand, includes the purchase of mineral rights for investment purposes where the mining operation is conducted by third parties. Debtors' existing mining operation on the property was not essential to the Defendant's business model and Defendant apparently had no interest in its own residential development of the surface rights. Defendant's interest in receiving royalties from the Debtors' residential development as the second asset purchased was part of its $30 million investment. No evidence was introduced to allocate or apportion the $30 million purchase price to each asset.[38] Neither party suggests, however, that the Mining Lease Agreement and the Land Royalty Agreement were functionally dependent on each other.[39] Thus, viewing the economic substance of the transaction from both sides, the Debtors apparently had an immediate need for $30 million and Defendant had a need to safely purchase both assets to satisfy its investors.[40] Both needs appear to have been met. At best, Debtors' interpretation of the economic substance of the entire transaction is no more

[38] The potential tax ramifications of the transaction, recharacterized or not, was referenced by both the Debtors and the Defendant. Unfortunately, neither side presented competent testimony explaining the differences resulting from the competing characterizations nor the significance of those differences in the parties' decision-making process. Moreover, because the transaction commenced in early 2018, it is unclear why neither side could present a comparative tax analysis based on two or more years of actual performance.

[39] The record indicates that the Defendant apparently did analyze and intend the transaction to be a passive investment in two separate assets with different streams of royalty payments. (Trial Exhibit 22b).

[40] Because of doubts concerning the sufficiency of the mineral reserves, the profitability of the mining operation reported by the Debtors, and the outcome of an environmental assessment, the Reserves Agreement included Tonnage Payment, QE (Quality of Earnings) Payment, and Environmental Payment provisions apparently designed to reduce the $30 million investment risk. Apparently, the concerns surrounding the Tonnage Payment requirement was resolved after the Reserves Agreement was entered and the Reserves Agreement was amended on August 8, 2018. (Trial Exhibit 2). Thereafter, a further amendment to the Reserves Agreement was entered on October 31, 2018 regarding the QE Payment. (Trial Exhibit 3). Debtors assert that the concerns surrounding the Environmental Payment has been resolved and the payment requirement should be released. If that is correct, then a further amendment to the Reserves Agreement may be appropriate.

compelling than the interpretation of the Defendant, and therefore falls short of meeting the Debtor's burden of proof.

Finally, the court also considers the economic reality of the transaction as it relates to the Debtors' reorganization efforts. As currently proposed, the latest iteration of the Proposed Plan offered in this Chapter 11 proceeding provides for two alternative treatments of Defendant's claims depending on whether or not the Mining Lease Agreement is recharacterized as a secured loan transaction. See Disclosure Statement at Art. I, §1.3 [Class 2(c)]; Art. V, §5.5, B.; and Art. V. §5.8, B. See also Proposed Plan at Art. II, §2.3(b)(iii) [Class 2(c)]. Debtors seek to confirm their Proposed Plan regardless of whether they prevail on the Adversary Complaint. In the event the Debtors succeed, the Proposed Plan will treat Defendant's allowed secured claim by transferring the entire interest in a portion of certain real property as the indubitable equivalent of the allowed claim. See 11 U.S.C. §1129(b)(2)(A)(iii).[41] In the event Debtors do not succeed on their Adversary Complaint, the Proposed Plan will treat Defendant's claim by, *inter alia*, rejecting the Mining Lease Agreement, ceasing all mining operations, and surrendering possession of the mining claims to the Defendant. By proposing such a reorganization plan, presumably in good faith, Debtors have acknowledged that rejection of the Mining Lease Agreement does not sound the death knell for their Chapter 11 reorganization, nor for the prospect of satisfying the creditor claims in this bankruptcy case. Thus, the economic reality is that continued application of Section 365(d)(4) in the circumstances of this Chapter 11 proceeding presents none of the risks presented in PCH Associates, Moreggia & Sons, or the other cases suggested by the Debtors.

CONCLUSION

Based on the foregoing, the court finds and concludes that the Debtors have failed to meet their burdens of proof and persuasion, or otherwise to demonstrate that the Mining Lease Agreement is not subject to the requirements of Section 365. The relief requested the Debtors in this adversary proceeding therefore will be denied.

[41] By the Valuation Motion, Debtors seek to establish the value of the portion of real property they propose to transfer to the Defendant in full satisfaction of Defendant's allowed secured claim.

A separate judgment has been entered contemporaneously with this Memorandum Decision.

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