UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
LEXINGTON DIVISION

IN RE

LEXINGTON HOSPITALITY GROUP **CASE NO. 17-51568**

DEBTOR

ORDER GRANTING STAY RELIEF AND SETTING STATUS CONFERENCE

This matter is before the Court on the Motion for Relief from the Automatic Stay and for Related Relief and Request to Shorten Notice of Hearing [ECF No. 87 (the "Relief Motion")] filed by the Creditor PCG Credit Partners, LLC, by and through Private Capital Group, Inc., its special servicer ("PCG"), and the combined final approval of the First Amended Disclosure Statement for Debtor's First Amended Plan of Reorganization under Chapter 11 of the United States Bankruptcy Code [ECF No. 224] and confirmation of the Debtor's First Amended Plan of Reorganization under Chapter 11 of the United States Bankruptcy Code [ECF No. 225.]

The Debtor, PCG, the Official Committee of Unsecured Creditors (the "Committee") and the Office of the United States Trustee (the "US Trustee") filed multiple papers in support of and against the Relief Motion and Disclosure Statement and Plan. The hearing on the Relief Motion was originally scheduled for an evidentiary hearing on November 20, 2017. That hearing was continued at the request of PCG so the new hearing would coincide with the combined hearing on approval of the Disclosure Statement and Plan. The combined hearing was held on December 21, 2017.

PCG has the burden of proof to show the Debtor has no equity in the collateral. 11 U.S.C. § 362(g)(1). The Debtor has the burden of proof on all other issues related to stay relief. 11 U.S.C. § 362(g)(2). For the reasons that follow, PCG is granted relief from the

automatic stay for cause. 11 U.S.C. § 362(d)(1). Further, the Disclosure Statement does not contain adequate information as required by 11 U.S.C. § 1125 and the proposed Plan is not confirmable pursuant to 11 U.S.C. § 1129.

I. PCG IS ENTITLED TO STAY RELIEF.

PCG seeks stay relief for cause and because the Debtor has no equity in the collateral and the collateral is not required for reorganization. The concern in this case is not any specific decrease in the value of PCG's collateral without adequate protection, a more usual fact pattern. The joint stipulations and other information suggest there is no significant decline in the value of the real property and improvements (the "Hotel") since the petition date. PCG's lien also covers accounts receivable and inventory. [*See* ECF No. 163-1.] Accounts receivable and inventory exceed $60,000 on the schedules and PCG is protected in part by a replacement lien. So the interests of the Debtor and other creditors might outweigh the small risk to PCG that its collateral value has materially declined since the petition date.

The lack of adequate protection in this case arises because the Debtor has not shown it can (1) produce accurate projections and financial results and (2) survive until its proposed Plan becomes effective. These reasons are cause to justify relief from the automatic stay. 11 U.S.C. § 362(d)(1). The conclusions could also justify dismissal or conversion of this case, but that decision will come after a future status hearing.

A. The Debtor Never Showed It Had or Could Produce Accurate Financial Information.

The record in this case indicates that, from the first day, the Debtor did not submit accurate financial statements and budgets. The first budget the Debtor submitted for the month of August failed to include something as simple as one of the bi-monthly payrolls. [ECF No. 8.] By a hearing on cash collateral use on November 14, 2017, the Debtor had submitted and

replaced multiple budgets. [*See* ECF Nos. 8, 16, 53, 54, 56, 62, 81, 90, 110, 117, 167, 176, 177.] Further, the Debtor had to replace the then-current budget before the November 14 hearing despite the numerous past problems. [ECF Nos. 176, 177.]

The Debtor acknowledged at a status conference on November 16, 2017, that cash flow issues and accurate financials were an ongoing concern. [ECF No. 205, 1:28-1:49.] The Debtor also admitted multiple times that the late fall and winter months were a down period and outside funding was required to survive. The problem was reiterated and confirmed at the December 21 hearing.

The Debtor's poor budgeting is highlighted on the comparison of the Debtor's final budget for each month to its Monthly Operating Reports. The projected revenues on the monthly budgets were substantially more than the actual revenues in each month: August - $48,000, September - $35,000, October - $42,000, and November - $30,000.[1] Not surprisingly, the EBITDA (which the parties referred to as the net income of the Debtor) was lower than projected income for the same months by $34,000, $35,000, $60,000 and $40,000.[2]

The Debtor also could not provide complete financial results for the Bennigan's Restaurant (attached to the Hotel and a significant part of the Debtor's operations), despite promises on multiple occasions to provide the information. The Debtor's Monthly Operating Report for November, submitted the day before the December 21 hearing, still lacked financial results for the Bennigan's Restaurant. [ECF No. 270.] The Debtor did supplement the

[1] The September and October amounts are consistent with the Joint Stipulations. [*See* ECF Nos. 249, 251.] The Joint Stipulations for August would show positive revenue of approximately $6,000 based on early budgets. [*See, e.g.,* ECF Nos. 8 and 62.] The calculation in this Order uses later budgets for the August projected revenue. [*See* ECF Nos. 81, 90 and 110.] There are no stipulations for comparison in November and December.
[2] The August and September amounts are consistent with the Joint Stipulations. [*See* ECF Nos. 249, 251.] There are no stipulations for comparison in October, November or December.

November Monthly Operating Report over the lunch break on December 21, but the parties were negotiating over lunch so they could not evaluate it and it was not part of the testimony.

These problems are exacerbated by questions regarding the management of the Debtor's representative, Kenneth Moore. The November Monthly Operating Report shows the Debtor used the reserve for ad valorem real property taxes to cover expenses at the Bennigan's Restaurant. [ECF No. 270 at 64-65.] The record confirms the Debtor should have had at least $17,500 in reserve for property taxes. [*See* ECF Nos. 110, 111, 117, 167, 176, 177; *see also* ECF No. 189, at 30:05-30 (Debtor's counsel confirmed the existence of the reserve account at the November 14 cash collateral hearing).

Also, the unopposed argument at the December 21 hearing indicated Janee Hotel Corporation, which the Debtor's representative controls, has withdrawn approximately $2,000 from its equity account since the petition date. More troubling is the existence of the line item "Owner's Expenses" in each Monthly Operating Report even though these expenses were never budgeted. Moore explained at the December 21 hearing that this line item represents his business expenses, such as reimbursement for parking or plane tickets. The expenses were $6-7,000 for three months, and over $36,000 in October. The lack of any budgeted line item for such a significant cost raises a question regarding the use of estate ass and calls into question the accuracy of the projections.

The Debtor knew that its inability to provide accurate and trustworthy financial information was a problem throughout the case. The Debtor was on notice that it had to provide financial results by the December 21 hearing and the Debtor acknowledged the problems and obligations on multiple occasions. [*See, e.g.,* ECF No. 235, 13:52-14:05; ECF No. 205, 1:28-49 and 39:39-40:19; ECF No. 189, 33:00-48.] The information provided for and at the December

21 hearing was insufficient to show the Debtor can provide accurate financial information for the past and the future.

B. <u>The Debtor Has Not Proven It Has the Financial Resources to Pay Debts as They Come Due Until the Effective Date of a Plan</u>.

1. <u>The Debtor Did Not Prove It Has Sufficient Cash to Survive for Any Period of Time</u>.

The Debtor acknowledged on multiple occasions that it could only survive the winter season with an infusion of cash. [*See, e.g.,* ECF No. 235, 13:52-14:05; ECF No. 216, 4:30-5:09; ECF No. 205, 3:35-4:21 and 39:39-40:19; ECF No. 189, 33:00-48.] The Debtor has provided accounts payable aging reports on several occasions that show the Debtor is not making all post-petition payments as they come due.

The Court calculated the Debtor has not paid approximately $120,000 of post-petition expenses based on the most recent aging report submitted on December 19, 2017. [ECF No. 265.] This conclusion was supported by the arguments of multiple parties at the December 21 hearing and was not disputed by the Debtor. The Debtor also explained that the aging report did not include projected legal fees of $125,000 for its counsel and cure costs due to the franchisor of approximately $65,000 prepetition and $21,000 post-petition.

The Debtor was on notice that it had to prove it has the ability to continue operations without going further into debt. As indicated, the Debtor admitted a cash infusion was required to support current operations. The need to prove not just the ability to obtain funds to support the Plan, but also the ability to survive until the Plan is effective, was discussed before and after the lunch break on December 21. Despite this knowledge, the Debtor's testimony fell short.

Moore testified that the equity owner, Janee Hotel Corporation, or he, had contributed $22,000 recently to cover cash shortfalls. But the Debtor did not explain which expenses were paid or provide proof the Debtor received the funds (or at least the benefit of the funds).

Moore also testified he would provide funding to cover any shortfalls so the Debtor could complete the confirmation process. But Moore's testimony indicated a mere intention to perform that is not binding. The non-binding nature of the Debtor's statements was confirmed during discussions with Debtor's counsel after testimony concluded.

Since the hearing, the Debtor filed the Debtor's Emergency Motion for Order Authorizing Debtor to Obtain Postpetition Financing from Managing Member Kenneth Moore. [ECF No. 277 ("Post-petition Financing Motion").] The Post-petition Financing Motion seeks authority to obtain a $60-80,000 loan from Moore to cover cash shortfalls. The offer falls short, however, because there is no proof the loan is enough. *See infra* Part.I.B.2 (it is unlikely the Plan would be effective until at least February). Also, the Debtor does not disclose important terms for the loan, such as the need for collateral, an interest rate, or repayment terms. *See* 11 U.S.C. § 364.

The record confirms the Debtor is not paying its bills as they come due. It is not fair to PCG or post-petition creditors to let this continue when there is no proof the Debtor can pay ongoing expenses. *See generally First Agric. Bank v. Jug End in the Berkshires, Inc. (In re Jug End in the Berkshires, Inc.)*, 46 B.R. 892 (Bankr. D. Mass. 1985) (discussing the inability to pay debts as a component of a § 362(d)(2)(B) analysis).

2. <u>The Debtor Has Not Shown the Proposed Plan Is Confirmable</u>.

The cash flow crisis and the insufficient financial information forced the Debtor to fast track the confirmation process. [ECF Nos. 150, 211 and 221.] The Debtor has the burden of proof by a preponderance of the evidence as to all elements of § 1129(a) and (b). *In re Trenton Ridge Investors, LLC*, 461 B.R. 440, 460-61 (Bankr. S.D. Ohio 2011); *Danny Thomas Props. II Ltd. P'ship v. Beal Bank, S.S.B. (In re Danny Thomas Props. II Ltd. P'ship)*, 241 F.3d 959, 963 (8th Cir. 2001); *Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. P'ship (In re Ambanc La Mesa*

Ltd. P'ship), 115 F.3d 650, 653 (9th Cir. 1997); *see also* 7 COLLIER ON BANKRUPTCY § 1129.05[1][d] (Resnick & Sommer eds. 2017) (the debtor must also prove the cramdown requirements). The Debtor has not satisfied its burden of proof.

a. The Debtor Has Not Satisfied Its Burden to Show the Treatment of PCG is Fair and Equitable.

The parties agree that cramdown is required and PCG, the Committee and the US Trustee concede the existence of an impaired consenting class. 11 U.S.C. § 1129(a)(10) and (b). Therefore, the Debtor may confirm the Plan over PCG's objection if the proposed treatment of PCG "does not discriminate unfairly" and is "fair and equitable." 11 U.S.C. § 1129(b)(1). The condition that a plan be fair and equitable for a class of secured claims requires that the holder of the claim retain its liens and receive "deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." 11 U.S.C. § 1129(b)(2)(A)(i)(I) and (II).

The Plan contemplates retention of liens, so the dispute is over the proposed deferred cash payments. The Debtor proposes to pay PCG's claim over 5 years at a 6% interest rate. Payments for the first 30 months are interest only. The Debtor will then make 30 monthly payments of principal and interest based on a 30-year amortization period. The balloon payment at the end of the 5-year term would come from new financing or sale of the Hotel.

PCG argues these terms are not fair and equitable because they do not compensate it for the risks involved. *See In re Am. HomePatient, Inc.,* 420 F.3d 559 (6th Cir. 2006); *In re Brice Road Devs, LLC*, 392 B.R. 274 (B.A.P. 6th Cir. 2008); *see also Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) (the interest rate should compensate the debtor for the time value of money and the risk of default). The Debtor contends that simply proposing the terms of the deferred cash

payments satisfies its burden of proof and shifts the burden to PCG to prove otherwise. [ECF No. 244 at 17.] But the Debtor still must show the repayment terms are fair and equitable in the first instance before the burden shifts. *In re Bellows*, 554 B.R. 219 (Bankr. D. Alaska 2016).

The cases the Debtor cites in support only placed the burden on the creditor after the debtor offered some evidence suggesting the proposed terms were fair and equitable. In *Brice Road Dev.*, the debtor satisfied its initial burden by presenting the testimony of the original lender and a person with significant experience in the field of real estate finance. 392 B.R. at 280-281. These witnesses specifically testified about the various options for financing with respect to multi-family housing, the collateral at issue. *Id.*

Similarly, the bankruptcy courts in *Till* and *Am. HomePatient* heard from competing witnesses about the appropriate cramdown interest rate applied to the lenders' allowed secured claims. *Till*, 541 U.S. at 470; *Am HomePatient*, 420 F.3d at 561. None of these cases abrogate the Debtor's ultimate burden to show that the terms proposed in the Plan are fair and equitable in the first instance. The Debtor has done nothing more than set out proposed terms, providing no proof, expert or otherwise, in support. This fails to satisfy its ultimate burden to establish all confirmation requirements are met. *Bellows*, 554 B.R. at 230.

Even if the burden had shifted to PCG, there is enough information to suggest a higher interest rate is warranted to shift the burden back to the Debtor. The interest rate is substantially less than the 12% non-default interest rate applicable to the Debtor's obligation to PCG. [*See* POC 6-2, Part 4 (the "Secured Promissory Note").] The rate is also sufficiently less than the range of interest rates proposed for the post-confirmation loan facility, which supports a finding that a higher rate is required. [ECF No. 152 (the rate is not listed because this document was filed under seal).]

b. The Projections Are Not Trustworthy.

The testimony at the December 21 hearing was sufficient to conclude the projections have problems that require significant revisions. [ECF No. 240 (the projections are Exhibit F to the Disclosure Statement).] The previous discussion indicated the following expenses are not in the projections: (i) at least $10,000 of administrative expense claims for operations (the projections show $110,000 of unpaid expenses, but the aging report shows $120,000); (ii) $125,000 for the legal fees of the Debtor's counsel; and (iii) over $85,000 in cure costs to assume the franchise agreement. The Debtor is also behind on its quarterly fees due to the US Trustee and the Committee's legal fees are not considered.

The testimony further showed capital expenditures are not fully considered. Moore testified that the Debtor must complete the fit-up required by the franchise agreement (referred to as PIP) by a June 2018 inspection. But the projections indicate $30,000 of the total funds will come after June 2018. Also, the projections require $60,000 in January, which cannot occur because there is no proof of available cash.

The Debtor presented evidence from Deborah Cannon, President of CUSA, the Debtor's Property Management Company, and Moore that indicated the proposed increases would put the Debtor's hotel in line with its competitors. Therefore, they believed the estimates were fair. But the testimony provided strong evidence that the revenue projections were overstated.

The Debtor's revenue projections are already suspect because the Debtor's cash collateral budgets were so inaccurate. *See supra* Part I.A. The testimony showed, however, that the projections are not supported by historical results. After testifying that the 2017 results were better than 2016, Cannon acknowledged on cross examination by the US Trustee that this only existed because the 2017 numbers did not include debt service due to PCG. When that is considered, the 2017 result is approximately $200,000 worse than 2016. [*See* ECF No. 270 at 2.]

Also, Moore admitted the roof was past its useful life and needed repair. The 2018 capital budget prepared by CUSA set the cost at $250,000. [ECF No. 250, Exh. 26.] Cannon explained that the roof repairs have a priority one designation, which means the repairs are required in 12-24 months. Despite this testimony, the projections do not include a line item for capital costs until June 2020, over 30 months from any effective date.

Therefore, not only does the need to revise the projections extend the time for confirmation, it shows additional funding is required. The Debtor has not shown it can get the minimum funding required to satisfy the current projections. Therefore, there is no reason to believe the Debtor can increase funding to support lower projected revenue over the next five years.

c. The Debtor Cannot Timely Confirm a Plan.

The Debtor's Plan as currently proposed is not confirmable. Significant changes are required, which means the information contained in the Disclosure Statement is not adequate and re-solicitation is necessary. 11 U.S.C. § 1125. Re-solicitation, even if combined with plan confirmation as currently contemplated, would add another approximately 28 days to the confirmation process. FED. R. BANKR. P. 2002(b). This would also require additional time to complete pre-effective date requirements.

Any delay confirming a plan raises additional concerns with the Debtor's ability to survive until it consummates a plan. *See In re Johnson,* Case No. 315-03929, Chapter 11, 2016 Bankr. LEXIS 1937 (Bankr. M.D. Tenn. May 5, 2016). ("[T]he debtor should not be allowed to continue gambling Heritage Bank's collateral on a case that is not going to result in rehabilitation.") It also provides further support for the conclusion that the Post-petition Financing Motion cannot solve the Debtor's problems.

II. CONSIDERATION OF DISMISSAL OR CONVERSION.

Granting relief from the stay to PCG likely ends any chance of reorganization for the Debtor. Also, the above discussion confirms sufficient cause probably exists to convert or dismiss the case. 11 U.S.C. § 1112(b)(4)(A), (E), (H), (J) and (K). Therefore, a status conference is required to determine how to conclude this bankruptcy proceeding.

Based on the foregoing, it is ORDERED that:

(1) PCG's Motion for Relief from the Automatic Stay and for Related Relief and Request to Shorten Notice of Hearing [ECF No. 87] is GRANTED pursuant to 11 U.S.C. § 362(d)(1).

(2) The stay of this Order in Fed. R. Bankr. Proc. 4001(a)(3) is waived for cause; this Order is effective immediately.

(3) The Disclosure Statement does not contain adequate information as required by 11 U.S.C. § 1125.

(4) The proposed Plan is not confirmable pursuant to 11 U.S.C. § 1129 and confirmation is DENIED.

(5) This matter will come before the Court for a status conference **at 9 a.m. on January 4, 2018, in the United States Bankruptcy Court, Second Floor Courtroom, 100 E. Vine Street, Lexington, Kentucky, 40507.**

The affixing of this Court's electronic seal below is proof this document has been signed by the Judge and electronically entered by the Clerk in the official record of this case.

Signed By:
Gregory R. Schaaf
Bankruptcy Judge
Dated: Thursday, December 28, 2017
(grs)