

Dismissal or Conversion
Appointment of Trustee

South Star Oil Co., Case No. 08-61072-fra11

9/15/2008 FRA

Unpublished

The DIP owns or operates ten service stations, but has not been profitable since 2005. Hayes Oil Co. supplied petroleum inventory to the Debtor and filed a proof of claim in the amount of \$2.3 million, of which \$1.5 million in inventory was supplied within 20 days of the petition date. Hayes asserted a priority claim under Code §§ 507(a)(2) and 503(b)(9) for the inventory supplied within 20 days of the petition date. Several creditors, as well as the United States Trustee, filed motions to dismiss or convert to chapter 7, or to appoint a trustee under Code § 1104.

The Court determined that there was "cause" to dismiss or convert the case to chapter 7. Hayes' priority claim would have to be paid in full at the effective date of a plan of reorganization under Code § 1129(a)(9)(A), as Hayes indicated that it would not consent to any other treatment. As there was nothing in the record to indicate that Hayes could come up with the cash necessary to pay the priority claim, it was not reasonably likely that the DIP could submit and confirm a plan of reorganization.

Where cause for conversion or dismissal is established, Code § 1104(a)(3) allows the court to appoint a trustee if it finds that appointment of a trustee is in the best interests of creditors and the estate. Dismissal would severely prejudice Hayes Oil's claim, as it would not have administrative priority in any subsequently filed case. Conversion, on the other hand, would not allow the estate to avail itself of any value the estate's properties have while they support ongoing businesses. The Court thus felt the best resolution would be appointment of a trustee.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case
SOUTH STAR OIL COMPANY,) No. 08-61072-fra11
Debtor.) MEMORANDUM OPINION

I. INTRODUCTION

The debtor-in-possession is an Oregon partnership which owns or operates gasoline service stations in southern Oregon. The Debtor's petition for relief under Chapter 11 was filed on April 4, 2008.

The United States Trustee, joined by several creditors, has filed a motion to appoint a Chapter 11 trustee, or, in the alternative, to convert the case to one under Chapter 7, or dismiss the case altogether. The matter was heard on August 20, 2008. The U.S. Trustee announced at the beginning of the hearing that he was withdrawing his motions to convert or dismiss. One of the creditors which had joined in the original motions, South Valley Bank, indicated that it still believed the Court should dismiss or convert the case.

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1 After considering the evidence and testimony of the parties,
2 the Court concludes that a trustee should be appointed pursuant to Code
3 § 1104.

4 II. FACTS

5 The debtor-in-possession's schedules reveal that it owns or
6 operates ten gas stations valued at \$5.7 million. The stations owned by
7 the Debtor are subject to debt roughly equal to their value. In addition
8 the Debtor discloses unsecured debt of \$3.6 million, including a
9 significant debt owed to a supplier, discussed in more detail below.
10 Debts exceed assets by roughly \$2.74 million.

11 Testimony reveals that the debtor-in-possession has not been
12 profitable since 2005. It is presently not servicing secured debt owed
13 to the Bank of the Cascades and South Valley Bank.

14 The Debtor's financial information is poorly organized, and it
15 does not provide a clear picture of its cash flow or potential
16 profitability. For example, the U.S. Trustee presented evidence
17 regarding payments to the company's partners as disclosed by the petition
18 and accompanying documents, and original and amended 2007 partnership tax
19 return, and specific discovery on the issue provided to the trustee.
20 These range from a low of \$87,533 disclosed by the filing documents to
21 \$186,290 ascertained through discovery.

22 Hayes Oil Company, which supplied petroleum inventory to the
23 Debtor, has filed a proof of claim in the amount of \$2,310,957.37. Of
24 this amount, \$1,508,614.78 constitutes the value of products sold to the
25 Debtor within the last 20 days preceding the filing of the petition for
26 relief. Hayes asserts a priority claim pursuant to 11 U.S.C. § 507(a)(2)

1 and 11 U.S.C. § 503(b) (9) for the value of the goods sold in the last 20
2 days.

3 III. LEGAL CRITERIA

4 Code § 1104(a) provides:

5 (a) At any time after the commencement of the case
6 but before confirmation of a plan, on request of a
7 party in interest or the United States trustee, and
after notice and a hearing, the court shall order the
appointment of a trustee -

8 (1) for cause, including fraud, dishonesty,
9 incompetence, or gross mismanagement of the affairs of
the debtor by current management, either before or
10 after the commencement of the case, or similar cause,
but not including the number of holders of securities
11 of the debtor or the amount of assets or liabilities
of the debtor;

12 (2) if such appointment is in the interests of
creditors, any equity security holders, and other
13 interests of the estate, without regard to the number
of holders of securities of the debtor or the amount
14 of assets or liabilities of the debtor; or

15 (3) if grounds exist to convert or dismiss the
case under section 1112, but the court determines that
16 the appointment of a trustee or an examiner is in the
best interests of creditors and the estate.
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18 Code § 1112 provides that a case may be converted or dismissed
19 for cause. Subsection 1112(a) (4) provides that "cause" includes a number
20 of criteria, including "substantial or continuing loss to or diminution
21 of the estate and the absence of a reasonable likelihood of
22 rehabilitation."

23 Code § 503 provides for payment of administrative expenses,
24 including the value of any goods received by the debtor within 20 days
25 before the date of commencement of a case in which the goods have been
26 sold to the debtor in the ordinary course of the debtor's business. 11

1 U.S.C. § 503(b)(9). In the context of a business, such claims are to be
2 paid before all others. § 507(a)(2).

3 Unless the holder of the claim agrees to different treatment, a
4 claim allowed under § 507(a)(2) must be paid in full on the effective
5 date of the plan. § 1129(a)(9)(A).

6 IV. DISCUSSION

7 If Hayes Oil's claim (which has not been objected to) is
8 allowed, the Debtor will not be able to confirm a plan unless the plan
9 provides for payment on its effective date of over \$1.5 million to Hayes.
10 One of the Debtor's partners testified that Hayes had in fact delivered
11 either \$1.1 million or \$1.5 million in product at the time in question,
12 but that Hayes had been paid \$988,000 during the same period. He further
13 admitted, however, that under the Debtor's agreement with Hayes all
14 payments were applied to the oldest open invoice. This would leave
15 \$1,322,957.30, more or less, attributable to the 20 day pre-petition
16 period. Even if the amount paid is allocated to deliveries in the last
17 20 days, if Hayes Oil's claim is accurate (and the Court believes that it
18 is, given the equivocal nature of the Debtor's testimony) there remains a
19 priority claim of roughly \$512,000.

20 Hayes, through its counsel, announced that it would not consent
21 to any treatment other than the full payment it is entitled to under
22 § 1129(a)(9)(A). Nothing in the record suggests that the Debtor can come
23 up with the cash necessary to pay Hayes Oil's claim on the effective date
24 of a plan. The Debtor's property holdings lack any significant equity,
25 and the Debtor has no cash on hand. It follows that it is not reasonably
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1 likely that the debtor-in-possession can submit and confirm a plan of
2 reorganization.¹

3 Cause for conversion or dismissal exists where there is a
4 substantial or continuing loss to the estate in the absence of a
5 "reasonable likelihood of rehabilitation." The Code does not define what
6 is meant by "rehabilitation," but the term must include, at the very
7 least, successful completion of a plan of reorganization. The evidence
8 here amply demonstrates continuing losses to the partnership.
9 Rehabilitation through a plan submitted by the Debtor is not reasonably
10 likely.

11 Where cause for dismissal is established, the Court may, in the
12 alternative, appoint a trustee or an examiner if it appears to be in the
13 best interest of the creditors to do so. At first blush, a dismissal of
14 the case appears to be the most likely remedy. However, dismissal would
15 severely prejudice Hayes Oil's claim, since it would not have
16 administrative priority in any subsequently filed case. Conversion to
17 Chapter 7, while it would provide for a speedy liquidation of the
18 debtor's assets, and payment of most of the secured debt, would not allow
19 the estate to avail itself of any value these properties have while they
20 support ongoing businesses. It follows that the best resolution to a
21 difficult situation is the appointment of a trustee under Code § 1104.

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26 ¹The Debtor's witness acknowledged that successful reorganization depends on reaching an agreement with Hayes.

1 The foregoing constitutes the Court's findings of fact and
2 conclusions of law. An order will be entered contemporaneously directing
3 the U.S. Trustee to appoint a trustee pursuant to 11 U.S.C. § 1104.
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6 FRANK R. ALLEY, III
7 Bankruptcy Judge
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