

Lien Release
Specific Performance

Avalon Hotel Partners, LLC et al v. Rivers Avalon Management, LLC,
Adversary No. 06-03065-rld
Avalon Hotel Partners, LLC, Case No. 03-40414-rld11

4/13/2006 RLD

Unpublished

The chapter 11 case was filed in 2003 to address financial and control disputes among membership interests in the LLC which owned and operated a luxury hotel. The LLC members resolved their disputes through negotiation, which ultimately facilitated confirmation of the plan in 2005.

As part of the resolution, the majority interest holders (RAM) agreed to accept, in satisfaction of its post-petition administrative claim, a note secured by a deed of trust on the hotel property. The parties referred to the note as a "Hope Note." Recognizing that the only "hope" of repayment of its note was a successful reorganization of the hotel and a significant increase in its value, RAM expressly subordinated the Hope Note to the anticipated post-petition credit line lender, whose identity was unknown when the Hope Note and supporting trust deed were executed. To protect RAM's concern that the minority interest holder (AHD) not receive a distribution from the hotel without payment of the Hope Note, the deed of trust contained three conditions precedent to release.

Ultimately, affiliates of AHD comprised a portion of Phoenix, which contributed 50% of the post-confirmation credit line. The other 50% was contributed by affiliates of Grand Heritage, the independent post-petition operator of the hotel.

When the hotel sold for a price one penny short of paying anything on the Hope Note, RAM refused to release its lien on the basis that the conditions precedent to release had not been satisfied. The new hotel owner sought specific performance of the release through this adversary proceeding.

The court held that the Third Condition, which required that "no part of the purchase price shall have been paid to Borrower [AHD] or any person or entity affiliated with or related to Borrower [AHD] or any affiliate of Borrower [AHD]," had not been satisfied. The court found that "no part of the purchase price" was not restricted to a return to equity, but that payment of the credit line lien with 15% interest was sufficient to preclude release of the subordinate RAM lien without payment in full of the Hope Note where AHD affiliates undisputably received some of the

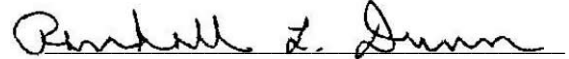
payment and interest on the credit line lien.

The court held that the First Condition, requiring that the sale be to a bona fide purchaser not affiliated with AHD in any manner, was met. Mr. Cullen was affiliated both with the Grand Heritage side of the credit line lender and with the new hotel owner. However, because he had severed his relationship with Grand Heritage well before exercising his option to purchase the hotel, the court found he had no affiliation with the credit line lender at the time of the purchase of the hotel.

As to the Second Condition, while the sale price was in excess of the fair market value of the hotel, the court could not determine that the actual purchase price was not engineered by the parties, where that price was sufficient to satisfy all liens one penny short of providing for any payment on the Hope Note.

P06(5)-17

Below is an Order of the Court.



RANDALL L. DUNN
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case
Avalon Hotel Partners, LLC,) No. 03-40414-rld11
Debtor.)
_____))
Avalon Hotel Partners, LLC and)
Avalon Hotel Owner, LLC,)
Plaintiffs,) Adv. Proc. No. 06-3065-rld
v.) MEMORANDUM OPINION
Rivers Avalon Management, LLC,)
Defendant.)
_____)

The issue before me is whether a secured promissory note obligation, characterized by the parties as a "hope note," is hopeless or in the money.

Factual Background

This adversary proceeding (the "Adversary proceeding") arises out of the chapter 11 case of Avalon Hotel Partners, LLC (the "Debtor"),

1 filed on September 15, 2003. The Debtor owned the upscale Avalon Hotel &
2 Spa (the "Avalon Hotel"), a 100-room boutique hotel located on the
3 Willamette River near downtown Portland, Oregon. Ownership of the Debtor
4 was divided among a number of members: Several related entities (the
5 "Pacific Western Entities") owned an aggregate 67.19% of the membership
6 interests in the Debtor. See Ex. 11, p. 2. The hotel developer, Avalon
7 Hotel Developer, LLC (the "Developer"), the principals of which were
8 Mr. Paul Brenneke ("Mr. Brenneke") and Mr. Terrence Bean ("Mr. Bean"),
9 held a 23.50% ownership interest in the Debtor. Id. Two other entities
10 held the remaining minority membership interests. Id.

11 At the time of the Debtor's chapter 11 filing, it is highly
12 doubtful that its members' equity interests had any value. That reality
13 did not prevent the Pacific Western Entities and the Developer from
14 wrangling at great expense of time and money virtually throughout the
15 chapter 11 proceedings, continuing the pattern of their relationship
16 established in prior state court litigation. In short, the Debtor's
17 chapter 11 case was extremely contentious.

18 However, in May 2004, following marathon negotiations and
19 numerous settlement conferences, a settlement was negotiated between the
20 Pacific Western Entities and the Developer which resolved many of the
21 claims between them. The settlement agreement (Ex. B, the "Settlement
22 Agreement") provided, among other things, for the issuance of a
23 promissory note (the "Promissory Note") in the face amount of \$427,978 to
24 Rivers Avalon Management, LLC ("RAM"), an affiliate of the Pacific
25 Western Entities, secured by a deed of trust (the "Trust Deed") on the
26 Avalon Hotel. The Promissory Note represented consideration to RAM for

1 advances used to fund operations of the Avalon Hotel in chapter 11, in
2 lieu of an administrative expense claim. Payment of the Promissory Note
3 expressly was subordinated to a number of prior liens on the Avalon
4 Hotel, including the lien of "any credit line lender" (the "Credit Line
5 Lender") up to \$2 million. See Ex. C, p. 6. The Credit Line Lender is
6 not identified in the Trust Deed, and the representatives of the Pacific
7 Western Entities who testified at the trial, confirmed that the identity
8 of the Credit Line Lender was not known by the Pacific Western Entities
9 at the time the Settlement Agreement was finalized.

10 Negotiation of the Settlement Agreement was a breakthrough that
11 allowed for confirmation of a reorganization plan (the "Plan") in the
12 Debtor's chapter 11 case. In May 2004, management of the Avalon Hotel
13 was transferred to GH-Avalon Hotel Management, LLC ("Avalon Management"),
14 after the Developer initiated negotiations with Avalon Management's
15 principal, Mr. John Cullen, who owned and managed the Governor Hotel in
16 Portland, Oregon through affiliated entities. Avalon Management's
17 agreement to manage the Avalon Hotel was approved by this court, finding
18 the proposed management company to be disinterested. See Ex. 4. The
19 Plan was confirmed by Order of this court entered on October 29, 2004.
20 See Ex. E.

21 Following confirmation of the Plan, the members of the
22 reorganized Debtor were Phoenix at Avalon Hotel, LLC ("Phoenix"), and
23 GHG-Avalon Hotel, LLC ("GHG-Hotel"), each of which held a 50% ownership
24 interest in the Debtor. See Ex. 11, p. 3, and Ex. V, p. 1.

25 Chapter 11 has been a success in this case: Postconfirmation,
26 all allowed administrative expense claims have been paid, general

1 unsecured creditors (primarily trade debt) have received the distribution
2 provided for in the Plan, and all liens on the Avalon Hotel with priority
3 ahead of the Trust Deed have been satisfied.

4 However, the Promissory Note has not been paid, and in the
5 Adversary Proceeding, the plaintiffs, Avalon Hotel Partners, LLC, and
6 Avalon Hotel Owner, LLC (the "Avalon Hotel Owners"), seek a specific
7 performance decree requiring RAM to release the Trust Deed or decreeing
8 that RAM's lien rights with respect to the Avalon Hotel property are
9 deemed released. The basis for the Avalon Hotel Owners' specific
10 performance cause of action is found in language of the "Due on Sale"
11 provision of the Trust Deed, providing as follows:

12 ...Borrower shall be entitled to the release of the
13 lien of this Deed of Trust and of any other instrument
14 securing the [Promissory] Note upon satisfaction of
15 all of the following conditions precedent: (a) the
16 release shall be in connection with the sale of the
17 [Avalon Hotel] Property to a bona fide purchaser who
18 is not affiliated with or related to the Borrower or
19 any affiliate of the Borrower in any manner; (b) the
20 purchase price shall be equal to the fair market value
21 of the Property as determined by Lender in its
22 reasonable discretion; and (c) no part of the purchase
23 price shall have been paid to Borrower or any person
24 or entity affiliated with or related to Borrower or
25 any affiliate of Borrower. Ex. C, p. 6.

26 In the Trust Deed, "Borrower" is defined as the Developer or the Debtor,
and "Lender" refers to RAM, its successors and assigns. See Ex. C, p. 2.

 On December 29, 2005, the Avalon Hotel was sold (the "Sale") to
Avalon Hotel Owner, LLC ("AHO") pursuant to a Purchase and Sale Agreement
that was entered into on December 27, 2005. See Ex. R. An appraisal
report prepared by PKF Consulting for the Royal Bank of Scotland gave a
market value for the Avalon Hotel as of December 1, 2005, of \$14,000,000.

1 See Ex. 10. The purchase price ("Purchase Price") was \$14,719,828.31.
2 See Ex. R, p. 2. The sale proceeds were paid to satisfy the five liens
3 preceding the Trust Deed in priority, including the lien of the Credit
4 Line Lender, with no net sale proceeds available to apply to the
5 Promissory Note obligation to RAM.

6 From the Purchase Price, the Credit Line Lender, Avalon Capital
7 NW, LLC ("Avalon Capital"), received \$1,921,950, including accrued
8 interest at the rate of 15%¹ per annum on principal funds advanced of
9 \$1,868,861. See Ex. P, pp. 2-3, and Ex. R, p. 2. It is unclear to me
10 from the organizational charts submitted into evidence by the parties
11 exactly how Avalon Capital is owned. (Compare Ex. 11, p.3 with Ex. V,
12 p.4.) However, the record is clear that Phoenix advanced a portion,
13 perhaps 50%, of the credit line funds advanced to the Debtor to fund the
14 operations of the Avalon Hotel postconfirmation. Phoenix is owned by
15 Dunavan Portland, LLC, of which Mr. Brenneke is president and an
16 affiliate, Bean Avalon, LLC, of which Mr. Bean may be an affiliate,
17 Miller Family Holdings, LLC, and Schwabe, Williamson & Wyatt, PC, the law
18 firm that represented the Developer in the Debtor's chapter 11
19 proceedings. See Ex. V, p. 2. No evidence was submitted by any party as
20 to what portions of the funds advanced from Phoenix to Avalon Capital to
21 be lent to the Debtor were advanced by the various owners of Phoenix
22 and/or their affiliates. No evidence was submitted by any party as to
23 how the Purchase Price proceeds paid to Avalon Capital were distributed
24

25 ¹ Mr. Cullen clarified in his testimony that only the Phoenix
26 component of Avalon Capital received interest. The GHG-Hotel component
of Avalon Capital forfeited its interest under the Option agreement.

1 through Phoenix to its owners and their affiliates.

2 Mr. Cullen severed his relationship with the Avalon Hotel and
3 Avalon Management effective January 1, 2005, retaining an option (the
4 "Option") to acquire the Avalon Hotel in conjunction with acquisition of
5 the Governor Hotel through October 31, 2005. See Exs. 7 and 8.
6 Mr. Cullen paid a total of \$200,000 to extend the Option through December
7 31, 2005. See Ex. 7, p. 1. He exercised the Option to allow the Sale to
8 AHO to be consummated on or about December 29, 2005.

9 Jurisdiction

10 This court has jurisdiction to hear this Adversary Proceeding
11 pursuant to 28 U.S.C. §§ 157 and 1334 and United States District Court
12 for the District of Oregon Local Rule 2100-1. The issues before me are
13 matters of contract interpretation, generally not within the core
14 jurisdiction of the bankruptcy court. However, the cause of action
15 stated in the Adversary Proceeding clearly arises out of the Debtor's
16 chapter 11 case, and concerns implementation of the Settlement Agreement,
17 which was incorporated in the confirmed Plan. Under Article VIII of the
18 Plan, this court specifically retained jurisdiction "[t]o hear and
19 determine disputes arising in connection with" the Plan and "[t]o hear
20 and determine any motion, application, adversary proceeding or contested
21 matter concerning the interpretation or enforcement of the Settlement
22 Agreement." In these circumstances, I find that this court has
23 jurisdiction to make a final decision in the Adversary Proceeding.

24 Legal Discussion

25 The Avalon Hotel Owners seek a specific performance decree
26 releasing the Avalon Hotel from the lien of the Trust Deed, arguing that

1 the three conditions stated in the Trust Deed for its release have been
2 fully satisfied.

3 The Trust Deed provides that it "shall be governed by,
4 construed and enforced in accordance with the laws of the State of
5 Oregon." Ex. C, p. 16. Accordingly, I will be guided by Oregon law in
6 interpreting the Trust Deed.

7 The Trust Deed further provides that, together with the
8 Promissory Note, it

9 constitutes the entire understanding and agreement of
10 the parties as to the matters set forth in this Deed
11 of Trust. No alteration of or amendment to this Deed
12 and signed by the party or parties sought to be
charged or bound by the alteration or amendment.
Ex. C, p. 15.

13 No evidence was presented by the parties that the Trust Deed ever was
14 amended. I find that the Trust Deed and the Promissory Note are
15 integrated, self-contained expressions of the agreement among RAM, the
16 Debtor and the Developer as to their respective terms.

17 Oregon Revised Statutes Section 41.740 provides that:

18 When the terms of an agreement have been reduced to
19 writing by the parties, it is to be considered as
20 containing all those terms, and therefore there can
21 be, between the parties and their representatives or
22 successors in interest, no evidence of the terms of
the agreement, other than the contents of the writing,
except where a mistake or imperfection of the writing
is put in issue by the pleadings or where the validity
of the agreement is the fact in dispute. However this
23 section does not exclude other evidence of the
24 circumstances under which the agreement was made, or
to which it relates, as defined in ORS 42.220, or to
25 explain an ambiguity, intrinsic or extrinsic, or to
establish illegality or fraud....

26 Oregon Revised Statutes Section 42.220 provides that:

1 In construing an instrument, the circumstances under
2 which it was made, including the situation of the
3 subject and of the parties, may be shown so that the
4 judge is placed in the position of those whose
5 language the judge is interpreting.

6 Consistent with these provisions of Oregon law, I held at the
7 outset of the trial that evidence as to the circumstances of the Debtor's
8 chapter 11 case and the negotiation and drafting of the Settlement
9 Agreement, the Promissory Note and the Trust Deed was admissible, and I
10 have considered all such evidence submitted by the parties to establish
11 context in the Adversary Proceeding. However, I am mindful of the limits
12 to my consideration of such evidence.

13 Admissible or not, evidence that is inconsistent with or that
14 contradicts unambiguous written terms of an Oregon contract is legally
15 ineffective. See, e.g., Abercrombie v. Hayden Corp., 320 Or. 279, 286,
16 289, 883 P.2d 845, 850, 851 (1994); Hatley v. Stafford, 284 Or. 523, 533-
17 34, 588 P.2d 603, 608-09 (1978).

18 The challenge facing the Avalon Hotel Owners from the inception
19 of this Adversary Proceeding is that they bear the burden of proof by at
20 least the preponderance of the evidence to establish that each of the
21 three conditions set forth in the Trust Deed has been met in order to
22 entitle them to a release of the Trust Deed as third party beneficiaries
23 of the Borrower. See, e.g., Murray v. Laugsand, 179 Or. App. 291, 294,
24 39 P.3d 241, 243 (2002). The three conditions are stated in the Trust
25 Deed as follows:

26 (a) the release shall be in connection with the sale
 of the [Avalon Hotel] to a bona fide purchaser who is
 not affiliated with or related to Borrower or any
 affiliate of Borrower in any manner; (b) the purchase
 price shall be equal to the fair market value of the

1 [Avalon Hotel] as determined by Lender in its
2 reasonable discretion; and (c) no part of the purchase
3 price shall have been paid to Borrower or any person
or entity affiliated with or related to Borrower or
any affiliate of Borrower. Ex. C, p. 6.

4 Evidence was submitted by both sides as to the alleged satisfaction or
5 nonsatisfaction of the three conditions. In reaching a decision, I have
6 focused on the third condition.

7 The third condition (the "Third Condition") for the release of
8 the Trust Deed provides that "no part of the purchase price shall have
9 been paid to Borrower or any person or entity affiliated with or related
10 to Borrower or any affiliate of Borrower." The Avalon Hotel Owners base
11 their claim that the Third Condition has been satisfied on two arguments.

12 In a post-trial letter to the court dated March 14, 2006, that
13 I treat as continuing argument, counsel for the Avalon Hotel Owners
14 argues that the term "no part of the purchase price" should be
15 interpreted as no return on equity "after payment of the 1st through 5th
16 liens." Doc. No. 15, p. 2. That argument represents a refinement on the
17 Avalon Hotel Owners' general position that in order to be consistent with
18 the subordination provisions of the Trust Deed, any distribution from the
19 Purchase Price to pay the obligation to the Credit Line Lender, or
20 indeed, to pay any lien prior to the Trust Deed, should not be
21 interpreted as inconsistent with satisfaction of the Third Condition. In
22 other words, the Avalon Hotel Owners argue that payment of debt senior to
23 the Promissory Note obligation secured by the Trust Deed cannot be
24 interpreted as a payment to the Debtor or a party affiliated with or
25 related to the Debtor, as a matter of law. I find the arguments of the
26 Avalon Hotel Owners not convincing for the following reasons.

1 First, I find the phrase "no part of the purchase price" is not
2 ambiguous and means what it says. RAM argues, and I agree that the term
3 "purchase price" is "commonly used and generally understood to mean money
4 paid to purchase or acquire something." Doc. No. 16, p. 2. If RAM, the
5 Developer and the Debtor intended an exclusion from any "part of the
6 purchase price" for payments of senior liens or indebtedness, they could
7 have said so in the Third Condition language. Roger Royse, a lawyer who
8 was the principal negotiator and draftsman for the Pacific Western
9 Entities, including RAM, with regard to the Settlement Agreement, the
10 Promissory Note and the Trust Deed, testified that "every word" of the
11 agreements was heavily negotiated. He testified in deposition that:

12 The purpose was to avoid [the Developer and Mr.
13 Brenneke] coming up with some way to avoid paying us.
14 And what we were concerned about is that they would do
15 what they've always done, and that's figure out a way
16 to transfer this property to some other entity and
17 avoid paying our note in the process. Ex. 13, p. 3.

18 The Avalon Hotel Owners argue that since RAM in the Trust Deed
19 expressly subordinated payment of the Promissory Note obligation to
20 payment of the secured credit line up to \$2 million of any Credit Line
21 Lender, the fact that Avalon Capital is affiliated with or related to the
22 Developer, the Debtor or any affiliate of either of them is irrelevant.
23 I disagree.

24 I find that the subordination and due on sale provisions of the
25 Trust Deed operate independently. At the time that the Settlement
26 Agreement, the Promissory Note and the Trust Deed were finalized, the
identity of the Credit Line Lender was not known. RAM agreed to
subordinate its Trust Deed lien to the lien of a Credit Line Lender up to

1 \$2 million to allow for future financing of Avalon Hotel operations in
2 order to preserve the possibility that its "hope note" would be paid.
3 However, the deal, as reflected in the Third Condition by its terms, was
4 that if the Debtor, the Developer or any affiliated or related person or
5 entity got any proceeds from the sale of the Avalon Hotel, whether
6 through payment of debt or return on equity or otherwise, the Third
7 Condition for release of the Trust Deed would not be satisfied.

8 There is no question that the Promissory Note debt represented
9 hard dollars advanced by RAM to fund Avalon Hotel operations in chapter
10 11. In the absence of the deal reflected in the Settlement Agreement,
11 RAM would have had an administrative expense claim in the Debtor's
12 bankruptcy case in the approximate amount of the Promissory Note debt
13 that the Debtor would have been required to pay in full, to the extent
14 allowed, following confirmation of the Plan. There is nothing
15 inconsistent with the subordination provisions of the Trust Deed in the
16 requirement of the Third Condition that if the Debtor, the Developer or
17 any affiliated or related party got any payment from the Purchase Price
18 for the Avalon Hotel, RAM should be paid as well.

19 Beyond the breadth of the phrase "no part of the purchase
20 price," the wording of the Third Condition reflects the concern of the
21 Pacific Western Entities that the Trust Deed not be released if any
22 portion of the Purchase Price went to the Debtor, the Developer or any of
23 their control persons or entities. The Third Condition specifies that no
24 part of the Purchase Price "shall have been paid to Borrower or any
25 person or entity affiliated with or related to Borrower or any affiliate
26 of Borrower." Mr. Royse testified at the trial that the terms

1 "affiliated" and "related to" were intended in the broadest sense
2 possible.

3 Affiliate is used in two senses in the Third Condition: In the
4 phrase "any affiliate of Borrower," it means a control person or entity,
5 consistent, for example, with the definition in several Oregon statutes,
6 characterizing an "affiliate" as "a person who directly, or indirectly
7 through one or more intermediaries, controls, or is controlled by, or is
8 under common control with, another person." See, e.g., ORS
9 §§ 60.801(3)(a), 60.825(1) and 90.820(4)(c).

10 However, "affiliate" is used in even a broader sense in the
11 specification that no part of the Purchase Price shall have been paid to
12 Borrower or any person or entity "affiliated with or related to" Borrower
13 or any affiliate of the Borrower. In that sense, the Third Condition
14 addresses payments to any entity that has any connection or relationship
15 to the Debtor or the Developer.

16 Avalon Capital is owned in part by Phoenix. Phoenix in turn is
17 owned in part by Dunavan Portland, LLC, whose President is Mr. Brenneke,
18 and in part by Bean Avalon, LLC, in which I assume Mr. Bean has an
19 interest. Mr. Brenneke and Mr. Bean were the principals of the
20 Developer. I cannot tell from the evidence presented what financial
21 contributions, if any, were made by Mr. Brenneke and Mr. Bean, either
22 directly or indirectly through intermediaries, to Phoenix to fund Avalon
23 Capital and the credit line loan(s) to finance Avalon Hotel operations
24 postconfirmation. However, the Debtor's Disclosure Statement states the
25 following with respect to Avalon Capital:

26 Avalon Capital, LLC will be an entity comprised of an

1 affiliate of GH-Avalon Management, LLC and an entity
2 to be formed and controlled by Paul Brenneke or by an
3 affiliate that is controlled by Paul Brenneke and/or
4 Terry Bean. Avalon Capital, LLC will be funded by the
5 members of Avalon Hotel [sic] Capital, LLC, including
6 Brenneke and/or Bean and/or an affiliated entity
7 funded and controlled by them. Ex. G, p. 22.

8 I further cannot tell from the evidence presented what
9 portions, if any, of the Purchase Price were distributed through Avalon
10 Capital to Phoenix and ultimately to entities owned or controlled by
11 Mr. Brenneke and Mr. Bean. However, with Mr. Brenneke and Mr. Bean
12 implicated in the ownership structures of Avalon Capital and Phoenix, in
13 order to meet their burden to establish that the Third Condition was
14 satisfied, the Avalon Hotel Owners were required to show that no portion
15 of the Purchase Price was paid to entities owned or controlled by
16 Mr. Brenneke or Mr. Bean, whether as repayment of debt or as a
17 distribution on equity. The Avalon Hotel Owners simply have not met that
18 burden. Accordingly, I find that the Avalon Hotel Owners have not met
19 the burden of proof to prevail on their specific performance cause of
20 action in the Adversary Proceeding, and RAM is entitled to judgment in
21 its favor.

22 With regard to the other two conditions for release of the
23 trust deed, I find as follows: The first condition ("First Condition")
24 specifies that release of the Trust Deed "shall be in connection with the
25 sale of the [Avalon Hotel] to a bona fide purchaser who is not affiliated
26 or related to Borrower or any affiliate of Borrower in any manner...."
27 Again, consistent with the testimony of Mr. Royse, I understand the term
28 "affiliate" in the First Condition to be used in its broadest sense.

29 At the outset, I find that the Avalon Hotel Owners' purchase of

1 the Avalon Hotel for a Purchase Price of \$14,719,828.31 is a bona fide
2 purchase for value. If anything, in light of the Avalon Hotel's
3 appraised value of \$14,000,000 as of December 1, 2005, and Mr. Cullen's
4 testimony that he found the appraised value surprisingly high, I agree
5 that the Purchase Price was in excess of the hotel's fair market value.

6 The parties' contentions with respect to the First Condition
7 focus on the relationship of Mr. Cullen to the entities on both the buyer
8 and seller sides of the Avalon Hotel sale transaction. Mr. Cullen was an
9 affiliate of the entity that managed the Avalon Hotel from some time in
10 May 2004, and he held an ownership interest in GHG-Hotel, which had a 50%
11 ownership interest in the Debtor postconfirmation. However, from the
12 uncontradicted evidence in the record, I find that Mr. Cullen severed all
13 connections with the Avalon Hotel manager and owners no later than
14 February 14, 2005, solely retaining the Option. The Option was exercised
15 in December 2005 by an entity that was not affiliated with the Debtor or
16 the Developer in any manner. I find that Mr. Cullen's relationships with
17 the Avalon Hotel Owners do not make him or them affiliates of the Debtor
18 or the Developer. Accordingly, I find that the First Condition has been
19 satisfied.

20 The second condition ("Second Condition"), which requires that
21 the Purchase Price "shall be equal to the fair market value of the
22 Property as determined by [RAM] in its reasonable discretion..." is
23 problematic. As discussed above, I find that the Purchase Price in all
24 likelihood was in excess of the fair market value of the Avalon Hotel at
25 the end of 2005. However, that does not mean that RAM is unjustified in
26 smelling a rat when the Purchase Price was set at an amount just high

1 enough to satisfy all liens prior to the Trust Deed, but not high enough
2 to pay any amount of the Promissory Note obligation to RAM.

3 From the record before me, I find that the Purchase Price was a
4 negotiated amount that captured the full current fair market value of the
5 Avalon Hotel, plus enough to satisfy the liens of all parties, other than
6 RAM, that might assert personal guarantee liabilities for a deficiency
7 against affiliates of the Borrower and the Developer. Based on the
8 testimony of the representatives of the Pacific Western Entities at
9 trial, I find that the Pacific Western Entities benefitted from the lien
10 satisfactions resulting from the sale. However, those findings do not
11 establish that the Purchase Price was not engineered by parties to the
12 Avalon Hotel sale, whether or not the Avalon Hotel Owners actively
13 participated in the engineering, to satisfy the liens on the Avalon Hotel
14 just short of providing for a payment on the Promissory Note obligation
15 secured by the Trust Deed. This result is precisely what Mr. Royse
16 testified in his deposition the Pacific Western Entities were seeking to
17 avoid in negotiating and drafting the terms of the conditions to release
18 of the Trust Deed. See Ex. 13, p. 3. From the record before me, I
19 cannot find that the Second Condition has been satisfied.

20 In its Answer to the Complaint, elaborated upon in the Pre-
21 Trial Order and in its trial memorandum, RAM raised as an alternative
22 defense to the Avalon Hotel Owners' cause of action that under the "due
23 on sale" clause of the Trust Deed, RAM had the option to declare all sums
24 secured by the Trust Deed due and payable upon the sale or transfer of
25 more than 35% of the membership interests of the Debtor. RAM argued that
26 sometime after confirmation of the Plan, a transfer of over 35% ownership

1 in the Debtor was effected. Accordingly, RAM should be able to enforce
2 its Promissory Note obligation based on the due on sale clause being
3 triggered in advance of the sale of the Avalon Hotel. However, prior to
4 the Avalon Hotel sale, RAM had neither declared a default under the
5 Promissory Note or Trust Deed, nor raised enforcement of the due on sale
6 clause of the Trust Deed as an issue, even though Mr. Royse testified at
7 the trial that he was aware of the transfers of 50% ownership interests
8 in the Debtor each to Phoenix and Grand Heritage from documents filed
9 with this court in late 2004.

10 The Avalon Hotel Owners have requested that I decide the
11 question as to whether the due on sale provision of the Trust Deed in
12 fact was triggered by a transfer of ownership interests in the Debtor in
13 advance of the Avalon Hotel sale. However, the record at trial with
14 respect to the due on sale question is sketchy at best. Since I have
15 decided the entire cause of action alleged in the Avalon Hotel Owners'
16 Complaint in the Adversary Proceeding through my decision on whether all
17 three conditions to release of the Trust Deed lien have been satisfied, I
18 do not need to decide the due on sale question. Not being required to
19 jump into that particular briar patch, I decline to do so.

20 Conclusion

21 I have found that the Avalon Hotel Owners have not met their
22 burden of proof to establish their entitlement to release of the Trust
23 Deed as a lien on the Avalon Hotel property. Accordingly, I find that
24 judgment in the Adversary Proceeding should be entered in favor of the
25 defendant, RAM. Counsel for RAM should prepare and submit a form of
26 judgment consistent with my rulings set forth in this Memorandum Opinion,

1 after submitting the draft form of judgment to counsel for the Avalon
2 Hotel Owners for review and comment as to form, within ten (10) days
3 following the date of entry of this Memorandum Opinion.

4 # # #

5 cc: John H. Durkheimer
6 S. Ward Greene
7 Keith S. Dubanevich
8 U.S. Trustee
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