

UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA  
RIVERSIDE DIVISION

In re:

ORANGE COUNTY NURSEY, INC.,

Debtor.

Case No.: 6:15-bk-12078 MJ

CHAPTER 11

**MEMORANDUM OF DECISION RE  
TREATMENT OF MINORITY VOTING  
TRUST'S CLAIM AND MODIFICATIONS  
TO CHAPTER 11 PLAN**

Date: Sept. 29, 2016  
Time: 1:30 p.m.  
Courtroom: 301

On July 7, 2016, this court entered its Order re Valuation of Minority's Claim, finding that the value of the claim ("Valuation Claim") is \$2,419,888. In accordance with two District Court Appellate Orders, this court recognized that it must treat the Valuation Claim as a claim, not an interest, but that the claim must be subordinated to the same priority as common stock<sup>1</sup>.

---

<sup>1</sup> Order re Bankruptcy Appeal issued by the District Court on October 10, 2010 (attached to Docket # 538-1) and Order re Bankruptcy Appeal issued by the District Court on September 24, 2014 (Docket # 806).

1 Therefore, the court invited briefing by the parties on the  
2 remaining issues in this chapter 11 case, including how the  
3 subordinated claim should be treated in the plan and what  
4 modifications, if any, needed to be made to the plan to accomplish  
5 that treatment. Briefs on those issues were filed by the parties  
6 on September 6 and 20, 2016; the matter was argued on September  
7 29, 2016, and then submitted for this written ruling. To the  
8 extent that findings of fact and conclusions of law are required  
9 for this court's ruling, this memorandum shall serve as those  
10 findings and conclusions as allowed by Rule 7052.<sup>2</sup>

12 The Minority Voting Trust (MVT) argued in its briefs that,  
13 although subordinated to the priority of common stock, its claim  
14 must be separately classified<sup>3</sup>. Then, to retain the unique  
15 "claim" aspect of its position, a value quantified in money as of  
16 the petition date, vis-à-vis the other shareholders' interests in  
17 common stock, quantified in a percentage of value on the Effective  
18 Date<sup>4</sup>, it posited that one of two approaches could be taken. The

---

21  
22 <sup>2</sup> Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532,  
and all "Rule" references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

23 <sup>3</sup> MVT states in its reply brief that Judge Mund already made a binding ruling that the claim should be separately  
24 classified. That statement is not true, as that ruling by Judge Mund was in the Supplemental Memorandum of Opinion,  
25 entered on November 15, 2012, Docket # 679, which was reversed by the District Court in Docket #806 entered on  
26 September 24, 2014. Since her ruling in the Supplemental Memorandum was reversed, it follows that any findings and  
conclusion in the memorandum are no longer valid. This is not the first time MVT has mischaracterized the binding  
aspects of this case's docket and prior rulings by Judge Mund. This repeated mischaracterization of the binding  
aspects of the docket by MVT is troubling and surprising to the court, given this court's prior admonishment of such  
behavior and the response filed by MVT.

27 <sup>4</sup> The Effective Date is defined in Section 1.35 of the 4<sup>th</sup> Amended Plan to mean "the first Business Day ten (10) days  
28 after the Confirmation Order becomes a final order." The Confirmation Order and the Effective Date described in the  
plan were stayed by a series of orders from the District Court in March and April 2010, found on the docket at #538-2,

1 first would be to pay the Valuation Claim in cash before the  
2 treatment of other equity interests of Class 7 shareholders ("off  
3 the top"). The second would be to reduce the non-MVT  
4 shareholders' claims to a liquidated amount (based on the  
5 Effective Date value of the corporate debtor), use the amount of  
6 the Valuation Claim in cash on the petition date, then  
7 redistribute the shares of OCN based on these values. The result  
8 of this recalculation of equity would be that, if OCN has declined  
9 in value after the petition date, MVT's percentage interest in OCN  
10 will increase and the Majority's and other shareholders' interests  
11 will decrease. As authority for these proposals, MVT cited a  
12 bankruptcy court opinion from Minnesota, In re SendmyGift.com,  
13 Inc., 280 B.R. 667 (Bankr. D. Minn. 2002), and a law review  
14 article, Nicholas L Georgakopoulos, *Strange Subordinations:*  
15 *Correcting Bankruptcy's §510(b)*, 16 Bankr. Dev. J. 91 (1999-2000).

16 MVT clarified that if the court does not follow the  
17 separate classification/pay off the top methodology, then a  
18 conversion ratio will need to be established, whereby MVT obtains  
19 new shares in respect to the value of the Valuation Claim,  
20 resulting in the diminution of equity for others. For this  
21 proposition it cited a Fifth Circuit case, Schaefer v Superior  
22 Offshore Int'l, Inc. (In re Superior Offshore Int'l, Inc.), 591  
23 F3d 350 (5<sup>th</sup> Cir. 2009), which affirmed a plan with a conversion

24  
25  
26  
27  
28 Exhibits E, F and G. A discussion of the Effective Date and treatment of Class 7 interests as of that date follows later in this memorandum.

1 mechanism which allowed a claim subordinated under §510(b)  
2 (denominated in dollars) to share in surplus funds with common  
3 equity (denominated in percentage shares), which resulted in a pro  
4 rata sharing in the same priority.<sup>5</sup>

5 MVT's proposal was not precise as to the equation for the  
6 conversion mechanism, and it only suggested the manner by which  
7 the court would determine the residual value of the shares as of  
8 the Effective Date, which is critical to the ratable distribution.  
9 It submitted that a lengthy valuation proceeding could be avoided  
10 by using current financials (balance sheets) and obtaining a  
11 stipulation of the parties.  
12

13 As to the separately classified claim for attorneys' fees and  
14 expenses<sup>6</sup>, MVT recognized that this court has already ruled that  
15 the fee claim must also be subordinated to the same priority as  
16 common stock<sup>7</sup>, meaning it would not be treated in Class 5B as  
17 proposed in the plan, but would be added to the Valuation Claim  
18 for the purposes of the ratable distribution. MVT submitted that  
19 further liquidation of the attorneys' fees claim would not be  
20  
21  
22  
23

---

24 <sup>5</sup> The court recognizes that Superior Offshore Int'l is factually dissimilar to this case because the court did not impose  
25 the conversion mechanism. It merely affirmed that the plan which treated the subordinated claim in this manner was  
26 not inconsistent with the purpose of §510(b).

27 <sup>6</sup> The 4<sup>th</sup> Amended Chapter 11 Plan, which was confirmed, has the attorneys' fees claim in Class 5B and the balance  
28 of the MVT claim in Class 7.

<sup>7</sup> Memorandum of Decision re Claim of Minority Shareholders For Attorneys' Fees and Expenses, entered on January  
12, 2016, as docket # 931.

1 required<sup>8</sup> because the currently allowed sum of \$907,098.13, when  
2 added to the Valuation Claim, would be sufficient to give MVT the  
3 majority controlling shares in OCN.

4 MVT also argued that the plan should be modified by the court  
5 to provide for the ratable distribution as well as to place the  
6 attorneys' fees claim in Class 7 rather the Class 5B.  
7

8 Not surprisingly, like everything else in this case, OCN,  
9 controlled by the Majority, took a contrary view in its briefs.  
10 It argued that, as a result of the second District Court ruling  
11 that the Valuation Claim is subordinated under §510(b) to the  
12 priority of common stock, MVT has only an equity interest in  
13 common stock and therefore should be treated like all other  
14 shareholders in Class 7. In the confirmed plan, Class 7 interests  
15 may either be retained as equity or, at the choice of the holder,  
16 canceled in exchange for their pro rata share of the liquidation  
17 value of the debtor as of the Confirmation Date. Calling the  
18 Valuation Claim an "Equity Claim", OCN submitted that as a result  
19 of its subordinated status, MVT's claim cannot be paid ahead of  
20 the rest of Class 7<sup>9</sup>. Citing a series of cases, OCN argued that a  
21  
22

---

23 <sup>8</sup> The sum of \$682,509.75 in attorneys' fees was ordered by the court in the Order on Allowance of the Minority  
24 Voting Trust's Attorney Fee Claim, entered on August 17, 2012, as docket # 635 and the sum of \$224,588.38 in  
25 expenses was determined by the court to be payable to MVT in the Memorandum of Decision re Claim of Minority  
26 Shareholders for Attorneys' Fees and Expenses, entered on January 12, 2016, as docket # 931, for a total sum of  
\$907,098.13 due on the claim as now calculated.

27 <sup>9</sup> In its opening brief OCN posits that MVT wants to be paid ahead of Classes 5 and 6 which have a higher priority  
28 under the plan. MVT does not claim it should be paid before those classes, so the court will not discuss that concept  
further.

1 chapter 11 plan may properly provide that subordinated claims and  
2 common stock retain their interest in a reorganized corporation  
3 but receive no distribution of money or property and that this  
4 outcome applies to the Valuation Claim. In other words, if the  
5 lowest class (here, equity) receives nothing, then a subordinated  
6 claim receives nothing; MVT merely retains its equity interest in  
7 OCN. In keeping with these arguments, OCN asserted that the  
8 Valuation Claim need not be placed into a separate class since it  
9 will be adequately treated in Class 7 and that the plan needs no  
10 modification because the plan properly provides for Class 7. In  
11 addition, OCN submitted that the court has no power to modify the  
12 plan, since such modification must come from a plan proponent.  
13

14  
15 This court's task is to treat the Valuation Claim in a manner  
16 that is consistent with the two District Court rulings which  
17 presently provide the law of the case. The first ruling firmly  
18 holds that MVT has a claim, not an interest, which is distinct  
19 from other shareholders: "From the moment the Superior Court  
20 entered the decree, the Minority had an enforceable right to  
21 payment for its shares --....In this way, the Minority did not  
22 'retain all of the indicia of any other shareholder.'" When OCN  
23 did not make the prepetition payment for the shares, "the Minority  
24 has a claim for the value of its shares had OCN been dissolved."<sup>10</sup>  
25 Notwithstanding that in its second ruling the District Court found  
26

---

27  
28 <sup>10</sup> Oct. 12, 2010 Order, page 10.

1 the claim should be subordinated to the priority of common stock,  
2 it still preserved its status as a distinct claim, different from  
3 the other shareholders: "This conclusion does not conflict with  
4 the Court's determination that '[t]o the extent the Bankruptcy  
5 Court's subsequent orders - including its order adopting OCN's  
6 reorganization plan - treat the Minority's interest as equity,  
7 these orders will need to be vacated or modified consistent with  
8 this Order.' [quoting its first ruling]....But this conclusion does  
9 not affect the Court's prior determination that Minority has a  
10 "claim" or right to payment as defined by 11 U.S.C. §101(5)...."<sup>11</sup>

12 To make these controlling rulings mesh, MVT argued that  
13 whereas the *priority* of the claim is determined by the  
14 subordination ruling, the *value* of the claim is addressed by the  
15 original claim ruling. OCN, on the other hand, made no attempt to  
16 mesh the two rulings. From its perspective, the first ruling is  
17 irrelevant because once the claim is subordinated to the priority  
18 of equity, it totally loses its "claim" status and MVT may only  
19 share in the effective date equity measured by its 40.25% shares.

20  
21 This court does not agree with OCN's assertion that after two  
22 District Court rulings, intervened by an interlocutory appeal to  
23 the Ninth Circuit, and followed by a contested valuation hearing  
24 which determined the amount of the Valuation Claim *on the petition*  
25 *date*, MVT has only a residual equity interest like all other

---

26  
27  
28 <sup>11</sup> September 24, 2014 Order, pages 9-10, fn 7.

1 shareholders. This conclusion gives no weight to the valuation of  
2 MVT's equity as of the petition date, the "claim" part of its  
3 interest. MVT is correct when it contends that subordination  
4 determined only priority, but the valuation hearing determined  
5 value; that value must be accounted for when the equity interest  
6 in the debtor is determined on the Effective Date.  
7

8 This court does agree with OCN that because MVT shares in  
9 priority with the other shareholders, it cannot be put into a  
10 separate class. Further, based on the priority scheme of the  
11 Bankruptcy Code, payment for the value of MVT's equity in cash is  
12 forbidden if the other shareholders do not receive cash. As a  
13 consequence, the only way to give due credit to the petition date  
14 value of the shares, represented by the Valuation Claim, is to  
15 accomplish some type of ratable redistribution of the shares as  
16 posited by MVT. As apparently recognized by both parties, because  
17 the residual value of OCN is substantially less than the value of  
18 equity on the petition date, the result may well be that MVT is no  
19 longer the Minority and all other shareholders will slip in  
20 percentage.<sup>12</sup>  
21

22 The Court recognizes there is no precedential case law which  
23  
24

---

25 <sup>12</sup> On more than one occasion the Majority, in the guise of the debtor, has argued that such ratable redistribution of the  
26 shares would be unfair to the shareholders not represented by either the Majority or the Minority. The court has a  
27 difficult time understanding why that is MVT's fault. The Majority has been in control of this chapter 11 proceeding  
28 from the day OCN filed to the present date, averting the direct consequences of the state court order but creating the  
costly proceedings and valuation outcome now before the court. If the Majority wanted to protect the voiceless  
shareholders, it could have taken some steps to do so and perhaps should have conducted this litigation differently. At  
a minimum, it would not have diminished the residual value of OCN by bleeding the Majority's attorney's fees from its



1 supports this treatment of the Valuation Claim. However, the  
2 Majority/OCN has cited no binding authority which prevents such  
3 redistribution of shares to give weight to the petition date value  
4 of MVT's claim. Therefore, the court finds and concludes that a  
5 ratable redistribution formula will provide to MVT what it holds  
6 in the Valuation Claim.  
7

8 Having reached that decision in concept, the court, however,  
9 is left with open questions which must be addressed before the  
10 court can enter a final order and certify its rulings to the Ninth  
11 Circuit. As the court sees it, the following are the open issues:

- 12 1. The formula for the ratable redistribution must be  
13 written. The court believes the formula to be as  
14 follows:  
15

16  $A = \text{residual value of equity today}$

17  $B = \text{Majority share value today} = A \times 50.25\%$

18  $C = \text{Others share value today} = A \times 9.5\%$

19  $D = \text{Valuation Claim plus awarded attorneys' fees} =$   
20  $\$3,326,986$

21  $E = \text{Total dollar value} = B + C + D$

22  $\text{Ratably redistributed Majority shares} = B \div E$

23  $\text{Ratably redistributed other shares} = C \div E$   
24  
25  
26  
27

28 coffers, as the court understands it has done. The Majority, not MVT, had a fiduciary duty to the other shareholders which may have been breached.

Ratably redistributed Minority shares =  $D \div E$ <sup>13</sup>

The parties are invited to correct the court if its formula is flawed.

2. A streamlined method for determination of the residual value at the present time must be determined.<sup>14</sup> MVT has suggested that the parties could stipulate to use the value of equity as shown on the current balance sheets of OCN. A stipulation is attractive, to avert another time consuming and costly valuation hearing just to create an ownership percentage in an order which will be immediately appealed to the Ninth Circuit. The court would entertain other suggestions on an expedited way to determine present value.

3. The plan needs to be modified to provide language consistent with this decision. The court rejects the argument of OCN that it lacks the power to do that modification based on the assertion that a court cannot be the proponent of a plan. The District

---

<sup>13</sup> For illustration purposes only, if the residual value today is \$4,000,000, B = \$4M x 50.25% = \$2,010,000; C = \$4M x 9.5% = \$380,000; D = \$3,326,986; E = \$5,716,986. Ratably redistributed shares for Majority = 35.64%; for others = 6.64%; for Minority = 58.2%.

<sup>14</sup> Logic demands that the time for such valuation of equity should be the Effective Date of the plan. The Effective Date is defined as the first day after 10 Business Days after the Confirmation Order is final. Under federal law an order is final after entry, notwithstanding an appeal. However, the decision in the appeal of the Confirmation Order in this case reversed the treatment of MVT's claim in the plan and compelled further modifications to the plan which are consistent with that decision. In a sense the order reversed those provisions in the Confirmation Order, so it is not yet final. Picking the present date as the Effective Date would be consistent with the procedural posture of the case.

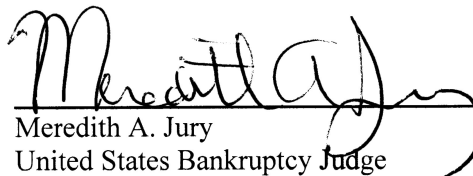
1 Court ordered that the plan be modified to be  
2 consistent with its ruling, gives in this court the  
3 power to make that modification. The parties need to  
4 suggest the exact language needed to modify the plan.

5  
6 4. After these issues are determined, the court must  
7 enter a final order and certify the matter for direct  
8 appeal to the Ninth Circuit. The parties may suggest  
9 arguments they would like included in that  
10 certification.

11  
12 Based on the foregoing memorandum and the open issues above,  
13 the court requests the parties to file simultaneous statements  
14 with the court addressing the open issues 14 days after entry of  
15 this Memorandum of Decision. Depending on the parties'  
16 submissions, the court will then either set a hearing or finalize  
17 all matters without further hearing.

18  
19 ###  
20  
21  
22  
23  
24

25  
26 Date: December 20, 2016

27  
28  
  
Meredith A. Jury  
United States Bankruptcy Judge