U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS

ENTERED

TAWANA C. MARSHALL, CLERK
THE DATE OF ENTRY IS
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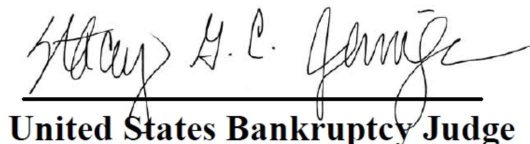
The following constitutes the ruling of the court and has the force and effect therein described.

Signed June 5, 2014



United States Bankruptcy Judge

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION**

IN RE:	§	
	§	
SCH INVESTMENTS, LLC,	§	**CASE NO. 14-31164-SGJ-11**
	§	
DEBTOR.	§	

SUA SPONTE MEMORANDUM AND ORDER DIRECTING THE APPOINTMENT OF A CHAPTER 11 TRUSTEE

I. INTRODUCTION

Horror vacui (translation: nature abhors a vacuum). This is an expression in the field of physics that is usually attributed to Aristotle.[1] Some great thinkers (scientists and philosophers alike) later challenged and criticized the statement. Galileo Galilei later restated the principle as "Resintenza del vacuo."[2]

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[1] ARISTOTLE, *PHYSICS* Book IV 6-9, *available at* http://ebooks.adelaide.edu.au/a/aristotle/physics/book4.html#section32.

[2] RENÉ DUGAS, *A HISTORY OF MECHANICS* 144 (1988).

This scientific principle seems especially fitting for this Chapter 11 case. In short, there has been a void or vacuum in leadership from the debtor-in-possession. The case needs a fiduciary to step into the void.

On May 28, 2014 and June 3-June 4, 2014, the court held a hearing (the "Hearing") on a Motion for Order Granting Relief from the Automatic Stay [DE # 32], and related Motion regarding the applicability of Section 362(d)(3) of the Bankruptcy Code to the above-referenced Debtor [DE #33] (collectively, the "Motions"), both filed by a secured creditor, 7636 Harwin, LLC (the "Movant"), in the above-referenced bankruptcy case (the "Bankruptcy Case") of SCH Investments, LLC (the "Debtor"). Based on the evidence presented during the Hearing, and for the reasons stated orally by this court thereafter, and the further reasons stated below, the court has determined that "cause" exists for the immediate appointment of a Chapter 11 Trustee under 11 U.S.C. §§ 1104(a) and 105(a). Such "cause" includes the Debtor's neglect of fiduciary duties, mismanagement, abdication of responsibilities, and gross inattentiveness with regard to a multimillion dollar piece of property. In short, there has been an utter vacuum of leadership in attending to the needs of the Debtor. And there has been a failure to focus on the duty to maximize value for the creditors ahead of the equity owners/guarantors.

II. BACKGROUND.

By way of background, the secured creditor Movant requested that the automatic stay be lifted, pursuant to section 362(d) of the Bankruptcy Code, to allow Movant to exercise its rights and remedies with regard to its collateral, which collateral consists of approximately 6.7 acres of real property at 7636 Harwin Drive, Houston, Harris County, Texas (which is in the so-called Westwood/Bellaire retail submarket of the Greater Houston Retail Market), on which there has been partial construction of what was intended to be an outlet retail shopping mall. To be

specific, there is approximately 2.16 acres of land on which there has been constructed one building with 17 units that are mostly finished and ready for occupancy (the units are missing only certain items like flooring and air conditioning), and there is an adjacent roughly 4.34 acre tract of land, on which a future building 2 and 3 were intended but never built, and this adjacent land has only been partially prepared for future construction, with such things as a concrete slab, and site work for utilities and parking lots. Hereinafter, the court will refer to this collateral in its entirety as the "Property," and, when referring to the building with the mostly finished units, the court will use the term "Building 1" and "Units" or "Units 1-17," as appropriate. The barely developed property adjacent to Building 1 will be referred to sometimes as the "Adjacent Real Property." It should be noted that the Debtor had the intention of marketing the Property as a Condominium Retail Project, meaning the Units would be individually ***sold*** to buyers, rather than individually rented or leased. Units 1-17 comprise 60,321 square feet of space. By way of further background, the Debtor filed a voluntary Chapter 11 bankruptcy case on March 4, 2013. The Debtor's sworn Statement of Financial Affairs [DE # 27], filed March 27, 2014, of which this court takes judicial notice, reflected at Question 21 that there are three equity owners that each own 33.3% of the Debtor: Amir Hussain, Rajiv Chhabra, and Rajinder Singh. The evidence reflected that these three equity owners are guarantors on Movant's debt. *See* Movant's Exs. A-6 through A-8. The Debtor's sworn Schedules [DE # 26], filed March 27, 2014, of which this court takes judicial notice, reflected a current value of the Property of $15,000,000 (Schedule A) and reflected that no other assets are owned by the Debtor. The Schedules also reflected approximately $14,268,979.68 of secured indebtedness against the Property, held by the following claimants in the following amounts: Movant with a scheduled $10 million claim; AZA Investments, LLC (hereinafter, "AZA") with a scheduled $750,000 claim; A & Skipol, Inc. with

a scheduled $1.6 million claim; Royal Bengal Construction with a scheduled $918,979.68 claim; and Target Builders, LLC with a scheduled $1 million claim. There are various vendors and insider claimants listed on Schedule F as well. No executory contracts are listed.

The Debtor originally opposed the Movant's Motions. On the eve of the hearing, the Debtor withdrew its opposition to the Motions.

III. A ROSY START.

The beginning of this case looked somewhat hopeful for creditors. Specifically, not only did the Debtor schedule the Property at a value of $15 million, but the Debtor fairly quickly filed motions to sell certain Units in Building 1 for prices that seemed favorable for all stakeholders. On March 12, 2014 [DE # 14], the Debtor filed a Motion to sell three Units in Building 1–specifically Unit 105 for $578,000 to a buyer named Nworen Hussain, pursuant to a contract that was dated prepetition on December 31, 2013, and Units 101 and 102 for a price of $1,232,330 to a buyer named Harwin Outlet Mall Ambashis Accessories, LLC, pursuant to a contract that was also dated prepetition on January 22, 2014. Then, on April 7, 2014, [DE # 35], the Debtor filed a Motion to sell two more Units in Building 1–specifically Units 108 and 109 for a price of $1,084,800 to a buyer named Yasii Management, pursuant to a post petition contract dated March 26, 2014. Thus, it looked as though the Debtor would be in a position to monetize five of its 17 Units fairly quickly into the Chapter 11 case, for an aggregate price of $2,895,130 (which calculates to an average of $579,026 per unit). The Debtor's counsel represented at a hearing on the record during this case that the hope was to use sale proceeds from these sales to pay down some debt and then obtain some new post petition financing pursuant to which it could reorganize.

Things quickly went downhill in this case.

Among other things, it was brought to the court's attention that the Property was not adequately insured. Rather, only a Builder's Risk insurance policy existed on the Property (obtained by the builder/contractor, not the Debtor) until Movant obtained yet additional coverage at its own expense. Movant filed two motions to lift stay and asked to take Rule 2004 examinations of the three Debtor principals. Then, on the day that the Rule 2004 examinations were scheduled to commence, just days before Movant's Motions to lift stay were set to be heard, the Debtor suddenly filed withdrawals of the sale motions and also filed a motion to dismiss the Chapter 11 case. When the court convened the hearing on the Movant's Motions to lift stay on May 28, 2014, the court was apprised by counsel for the Debtor and Movant that the Debtor had agreed to the stay relief, and the parties had reached an overall compromise that contemplated: (a) that the Debtor would not oppose relief from the stay in favor of Movant; (b) the Debtor would move for dismissal of its Chapter 11 case; (c) the Debtor would give Movant a deed in lieu of foreclosure on the Property; (d) the Movant would be paid $450,000 in exchange for a full release of the guaranties against the Debtor's three principals ($100,000 of which was already in escrow; source of funds unclear—probably the Debtor's guarantors since the Debtor has no funds); and (e) the Movant would release liens it had on certain property in Dallas owned by an affiliate of the Debtor, known as SCH-Trident, which affiliate is in a bankruptcy case pending before Judge Harlin Hale. To be clear, no motion to approve a compromise is before this court. And no motion asking for permission to transfer the Property by deed in lieu of foreclosure to the Movant is pending. Only the Movant's Motions to lift stay are now before the court (and there is a pending motion to dismiss case that is not yet set for hearing). When Debtor's counsel was asked what happened to the buyers on the sale motions, he said that they did not seem ready, willing, and able to close and were not prepared to come to court and testify

that they were. Apparently, one of the now-reluctant buyers is a daughter of one of the principals of the Debtor.

One last interesting fact is that the Debtor's principal, Rajvi Chhabrra, represented during this case (at a hearing on May 5, 2014, when asked by the court) that the Property was acquired for $5.4 million. This was in year 2007. Thus, 7 years ago, before any construction on the Property, this is how much money was paid to acquire the undeveloped Property.

At the three-day Hearing on the Movant's motions, three junior secured creditors appeared through counsel and opposed the Movant's Motions (one through pleadings and evidence, and two through oral argument). Debtor's counsel showed up two of the three days of Hearing (not on the last day when the court orally ruled) and sat and observed, but put on no evidence or argument. No representatives/principals from the Debtor appeared in person during the three-day Hearing. The court determined that the Movant, which had the burden of proving no equity, had not met its burden on the issue of equity (there was an appraiser whose "comparables" seemed lacking). However, the court is concerned about the adequate protection of ***the Movant and all lienholders***. The court is entering a separate adequate protection order.

IV. NEED FOR A TRUSTEE, AS LEAST BAD SOLUTION.

But the court is in a difficult position. It appears that the Property may have enough value for multiple creditors to realize some recovery, but there is no reorganization in prospect or recovery in prospect with the debtor-in-possession in place. There is a vacuum in leadership and control in this Chapter 11 case. The Debtor is neglecting its fiduciary duties. The Debtor seems to have "given up without a fight" once its principals negotiated a release of their guarantees from Movant. Suddenly the sales of five units just went away. The court was troubled that the Debtor's principals were able and willing to fund a $100,000 escrow to get a release of their

guarantees from Movant, as was announced in court, but cannot afford insurance, security, and other safeguarding of the Property. The Debtor did not appear in court to announce why it was a reasonable exercise of its business judgment to: (a) withdraw opposition to the Motions; (b) withdraw the various sale motions; and (c) move to dismiss the case—when three junior lienholders are very concerned there may be value being left unexploited. Was the $15 million value on the Schedules overly optimistic? Quite possible. Has the Debtor said or explained that? No. Moreover, at the third day of hearing on the Motions, a junior lienholder (AZA) offered to: (a) make a postpetition loan to fund administrative expenses; and (b) make an offer to buy several units. The Debtor and Debtor's counsel were not present to hear this.

This case needs a neutral third party to exercise fiduciary duties and decide if there are any viable alternatives other than capitulation to the first lienholder and dismissal of the case. Someone needs to step into the vacuum that the Debtor has left. Because of the precarious situation with the Property, the court will impose a tight time frame.

It is, therefore,

ORDERED that the United States Trustee is directed to appoint a Chapter 11 Trustee in the above-captioned bankruptcy case; it is further

ORDERED that the court reserves the right to supplement the record supporting the appointment of a Chapter 11 Trustee; and it is further

ORDERED the court will hold a status conference; a further hearing on the Motions; and a hearing on the Motion to Dismiss on **<u>July 28, 2014 at 1:30 p.m.</u>**, to determine the future of this case. If the Chapter 11 Trustee is not able, at such status conference/hearing, to: (a) offer some prospects for rehabilitation of this Debtor and recovery to creditors other than the Movants; and

(b) provide a mechanism for paying administrative expenses and provide adequate protection to the lienholders, then this court may grant the Motions and/or dismiss the case.

END OF ORDER