

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE: §
§
TREATS INVESTMENTS, LLC. and § CASE NO. 02-40131-DML-11
TREATS OPERATING COMPANY, §
Debtors. § CASE NO. 02-40132-DML-11
§

MEMORANDUM OPINION AND ORDER

Before the Court is the Debtors' Motion to (1) Determine Secured Status of Creditors and (2) Approve Stipulation with Wells Fargo Bank, et al. (the "Motion"). DQF, Inc. ("DQF") responded to the Motion, and the Court received evidence¹ and heard oral argument from Debtors and DQF at a hearing on July 19, 2002. The Motion is subject to the Court's core jurisdiction (28 U.S.C. §§ 1334(a) and 157(b)(2)(O)). This Memorandum constitutes findings of fact and conclusions of law as permitted by Fed. R. Bankr. P. 9014 and 7052.

I. Background

The Debtors are in the business of owning and operating Dairy Queen restaurants. The actual restaurants are owned by Debtor Treats Operating Company ("Operating"), while Treats Investments, LLC ("Investments") is a holding company which owns the Dairy Queen franchises under which Operating conducts business. At the commencement of these Chapter 11 cases, Debtors had 55 restaurants. By the time of the hearing on the Motion, Debtors were down to five operating and one closed location.

¹The evidence was limited to the issue of whether DQF had been granted a lien on Debtors' furniture, fixtures and equipment.

Debtors' principal secured creditor is Wells Fargo Bank ("Wells Fargo"). At the commencement of the case Wells Fargo was owed \$6,600,000 secured by liens on, *inter alia*, Investments' franchise agreements and Operating's furniture, fixtures and equipment. DQF, as of that date, was owed \$600,000, secured by a pledge by Investments of assets including the Dairy Queen franchises and Investments' furniture, fixtures and equipment. DQF's security interest is admittedly inferior to that of Wells Fargo.²

Since the commencement of these cases, Debtors have succeeded through various means in reducing the debt to Wells Fargo by \$2,600,000. By the Motion, Debtors seek approval of a stipulation with Wells Fargo (the "Stipulation") which provides that Wells Fargo, in exchange for a payment of \$100,000, will (1) release its remaining liens and (2) relinquish any deficiency claim it may have.

Debtors also seek in the Motion a determination for all purposes, including a plan, that DQF is not a secured creditor with respect to the Dairy Queen franchises and furniture, fixtures and equipment. Debtors argue that the value of Wells Fargo's collateral, including the franchises (and the personalty), is less than Wells Fargo's claim and, therefore, DQF's lien does not include those assets. Debtors also assert that Investments owns no furniture, fixtures or equipment, title to all such items belonging to Operating. Since only Investments pledged property to DQF, DQF cannot have a lien on furniture, fixtures and equipment.

DQF does not dispute that Wells Fargo's debt far exceeds the value of its collateral or that it is entitled to a lien only on property of Investments. Rather, DQF argues the Court should evaluate its secured position in connection with any plan after that plan has been filed. DQF takes

²The claims of other secured creditors as well as some other assets are not listed, not being relevant to the issues the Court must address.

the position that any such future valuation should take into account elimination of Wells Fargo's claim. The effect of adopting DQF's position would be that DQF would move up to become the senior lienholder on, at least, the franchises.

II. Discussion

A. Furniture, Fixtures and Equipment

As a preliminary matter, the evidence at the July 19 hearing clearly supports Debtors' position respecting the furniture, fixtures and equipment. The Court finds that all furniture, fixtures and equipment used by Debtors in their business are owned by Operating.³

B. Dairy Queen Franchises

The situation is different with respect to the franchises. DQF, the parties agree, has a properly perfected security interest in the franchises. Absent this bankruptcy case, satisfaction of the Wells Fargo claim would result in an improvement of DQF's position, since the value of the franchises would then be sufficient to reach DQF's lien.

In chapter 11, however, a creditor is only a secured creditor to "the extent of the value of such creditor's interest in the estate's interest" in property subject to the creditor's lien. 11 U.S.C. § 506(a).

In the instant case, at this writing, the parties agree that the value of the franchises is insufficient to reach DQF. Thus, at this moment, before consummation of the Stipulation, DQF is unsecured with respect to the franchises. But DQF points to the last sentence of section 506(a), which requires that the value of the creditor's interest (i.e., the amount of its secured claim) "be

³The Motion was not clear that Investments had no such assets, and it was reasonable for DQF to require proof at the hearing of this fact. Testimony of Debtors' owner, Mr. Hall, inventories of Operating's assets and Operating's tax return for the year 2000 provided this proof.

determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." *Id.*

There will be no difference in a determination of the value⁴ of the franchise agreements as between today and the date of confirmation of a plan. The question of value runs to the value of the property which is subject to the security interest. Elimination of the lien of Wells Fargo will not alter the value of the franchise agreements. The questions facing the Court are whether it must defer valuation of DQF's position until after completion of the transactions contemplated by the Stipulation, and whether DQF is therefore entitled to the benefit of the satisfaction of Wells Fargo's claim.

The Court therefore must decide whether the words "in conjunction with any hearing. . . on plan affecting such creditor's interest" require that valuation of DQF's secured claim be deferred until a plan is before the Court. This language, at first blush, would seem to require as DQF urges; that the Court must wait until the confirmation hearing to determine whether DQF is a secured or unsecured creditor. Debtors on the other hand, argue that under section 506(a) they may "affect" DQF's interest now, in anticipation of a plan.

Congress knew how to refer to confirmation when that is what it meant. *See, e.g.* 11 U.S.C. §§ 105(d)(2)(B)(vi), 362(d)(3)(A), 365(d)(2), 1125(F)(3), 1128(a); 28 U.S.C. § 157(b)(2)(L); similarly, *see, e.g.*, Fed. R. Bankr. P. 2002(b), 3017(d), 3017.1(c)(3), 3020(b). Had Congress

⁴This is not to say market value of a Dairy Queen franchise is not subject to change; rather, the Court would determine value in the same way at either time.

intended the words “hearing on a plan” to be limited to the confirmation hearing it would have said so.

Indeed, to interpret section 506(a) to require valuation of secured claims for plan purposes at the time of confirmation would conflict with other provisions of the Bankruptcy Code and Rules of Bankruptcy Procedure. Without a valuation of its secured claim a creditor could not intelligently elect whether to be treated under 11 U.S.C. § 1111(b)(2) within the time permitted by Fed. R. Bankr. P. 3014 (the conclusion of the hearing on the disclosure statement). Debtors would be unable to determine classifications (11 U.S.C. §§ 1122 and 1123(a)); to make proper disclosure concerning secured and unsecured claims (11 U.S.C. § 1125; *see, e.g., In re U.S. Brass Corp.*, 194 B.R. 420, 424-25 (Bankr. Ed. Tex. 1996)); to determine whether to leave a claim unimpaired (11 U.S.C. § 1124). In short, if a debtor cannot determine its secured debt for plan purposes before the terms of the plan become fixed, it would be seriously hobbled in fashioning a plan of reorganization.

For all these reasons, the Court concludes that the word “on” as used in the phrase “on a plan” in section 506(a) means “in connection. . .with.” Webster’s Encyclopedic Unabridged Dictionary of the English Language (1989).⁵ In the instant case, resolution of the Wells Fargo claim and, hence valuation of DQF’s security interest in the franchises, is being undertaken “in connection with” the plan Debtors propose to file.⁶

There is nothing in section 506(a) to suggest that a determination of secured status for plan purposes may not antedate confirmation, and even filing, of a plan. As discussed, *supra*, there is

⁵The three definitions of “on” preferred by Webster – “supported by or suspended from”; “attached to or unified with”; and “to be a covering or wrapping for” – would not make sense in the context of section 506(a). The definition selected by the Court makes perfect sense.

⁶The Stipulation, according to Debtor’s counsel, would have been included in a plan had time permitted. As it is, for the agreement with Wells Fargo to benefit Debtors as intended, it must be effective before August 6, 2002.

every reason why a debtor may need to determine the extent of one or more secured claims in order to formulate a plan. See *In re Saunders*, 112 B.R. 844, 846, n. 7 (Bankr. W.D. Tex. 1990); *In re Hudson*, 260 B.R. 421, 430 n. 16 (Bankr. W.D. Mich. 2001) (“Whether a creditor’s claim is an ‘allowed secured claim’ can be determined before, at, or after the confirmation hearing depending upon the circumstances.”). Fed. R. Bankr. P. 3012 allows determination of a secured claim upon motion. Such a motion may be used to ascertain whether and to what extent a creditor is secured for plan purposes. *Hudson* at 430; 9 COLLIER ON BANKRUPTCY ¶ 3012.01 (15th ed. rev. 2002). Just as a motion under Fed. R. Bank. P. 3013 to determine classification (9 COLLIER ON BANKRUPTCY ¶ 3013.01, n. 7 (15th ed. rev. 2002)) may be pursued to assist in formulation of a plan, so too may Rule 3012 be used to establish secured and unsecured debt.

The Court’s determination that DQF’s secured position may be determined for plan purposes pursuant to the Motion is consistent with controlling case law in this circuit. The Court of Appeals for the Fifth Circuit has held that settlement of a claim must conform to the absolute priority rule in order for the settlement to be approved before the filing of a plan *U.S.V. Aweco (In re Aweco)*, 725 F.2d 293, 298 (5th Cir), *cert denied*, 469 U.S. 880, 105 S. Ct. 244 (1984); *see, also, In re Boston & Providence R.R. Corp.*, 673 F. 2d 11 (1st Cir. 1982). Likewise, the Court of Appeals has held that a debtor may not undertake transactions outside of a plan which would be dispositive of the terms of a plan (at least without the protections afforded by the plan process). See *Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F. 2d 935 (5th cir. 1983). As these decisions recognize, the process of restructuring the debtor-creditor relationship may begin before the plan is filed. So long as creditors are protected - so long as the steps undertaken by a debtor clearly are in the best interests of the creditors and in furtherance of a confirmable plan, they may

be pursued. In the case at bar, the proposed resolution of Wells Fargo's claim and the valuation of DQF's debt are not attacked as being contrary to *Aweco* or *Braniff*. DQF in fact acknowledges that the stipulation with Wells Fargo is a good result for creditors. The Court concurs. As *Braniff* and *Aweco* establish guidelines as to what may be done respecting restructuring of the debtor-creditor relationship pre-plan, and as the Court concludes that the relief sought in the Motion falls within those guidelines and is in the best interests of creditors, that relief may be granted for purposes of a plan at this time.

The Court has been cited by the parties to *In re Wood*, 190 B.R. 788 (Bankr. M.D. Pa. 1996). That case establishes a list of 11 factors⁷ for determining the date as of which a valuation of a creditor's security should occur. While this Court is not prepared to adopt the factors used by the *Wood* court, application of those factors overwhelmingly favors valuing DQF's claim before disposition of Wells Fargo's claim. Any improvement in DQF's position is due to Debtors' efforts. Use of different valuation dates would lead to an absurd result. Valuation for plan purposes at this

⁷The court there stated (190 B.R. at 794-5):

1. The impact of the debtor's efforts on the postpetition change in value.
2. The expectancies of the parties at the time they may have made the loan agreement (if any).
3. The desirability of uniformity. Will the application of different dates for valuation purposes reach an absurd result?
4. The convenience of administration.
5. The equitable concept that those who bear the risk should benefit from the rise in value.
6. A resulting windfall to any one party should be discouraged.
7. The bankruptcy policy set forth in section 552(b) which extends prepetition liens to postpetition proceeds in certain situation.
8. The bankruptcy policy set forth in 11 U.S.C. § 362(d), which encourages the tendering of adequate protection payments to a creditor holding depreciating collateral.
9. The off-stated policy of bankruptcy to secure the debtor a "fresh start". *Lines v. Frederick*, 400 U.S. 18, 19, 91 S. Ct. 113, 27 L. Ed. 2d 124 (1970).
10. The result of utilizing a specific date of valuation on the bankruptcy itself including that impact upon senior and junior lien creditors.
11. Whether the party benefitting from a delay in valuation has been responsible for that delay.

time serves administrative convenience. DQF bore none of the burden associated with improved value and would receive a windfall if the Court accepted its arguments. The fresh-start policy of the Bankruptcy Code favors a valuation now for plan purposes. Valuation now, as opposed to later in the bankruptcy, leads to a more appropriate result. The remaining few factors listed in *Wood* are either neutral or not applicable.

Moreover, not only would DQF's argument provide it with a windfall earned by Debtors' labor, the bulk of that labor was performed by Operating, which earned the money to pay Wells Fargo. It would be anomalous and inequitable to allow DQF to use the valuation process to bootstrap itself into a secured position at the expense of Operating's creditors when Operating will have made that secured position possible.

III. Conclusion

For the foregoing reasons, the Motion will be granted.

IV. Order

It is therefore

ORDERED that Debtors be, and they hereby are, authorized to take all steps and execute all papers necessary to carry out their obligations under the Stipulation with Wells Fargo; and it is further

ORDERED, ADJUDGED and DECREED that, for purposes of any plan of reorganization in these cases, DQF is not secured by any franchise or furniture, fixtures or equipment which are property of Debtors' estates; and it is further

ORDERED that this order shall become effective as of 4:00 p.m., Fort Worth time, August 5, 2002, unless stayed by order of this or the District Court.

SIGNED this the 31st day of July, 2002.

Respectfully submitted,

D. MICHAEL LYNN
United States Bankruptcy Judge