



UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re)
PRESIDIO HEIGHTS INC.,) Bk. No. SV 03-16029-KT
)
) Chapter 11
)
)
)
 Debtor.) MEMORANDUM ORDER ON DEBTOR'S
) APPLICATION FOR ORDER ALLOWING
) DISBURSEMENTS FROM SALE OF LOT
) NO. 1
)
)
)
) DATE: September 5, 2006
) TIME: 2:00 p.m.
) PLACE: "301"
) 21041 Burbank Blvd.
) Woodland Hills, CA 91367
)
 _____)

Presidio Heights, Inc. (the “Debtor”) was the debtor in possession in the above-captioned case from July 18, 2003, until the case was converted to Chapter 7 on August 2, 2006. The primary asset is real property (the “Property”), a portion of which is developed with 5 nearly completed new homes which the Debtor has been marketing for sale (the “Project”).

On June 28, 2006, the Debtor filed a request for the court to determine a dispute with its primary secured creditor as to the disposition of proceeds from the sale of Lot No. 1. Thereafter, four of the parties in interest to this dispute stipulated to disbursements to various claimants and narrowed the disputes to 16 claims totaling \$53,790.95.

The matter came on for hearings on August 17, 2006, and on September 5, 2006. The following persons were present at the hearing on September 5:
Presidio Heights, Inc. – represented by counsel, Michael D. Kwasigroch;
Richard Staton, the 100% shareholder of Presidio Heights (“Staton”), on behalf of himself;
Dayco Funding Corporation (“Dayco”) – represented by Andrew K. Alper;
David Seror, Chapter 7 Trustee of the bankruptcy estate of Fred A. Madjar (“Seror”) – represented by Howard I. Camhi;
David K. Gottlieb, Chapter 7 Trustee of the Presidio Heights case – represented by Jonathan J. Kim;¹
James Kunkle on behalf of his company JPS Surface Solutions; and
Bryan Schwartz on behalf of his company Paradise Homes.

Background Facts

This case has a lengthy and litigious history primarily among the Debtor, its construction lender and senior secured creditor, and Seror, the holder of junior secured claims on the Property. When the case was filed, United Commercial Bank (“UCB”), the Debtor’s original construction lender, was the holder of a claim secured by all of the Property. After a lengthy trial, UCB’s request for relief from stay was denied because the court found UCB to be substantially oversecured. Subsequently, in May 2004, UCB agreed to fund additional monies to complete construction of the homes then in progress (the “Priming Loan”). Attached to the Priming Loan was a schedule for disbursement titled “Priority Repayment Schedule from Sales Proceeds.”

In April 2005, UCB and the Debtor agreed to an extension to and increase in the Priming Loan, to which an updated schedule for disbursement of proceeds was attached (the “Schedule”). An order was entered approving the extension agreement and the parties to the current dispute agree that the Schedule is the operative document

¹ Mr. Gottlieb has filed a statement of no position regarding this dispute.

on which the current disagreement is based.

Dayco is the successor in interest to UCB. Dayco agreed to disbursements consistent with all of the entries allocated to Lot No. 1 on the Schedule except the following:

- (1) delinquent property taxes were in excess of the amount listed on the Schedule;
- (2) real estate commissions were adjusted upward to account for a higher sale price;
- (3) administrative expenses were adjusted upward to account for a higher sale price;
- (4) payment to Staton was adjusted upward to account for a higher sale price;
- (5) payment to Seror was \$6,739 less based on a dispute as to whether Seror agreed, after the approval of the Schedule, to take a lesser payment; and
- (6) actual closing costs were \$9,553.41 less as a result of the Debtor's negotiations subsequent to the approval of the Schedule.

Seror and Dayco informed the court that any disagreements between them about Seror's entitlement to an additional \$6,739 will be decided, if necessary, in another proceeding.

Among the items which Dayco agreed to pay were claims of suppliers of flooring and countertops up to an aggregate maximum of \$35,000. The Schedule allocates \$35,000 from the sale of Lot No. 1 for "Est. All Tile & Stone Floor & Counter Costs Paid Out of Escrow."

The dispute which is the subject of this motion is whether Dayco must pay more than \$35,000 to claimants who supplied goods and services to the Project and have claimed a right to payment out of the proceeds of sale of Lot No. 1. The excess claims, less the Seror dispute, total \$47,052.45.

None of the claimants in the disputed category filed mechanics liens against the Property. None of the claimants have filed papers in this dispute or in the case. None of the claimants appeared at the first hearing and only two appeared at the second hearing.

Discussion

Debtor's and Staton's Arguments on Estimated Line Items and Fairness

As noted above, the Schedule allocates \$35,000 from the sale of Lot No. 1 for "Est. All Tile & Stone Floor & Counter Costs Paid Out of Escrow." Staton and the Debtor argue that "Est," standing for "estimated," should not be construed as a maximum or cap. Instead, they assert that the court should construe the Schedule to mean that all costs for flooring, tile and countertops on Lot No. 1 should be paid out of

escrow, regardless of amount. Of the disputed claims, the descriptions provided by Staton indicate that only two relate to the categories in the Schedule: JPS Surface Solutions, tile countertop & flooring in the amount of \$21,240, and Paradise Homes, rough flooring repair, in the amount of \$750. Therefore, accepting Staton and the Debtor's position means that the "estimate" of expenses in this category alone was underestimated by 62%.

There are no categories in the Schedule for the balance of the claims which Staton and the Debtor seek to have paid out of the proceeds of Lot No. 1. However, Staton and the Debtor argue that fairness demands that the disputed claims be paid out of the proceeds of sale because Lot No. 1 sold for \$1,175,000, an amount \$200,000 in excess of the estimated sale price in the Schedule.

Estimated Line Items

An "estimation" is not the same thing as a "cap." The Schedule uses both concepts, thereby indicating that UCB and the Debtor did not intend these terms to have the same meaning. Line items for property taxes and closing costs were also listed as estimates. Real estate commissions is listed as an "estimated" line item but also caps this line item at a "5% Max."

The context in which the Schedule was adopted is relevant to the interpretation of any ambiguity raised by the use of finite numbers in conjunction with the term "estimate." Here, the Schedule is an integral part of a loan agreement and a loan relationship in which the Debtor was trying to secure sufficient funds to finish construction of the homes which stood as collateral for the series of construction loans from UCB. The amount of the last loan was directly related to and a function of the amount needed to complete the project. Arriving at the correct amount to accomplish this purpose requires some of the component expenses to be estimated. The amounts set forth on the Schedule are not only a compilation of those estimates but also a representation of the commitments which the parties believe will accomplish their common goal, i.e., completion of construction.

In this context, the estimates for property taxes, closing costs, commissions, and administrative expenses reflect recognition of at least two unknown elements: (1) when will a sale take place; and (2) what price will each house bring? If property taxes, closing costs, and commissions are not paid, the sales will not close and no one will benefit. Awareness of this market reality was equally accessible to both UCB and the Debtor. In addition, the Schedule expressly provides for adjustment of the administrative fee negotiated by Staton based on variance of the sale price from that listed on the Schedule.

Unlike the foregoing line items, the estimates for flooring, tile and countertops are not tied to timing and price and the information about tasks and costs necessary for completion was the province of the developer, not the lender. Although the court has

few facts on this issue, it appears that the uncertainty in these listings is a function of open items in the contracts with providers of goods and services or with the ultimate purchasers. In any case, it is clear that the assumption that the houses could be completed with the funds from the increase in the Priming Loan was incorrect based on information for which the Debtor, as the developer, was responsible.

Based on the foregoing, the court cannot conclude, based on the “estimates” in the Schedule, that UCB contracted to pay any and all amounts spent for flooring, tile, and countertops out of the proceeds of sale of Lot No. 1. Instead, the court finds and concludes that the function of the “estimate” was to detail the category of expense required and leave some flexibility as to payee or particular service.

Allocation of Proceeds from Higher Sale Price

As noted above, the Schedule expressly acknowledges the possibility of a higher sale price than the “minimum sale prices” listed on the Schedule and provides that a portion of such proceeds will be passed along to Staton as an adjustment in administrative fees. The Schedule states that the sales proceeds “shall be distributed in the following priority.” UCB, as the last named party in the priority scheme, becomes the recipient of the excess. Therefore, the contract covers the allocation of higher sale prices.

Even if the court agreed Dayco should pay those whose goods and services increased their benefit, the court does not have the discretion to impose some “fairness” standard on Dayco, as UCB’s successor, that is directly contrary to Dayco’s contractual and lien rights.

Waiver of Lien Rights in Sale Proceeds

In effect, by agreeing to distribute sale proceeds as set forth in the Schedule, UCB waived its first priority lien rights in the proceeds of sale for the benefit of those set forth therein. Waivers must be strictly construed.

As set forth above, Dayco has the benefit of this strict construction with regard to most of the cost overruns on Lot No. 1. However, one such waiver of lien rights in the proceeds works to the benefit of the developer. Although the sum of \$14,625 was allocated for estimated closing costs, actual closing costs were only \$5,071.56. It is undisputed that this “benefit” was negotiated by the Debtor, not UCB or Dayco.

The difference between these sums, \$9,553.44, should be paid to those entities or categories who remain unpaid, in the priority set out in the Schedule. In this case, these sums should be paid on a pro rata basis to those who have provided floors and countertops on Lot No. 1; i.e., JPS Surface Solutions and Paradise Homes. In no event should any of these funds be paid to Staton whose underestimates, to a large degree, created the problems raised in this motion.

Conclusion

IT IS SO ORDERED.

Dated:

/s/
KATHLEEN THOMPSON
U.S. Bankruptcy Judge

CERTIFICATE OF MAILING

I hereby certify that copies of the **MEMORANDUM ORDER ON DEBTOR'S APPLICATION FOR ORDER ALLOWING DISBURSEMENTS FROM SALE OF LOT NO. 1** were mailed to the following parties of interest:

Dated: SEP 19 2006

JON D. CERETTO
CLERK OF COURT

By


Deputy Clerk

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