IT IS ORDERED as set forth below:

Date: November 20, 2009

Mary Grace Diehl

Mary Grace Diehl
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

In Re:	:	Chapter 11
	:	
DIPLOMAT CONSTRUCTION, INC.,	:	Case No. 09-68613-MGD
	:	
Debtor.	:	Judge Mary Grace Diehl
	:	

ORDER DENYING CONFIRMATION

The confirmation hearing on Diplomat Construction, Inc.'s ("Debtor") Amended Chapter 11 Plan of Reorganization (the "Plan") was held November 16, 2009. (Docket Nos. 121 & 157). Written objections were filed by City of Atlanta ("City") and State Bank of Texas ("SBT"). (Docket Nos. 145 & 149). Laura Woodson of Scroggins and Williamson and James Sacca of Greenberg Traurig, LLP were present at the hearing representing Debtor. James Rankin and Joshua Lewis of Parker, Hudson, Rainer & Dobbs LLP were present at the hearing representing SBT. Eric Smith of Schnader, Harrison, Segal & Lewis, LLP appeared at the hearing representing City.

Ms. Woodson announced at the hearing that Debtor had resolved City's objection to confirmation by payment of the outstanding cure amount and execution of an unconditional personal guarantee by R.C. Patel, Debtor's principal. The Court heard testimony from R.C. Patel, and Sashil Patel, chief lending officer of SBT. SBT's exhibits 1 through 41 were admitted into evidence without objection. At the close of the hearing, the Court made an oral ruling denying confirmation.[1] This Order memorializes that oral ruling.

I. Case History

Debtor filed a chapter 11 voluntary petition on April 3, 2009. Debtor owns and operates a 192-room hotel known as the Red Roof Inn-Atlanta Airport (the "Hotel") located near Hartsfield-Jackson Atlanta International Airport. Debtor leases the tract of real property from the City of Atlanta under a long-term lease that expires December 31, 2034. An Order approving assumption of the groundlease was entered October 27, 2009. (Docket No. 133). The Court approved Debtor's rejection of the Red Roof Inn franchising agreement effective December 1, 2009. (Docket Nos. 116 & 136).

Debtor refinanced its debt on the Hotel in January of 2002, executing a promissory note in favor of Integrity Bank in the amount of $10,500,000.00. The note is secured by Debtor's interest in the Hotel. Integrity Bank later sold participations totaling 51 percent of the note and remained the lead servicer on the note. In 2008, the Federal Deposit Insurance Corporation ("FDIC") assumed Integrity Bank's interest in the note, as receiver for the bank. The FDIC sold Integrity Bank's interest in the note at auction in November of 2008. The winning bidder was SBT, Debtor's only

[1] At the close of the hearing, the Court also ruled that State Bank of Texas's Motion for Relief from Stay, also schedule for hearing was granted. Relief from stay was granted effective upon the ruling on November 16, 2009 and will be memorialized by separate order.

secured creditor in this proceeding. Debtor defaulted on note payments, and SBT had commenced a non-judicial foreclosure that was scheduled for April 7, 2009.

Debtor had contacted SBT prior to the auction on the note to secure financing to bid on the note at the FDIC auction. Debtor alleges that SBT improperly used information shared at the time it sought financing to make the winning bid at the auction. Debtor seeks damages for unjust enrichment, fraud, misappropriation of trade secrets, and breach of an implied duty of good faith and fair dealing in a pending United States District Court for the Northern District of Georgia case, *Diplomat Construction, Inc. v. The State Bank of Texas*, civil action no. 1-09-CV-1419, filed May 27, 2009. In the chapter 11 case, Debtor moved for authority to sell the Hotel to Rick's Hotel for $12,575,00.00. (Docket No. 51). The Asset Purchase Agreement provided purchaser with a finite period of time to obtain financing. The APA was amended three times to extend the time to secure financing. No financing for the sale has been secured and the APA had been terminated at the time of the hearing. At the time of the confirmation hearing, Debtor had no contract for sale of the Hotel and no broker had been engaged to procure a buyer.

Debtor's Plan proposes a sale without a fixed closing date. The Plan proposes that Debtor continue to operate the Hotel until a sale for a purchase price of $12,575,000.00. SBT's claim will be treated as fully secured under the Plan. SBT shall retain its lien on the Hotel and, if a sale occurs, on any sale proceeds following confirmation. The Plan provides that SBT will be paid interest only from the effective date until the earlier of February 2011, the resolution of the district court action, or a sale. The interest rate under the Plan is prime plus 1.35%, adjusted annually. Principal payments to SBT shall commence February 2011, based upon a debt amortized over twenty years. If no sale or refinancing occurs within nine months after the conclusion of the district court action,

then SBT shall be allowed to exercise its state law rights against the Hotel.

For the reasons set forth below, confirmation is denied because the Plan is not feasible, not proposed in good faith, and fails to satisfy the cramdown requirement of fair and equitable treatment.

II. The confirmation requirements of 11 U.S.C. § 1129(a) are not satisfied.

Section 1129(a) provides that "The court shall confirm a plan only if all of the following requirements are met . . . ." 11 U.S.C. § 1129(a). To confirm a plan of reorganization, the debtor has burdens as to introduction of evidence and persuasion that each subsection of section 1129(a) has been satisfied. *See*, *e.g.*, *In re Acequia, Inc.*, 787 F.2d 1352, 1359 (9th Cir. 1986). Debtor failed to establish the confirmation requirements of feasibility and good faith. 11 U.S.C. §§ 1129(a)(11) and (a)(3).

In order to be confirmed, a plan of reorganization must be feasible within the meaning of 11 U.S.C. § 1129(a)(11). Section 1129(a)(11) states that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." The use of the word, likely, requires the Court to assess whether the plan offers a reasonable "probability of success, rather than a mere possibility." *In re Kent Terminal Corp.*, 166 B.R. 636, 650 (Bankr. S.D.N.Y. 1994). While § 1129(a)(11) does not require the debtor to guarantee success, establishing feasibility requires more than a promise, hope, or unsubstantiated prospect of success. *See*, *e.g.*, *Wiersma v. Bank of the West (In re Wiersma)*, 227 Fed. Appx. 603, 606 (9th Cir. 2007); *In re T-H New Orleans Ltd. P'shp*., 116 F.3d 790, 801 (5th Cir. 1997) ("reasonable assurance of commercial viability is required"); *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir. 1988). "The purpose of the feasibility requirement []is to prevent confirmation of visionary schemes which

promise creditors and equity holders more under a proposed plan that the debtor can possibly attain after confirmation." *In re Investors Fla. Aggressive Growth Fund*, 168 B.R. 760, 765 (Bankr. N.D. Fla. 1994) (internal quotations and citations omitted).

A determination of feasibility must be "firmly rooted in predictions based on objective fact." *In re Clarkson*, 767 F.2d 417, 420 (8th Cir. 1985). Plans that involve "pipe dreams" or "visionary schemes" are not confirmable. *In re Sovereign Oil Co.*, 128 B.R. 585, 587 (Bankr. M.D. Fla. 1991). Courts consider the earning power of the business, its capital structure, the economic conditions of the business, the continuation of present management, and the efficiency of management in control of the business after confirmation to determine feasibility of the plan. *In re Immenhausen Corp.*, 172 B.R. 343, 348 (Bankr. M.D. Fla. 1994).

The testimony and evidence presented by Debtor fail to adequately establish that the Plan has a reasonable and objective likelihood of success. Feasibility is lacking in several areas of the Plan. First, based on the evidence and testimony, closing a sale in the approximate amount of $12,575,00.00 is not probable. The Court is sympathetic to the unprecedented economic times and the absence of available credit; however, current economic conditions are a proper factor to be considered in making a feasibility determination. *See*, *e.g.*, *In re WCI Cable, Inc.*, 282 B.R. 457, 486 (Bankr. D. Or. 2002). The current economic climate and the history of Debtor's and the proposed purchaser's inability to secure financing weigh against feasibility. Debtor's unsuccessful efforts, though diligent and creative, to secure financing demonstrate that the feasibility of the Plan's sale is more akin to a visionary scheme than a reasonable assurance of viability.

Second, viability of the Plan is premised on Debtor's unreasonable projections as to the funds available to make the payments required by the Plan. The projections were admitted into evidence

as SBT's Exhibit 36 and testified to by Mr. Patel. Debtor's ability to make the payments proposed under the Plan is not probable based on the recent performance of Debtor. Debtor has routinely missed its projections during the pendency of the case. Debtor has made laudable efforts to limit losses by reducing expenses, but Debtor's revenues continue to underperform and no credible reason is offered as to why this will change in the future. The projections with respect to revenue are not reasonable, irrespective of limits on expenses. Further, Mr. Patel testified that the proposed change to a Budgetel Inn branded hotel would cause a short-term decrease in revenues for the first 60 to 90 days. The projections in support of Plan payments do not reflect this anticipated downturn. Additionally, the projections provide for no margin of error. No capital reserves are included in the projections and property maintenance expenses are limited. The Plan does not provide for any capital improvements or replacement of case goods. Mr. Patel testified that case goods would need to be replaced if the Hotel continued as a Red Roof Inn franchise. He also testified that there was no such replacement requirement as a Budgetel Inn franchise. The indefinite time frame of the Plan makes this problematic. Debtor seeks to substantiate the feasibility of the Plan by offering Mr. Patel's personal contribution, as needed, to conform to the Plan. Mr. Patel testified that he would personally contribute any additional money to Debtor to comply with the Plan, but no documentary evidence was produced to support his ability to do so.

Third, the Plan is not feasible because Debtor has failed to establish a reasonable valuation of the Hotel. Although the parties did not introduce valuation testimony at the confirmation hearing, the relief from stay hearing on August 18, 2009 included extensive valuation testimony. It is appropriate for the Court to consider this testimony at confirmation. *In re Acequia, Inc.*, 787 F.2d 1352, 1359 (9th Cir. 1986) (approving bankruptcy court's consideration of evidence presented by

the parties at a prior evidentiary hearing). The value of the Hotel on which Debtor bases the proposed sale price assumes that Debtor has made two million dollars of capital improvements to the Hotel. These improvements were projected to increase room rates, occupancy rates, and revenue streams. The capital improvements were a key assumption for each appraiser at the August 18, 2009 hearing. Without any improvements, the sale of the Hotel on the terms provided for in the Plan are wholly speculative. The earlier determination to conditionally deny SBT's Motion for Relief from Stay was based on a distinct set of facts. At the time of the August 18, 2009 hearing, Debtor had an executed sale contract in the amount of $12,575,000.00, imminent financing for second mortgage for the proposed purchaser, committed cash for capital improvements, and the Hotel's status as a Red Roof Inn. There is no objective basis to find the Plan feasible because Debtor has not established the relevant value of the Hotel as a Budgetel Inn without capital improvements.

Another confirmation requirement is good faith. 11 U.S.C. § 1129(a)(3). A Chapter 11 reorganization plan must be "proposed in good faith and not by any means forbidden by law." *Id*. The Bankruptcy Code does not define the term, yet courts have interpreted "good faith" as requiring that there is a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Code. *McCormick v. Banc One Leasing Corp. (In re McCormick)*, 49 F.3d 1524, 1526 (11th Cir. 1995) (citing *In re Block Shim Dev. Co.-Irving*, 939 F.2d 289, 292 (5th Cir.1991); *In re Madison Hotel Assocs.*, 749 F.2d 410, 425 (7th Cir.1984); *In re Coastal Cable T.V., Inc.*, 709 F.2d 762, 764-65 (1st Cir.1983) (in corporate reorganization, plan must bear some relation to statutory objective of resuscitating a financially troubled company)).

In assessing whether the plan was proposed in good faith, the assessment is focused on the plan itself, while also considering the totality of circumstances surrounding the plan. *Kaiser*

Aerospace & Elec. Corp. v. Teledyne Indus. (In re Piper Aircraft Corp.), 244 F.3d 1289, 1300 (11th Cir. 2001) (citing *In re McCormick*, 49 F.3d at 1526). The good faith requirement is met where the plan is proposed with a "legitimate and honest purpose to reorganize and has a reasonable hope of success." *Id.* (citations omitted).

The Debtor fails to establish that the Plan has been filed in good faith. The Plan essentially places all the risk on SBT because it withholds SBT's right to amortization while the Debtor waits for market conditions to improve. Plans proposed as a scheme for delay have been found not to be good faith. *E.g.*, *Travelers Ins. Co. v. Pikes Peak Water Co. (In re Pikes Peak Water Co.)*, 779 F.2d 1456 (10th Cir. 1985) ; *Crestar Bank v. Walker (In re Walker)*, 165 B.R. 994 (E.D. Va. 1994); *In re Hoosier Hi-Reach, Inc.*, 64 B.R. 34 (Bankr. S.D. Ind. 1986).

Additionally, the Plan does not provide for any improvement or reasonable maintenance program for the Hotel. The Plan provides if no sale has occurred nine months after the conclusion of the district court action, then SBT may then exercise its state rights. SBT bears the risk of deterioration from normal wear and tear and the resulting diminution in the value of the Hotel. SBT's exhibit 36 shows a $400,000.00 cash infusion, but Mr. Patel testified that this cash would primarily go towards payment in full of administrative and priority tax expenses. Mr. Patel's testimony also revealed that the source of his personal contribution had not been determined at the time of the hearing. He expected that a Gwinnett County condemnation award to an affiliated entity of Debtor would provide the cash, or that CDs held personally by Mr. Patel could serve as the source of the cash. No evidence outside Mr. Patel's testimony was provided to support his ability to make this contribution.

III. The Plan does not meet the cramdown standards under 11 U.S.C. § 1129(b).

Although the finding of lack of feasibility and good faith is adequate to deny confirmation on either ground, the Plan is also not confirmable because it is not fair and equitable. The Bankruptcy Code provides that a plan of reorganization may be confirmed either consensually, pursuant to 11 U.S.C. § 1129(a)(8), or nonconsensually, pursuant to 11 U.S.C. § 1129(b). If Debtor does not obtain acceptance of each impaired class of creditors, it may, alternatively, exercise "cramdown" under § 1129(b). If at least one class of impaired creditors accepts the plan, a debtor may confirm a plan if it is "fair and equitable" with respect to each impaired class of claims or interest that has not accepted the plan. 11 U.S.C. § 1129(b)(1).

Requirements for "fair and equitable" treatment are outlined in § 1129(b)(2).[2] A Plan is fair and equitable with respect to a secured claim if, under the Plan, the holder of the secured claim retains the lien securing the claim and receives payments over the life of the plan totaling at least the allowed amount of the claim of a value as of the effective date, of the value of the secured claim. 11

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[2] 2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides–

> (i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
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> (II) that each holder of a claim of such class receive on account of such claim 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;
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> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2).

U.S.C. § 1129(b)(2)(A)(I). The requirement of payments with a value as of the effective date requires interest to offset the fact that payments are made over time, not upon the effective date of the plan. *In re D & G Invs. of W. Fla., Inc.*, 342 B.R. 882, 888 (Bankr. M.D. Fla. 2006). The plan may also be fair and equitable as to a secured claim if it provides for the indubitable equivalent of such claims to the secured party. 11 U.S.C. § 1129(b)(2)(A)(iii). However, the Debtor need only satisfy one of these requirements. *In re D & G Invs. of W. Fla., Inc.*, 342 B.R. at 888 (citations omitted). The debtor has the burden of establishing that the plan is fair and equitable. *E.g.*, *Imperial Bank v. Tri-Growth Centre City, Ltd.*, 136 B.R. 848, 851 (Bankr. S.D. Cal. 1992).

Here, the Plan treatment of SBT is not fair and equitable. The Plan provides that the applicable interest rate payable to SBT will be Wall Street Prime plus 1.35%, adjusted annually. Debtor asserted that this rate was fair because it was based on the index in the note and comparable to the market rate. However, the testimony also established that currently there is no market available for this type of loan. The Debtor also conceded that risk was not factored into the Plan interest rate. The non-default rate of interest on the note is currently 9.6%, adjustable every five years with the next adjustment period in 2012.

"The appropriate discount rate must be determined on the basis of the rate of interest which is reasonable in light of the risks involved." *In re Southern States Motor Inns*, 709 F.2d 647, 651 (11th Cir. 1983) (discussing interest rate within the context of § 1129(a)(9)(C)). The market rate of interest and the risk of default should be considered in determining a fair and equitable interest rate. *See In re D & G Invs. of W. Fla., Inc.*, 342 B.R. at 888. Sushil Patel, chief lending officer of SBT, testified that prime was approximately 3.25% at the time of the hearing. Debtor asserts that following the index in the note is fair and equitable treatment. The index in the note does not

accurately reflect the market rate of interest when there is no market for this type of loan. Because risk of default was not factored into the Plan's interest rate, especially given the recent performance of Debtor, the Plan's treatment of SBT is not fair and equitable. Accordingly, for the reasons set forth herein, it is hereby

ORDERED that Confirmation is **DENIED**.

The Clerk is directed to serve a copy of this Order on all parties at interest.

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