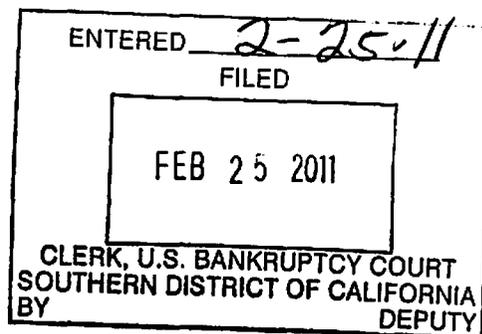


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WRITTEN DECISION – NOT FOR PUBLICATION



**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA**

In re:) BANKRUPTCY NO: 10-11351MM-11
)
PACIFIC SHORES DEVELOPMENT, INC.,) CHAPTER: 11
)
) MEMORANDUM DECISION RE:
Debtor,)
) MOTION FOR APPROVAL OF
) DISCLOSURE STATEMENT, MOTION FOR
) CONFIRMATION OF PLAN
) REORGANIZATION IN CHAPTER 11 CASE,
) AND MOTION FOR AUTHORITY TO
) OBTAIN CREDIT THROUGH THE
) ISSUANCE OF PROMISSORY NOTES
)
) DATE: 1/27/11
) TIME: 3:00 P.M.
) CRTRM: 1
)
) JUDGE: Margaret M. Mann

1 **I. Introduction**

2 On June 29, 2010, Pacific Shores Development (“Debtor”) commenced a voluntary Chapter 11
3 petition. Debtor is a California corporation formed to acquire, hold and develop real estate through its
4 five subsidiaries. Beginning in 2007, Debtor found itself in serious financial difficulty. By 2009, all
5 of Debtor’s properties were in arrears. Eventually Debtor was forced to suspend all of its operations
6 and contemplate bankruptcy. Debtor’s business activities are currently dormant, and it has had no
7 income for the past two years. Debtor’s only assets, other than the non-operating subsidiaries, are
8 office furniture and four dollars.

9 Debtor filed its Plan of Reorganization (“Plan”) and Disclosure Statement on June 29, 2010.
10 Solicitation and balloting of the Plan occurred prior to Debtor’s filing of its Chapter 11 petition, in
11 what is known as a prepackaged plan. All votes tallied were in favor of the Plan.¹

12 However, after considering objections by the United States Trustee and the Securities and
13 Exchange Commission to the solicitation and the Plan, and despite concessions made by Debtor in
14 response to these objections, the Court concludes that Debtor’s Disclosure Statement did not fully
15 comply with the twofold disclosure requirements of Section 1126(b) of the Bankruptcy Code. Under
16 Bankruptcy Rule 3018(b), the Court will therefore invalidate the acceptances and concomitantly
17 require re-disclosure and re-solicitation of the Plan. The Court will also deny confirmation of the Plan
18 without prejudice to the outcome of the re-solicitation.

19 **II. Debtor's Plan**

20 In its Plan, Debtor proposes to acquire National Transport Holdings, Inc. (“NTG”), a newly
21 established Delaware corporation engaged in the acquisition and operation of trucking businesses.
22 NTG is operated by the same principal of Debtor, Konstantin Zecevic. Debtor will then cease to exist
23 as a separate entity. As part of the Plan, Debtor seeks to restructure each of its five subsidiaries as
24 independent corporations and transfer 100% of its ownership in each of the subsidiaries to the creditors
25

26 ¹ Mailing of the Plan and Disclosure Statement for solicitation occurred on March 10, 2010.
27 Creditors had until April 23, 2010 to vote. Of the Class 3 creditors, six votes were gathered, and all six
28 voted to approve the plan. Of the Class 4 creditors, three votes were gathered, and all three voted to
approve the plan. No creditors in Classes 1 or 2 submitted votes on the Plan.

1 and shareholders of Debtor. These restructured entities are now defunct, and will not operate unless
2 Zecevic decides to reactive them.

3 Debtor proposes to fund the Plan by borrowing up to \$50,000 from five individuals with
4 business and investment experience, who are familiar with the business of NTG ("Administrative
5 Lenders.")

6 Debtor's Plan provides for the payment to unsecured creditors of a cash dividend totaling
7 \$40,000, and a stock dividend in NTG totaling 80,000 shares. In addition, unsecured creditors will
8 receive their pro rata share from a total of 80,000 shares in each of Debtor's subsidiaries.

9 Administrative Lenders will receive notes which can be converted to 500,000 shares in NTG and in
10 each subsidiary.² Administrative Lenders will also receive warrants for up to a total of 5,000,000
11 shares in NTG and each of the subsidiaries. NTG's owners will receive a total of 1,000,000 shares in
12 NTG.

13 Debtor claims only two classes of creditors are impaired: Class 3 (general unsecured non-
14 priority claims) and Class 4 (equity interest holders). Classes 1 and 2 consist of secured creditors who
15 had already non-judicially foreclosed on their undersecured security—properties located in Kirkwood,
16 California and Scottsdale, Arizona. Since the foreclosure sales eliminated the secured portion of these
17 claims, Debtor contends that applicable anti-deficiency statutes eliminate the undersecured portions of
18 these secured creditors' claims.

19 **III. Procedural History**

20 On August 12, 2010, the Court conducted a hearing on the motion for authority to obtain credit
21 through the issuance of promissory notes; motion for approval of disclosure statement; motion for
22 confirmation of Chapter 11 plan of reorganization; and status conference on the Chapter 11 petition.
23 The Court requested additional documents from Debtor before it could decide on these matters. The
24 Court also requested the involvement of the United States Trustee.

25
26 ² The Plan originally provided that Administrative Lenders would receive 1,000,000 shares initially in NTG and
27 in each subsidiary, however Debtor agreed to reduce this amount at the January 27, 2011 hearing. The Plan also
28 originally provided that Debtor's equity interest holders would receive 5,000 shares in NTG and in each
subsidiary. Debtor also agreed to eliminate this provision from the Plan at the January 27, 2011 hearing.

1 Debtor filed four additional documents on September 10, 2010: declaration of CEO of Debtor
2 on value of Debtor, declaration of a CPA concerning the tax consequences of Debtor's Plan,
3 declaration of CEO of NTG on regulatory requirements of its business, and a brief on Debtor's
4 compliance with applicable nonbankruptcy law ("Compliance Brief"). Docket #'s 41-44. In the
5 Compliance Brief, Debtor stated that registration of its offer of securities in the Plan was exempt under
6 the SEC's Regulation D and other laws.

7 The United States Trustee, conveying the position of the Securities and Exchange Commission,
8 subsequently filed a brief raising several objections to the Disclosure Statement. The United States
9 Trustee expressed concern over the value of the stock issued in NTG being de minimus due to the large
10 number of stock issued and the relatively small worth of NTG and the shell corporations, and felt that
11 the return to the unsecured creditors was therefore misleading. Furthermore, the United States Trustee
12 requested that the registration exemptions relied on by Debtor be listed in the Disclosure Statement,
13 and noted that 11 U.S.C. § 1145 does not apply to all issuances of stock because some entities
14 receiving stock pursuant to the Plan should be deemed to be "underwriters" not entitled to the
15 exemption. Finally, the United States Trustee alleged Debtor might be attempting to circumvent
16 securities law restrictions on issuing stock pursuant to 11 U.S.C. §1129(d), by seeking refuge under
17 bankruptcy exemptions for securities law.

18 On January 27, 2011, the Court conducted an evidentiary hearing on these matters. Konstantin
19 Zecevic, CEO of Debtor, testified that the Plan provides for the issuance of stock in NTG because he
20 wanted to provide some return to his creditors and shareholders, and Debtor was unable to secure any
21 other financing option besides NTG. Zecevic also clarified that NTG is the parent of Pacific Shores
22 Trucking, an entity whose identity was previously questioned by the United States Trustee. Zecevic
23 further stated that the parent has no assets other than stock.

24 In response to the objections raised by the United States Trustee, several concessions were
25 made by Debtor to the Court. Debtor agreed to waive its ability to issue stock to equity holders, and
26 Debtor also agreed that the stock received by the Administrative Lenders and NTG owners would need
27 to be registered before it could be resold. The stock certificates will contain a legend indicating this
28

1 restriction. However, the United States Trustee continued to object that the Disclosure Statement did
2 not contain adequate information and was misleading, and the Court took the matter under submission,
3 requesting additional briefing from the United States Trustee on whether or not the pre-bankruptcy
4 solicitation complied with nonbankruptcy law. The United States Trustee filed a final brief arguing
5 that Debtor's statements in the Disclosure Statement regarding Bankruptcy Code section 1145 were a
6 material legal mischaracterization, requiring re-solicitation.

7 **IV. Discussion**

8 The Bankruptcy Code provides for the prepetition solicitation of a plan of reorganization if the
9 solicitation complies with Section 1126(b) of the Bankruptcy Code. 11 U.S.C. § 1126; *In re Pioneer*
10 *Fin. Corp.*, 246 B.R. 626, 630 (Bankr. D. Nev. 2000); *see also In re Sunshine Precious Metals, Inc.*,
11 142 B.R. 918 (Bankr. D. Idaho 1992). Because the disclosure statement has not been approved by the
12 Bankruptcy Court prior to solicitation, the adequacy of disclosure is evaluated under applicable
13 nonbankruptcy law, or if there is none, under the "adequate information" standard in 11 U.S.C. §
14 1125(a). Section 1126(b) provides as follows:

15 [a] holder of a claim or interest that has accepted or rejected the plan
16 before the commencement of the case under this title is deemed to have
17 accepted or rejected such plan, as the case may be, if (1) the solicitation of
18 such acceptance or rejection was in compliance with any applicable
19 nonbankruptcy law, rule, or regulation governing the adequacy of
20 disclosure in connection with such solicitation; or (2) if there is not any
21 such law, rule or regulation, such acceptance or rejection was solicited
22 after disclosure to such holder of adequate information, as defined in
23 section 1125(a) of this title.

24 11 U.S.C. § 1126(b).

25 Although 11 U.S.C. §1126(b) expressly applies 11 U.S.C. §1125(a) bankruptcy disclosure
26 standards only in the absence of controlling non-bankruptcy law controlling, at least one court has held
27 that "[r]egardless of whether a plan is prepackaged or 'prenegotiated,' it must comply with the
28 provisions of the Bankruptcy Code." *In re Pioneer Fin. Corp.*, 246 B.R. 626, 630 (Bankr. Nev. 2000).
See also In re Zenith Elecs. Corp., 241 B.R. 92, 98 (Bankr. Del 1999) (noting both factors were met in
determining the adequacy of disclosure). Because the Court finds that Debtor's Disclosure Statement

1 does not comply with applicable non-bankruptcy law or bankruptcy law, the pre-packaged Plan cannot
2 be approved.

3 **A. Securities Law Disclosure Requirements**

4 Debtor's Plan contemplates the issuance of securities, and therefore 11 U.S.C. § 1126(b)(1)
5 directs that nonbankruptcy securities law must govern disclosure. Nat'l Bankr. Rev. Comm'n, Final
6 Report 589 (1997); *see also* G-44 *Collier on Bankruptcy* 2.4.17 (2010); *In re Zenith Elecs. Corp.*, 241
7 B.R. 92 (Bankr. Del. 1999). Debtor asserts securities law exempt from registration certain non-public
8 offerings, such as Regulation D's Rule 504. The SEC did not dispute the applicability of any of these
9 exemptions.

10 However, the SEC claimed the solicitation could not be approved and the Plan confirmed as a
11 matter of securities laws since the Debtor's Disclosure Statement is misleading. The importance of
12 accurate and complete issuer disclosure to the integrity of the securities markets cannot be
13 overemphasized. *Basic v. Levinson*, 485 U.S. 224, 235 n.12 (1988); *see also SEC v. Ralston Purina*,
14 346 U.S. 119, 124 (1953).

15 Due to certain misleading aspects of the Disclosure Statement, securities law would not
16 countenance the pre-petition solicitation.

17 **B. Bankruptcy Law Disclosure Requirements**

18 Section 1125(a) of the Bankruptcy Code governs adequacy of disclosure as a matter of
19 bankruptcy law, according to the following standard:

20 "Adequate information" means information of a kind, and in sufficient
21 detail, as far as is reasonably practicable in light of the nature and
22 history of the debtor and the condition of the debtor's books and
23 records, including a discussion of the potential material Federal tax
24 consequences of the plan to the debtor, any successor to the debtor,
25 and a hypothetical investor typical of the holders of claims or interests
26 in the case, that would enable such a hypothetical investor of the
27 relevant class to make an informed judgment about the plan, but
28 adequate information need not include such information about any
other possible or proposed plan and in determining whether a
disclosure statement provides adequate information, the court shall
consider the complexity of the case, the benefit of additional

1 information to creditors and other parties in interest, and the cost of
2 providing additional information; [...].

3 11 U.S.C. § 1125(a)(1) (2011). The determination of what is adequate information is subjective and
4 made on a case-by-case basis. *In re Brotby*, 303 B.R. 177, 193 (B.A.P. 9th Cir. 2003). This
5 determination is largely within the discretion of the bankruptcy court. *Id.* In making such a
6 determination, courts have considered relevant factors such as: (1) a description of the available assets
7 and their value; (2) the scheduled claims; (3) the estimated return to creditors under a Chapter 7
8 liquidation; (4) the collectability of accounts receivable; (5) the actual or projected realizable value
9 from recovery of preferential or otherwise voidable transfers; (6) litigation likely to arise in a non-
10 bankruptcy context; (7) tax attributes of the debtor; and (8) the relationship of the debtor with
11 affiliates. *In re Reilly*, 71 B.R. 132, 134 (Bankr. D. Mont. 1987) (citing *In re Metrocraft Publishing*
12 *Svcs Inc.*, 39 B.R. 567, 568 (Bankr. N.D. Ga. 1984)); *In re Neutgens*, 87 B.R. 128, 129 (Bankr. D.
13 Mont. 1987) (also citing *Metrocraft*); see also *In re Diversified Investors Fund XVII*, 91 B.R. 559, 561
14 (Bankr. C.D. Cal. 1988).

15 Applying the *Metrocraft* factors to this case, the Court is particularly concerned with the
16 disclosure on factors two, seven, and eight. The Court is also concerned with the securities disclosure
17 in the Disclosure Statement.

18 1. Securities Exemption Disclosure

19 Debtor's Disclosure Statement specifically provides, in section H, that shares issued under the
20 Plan will be exempt from registration requirements pursuant to 11 U.S.C. § 1145. Section 1145
21 exempts from securities law certain securities transactions conducted under the purview of bankruptcy
22 law, including the offer and resale of securities issued under a plan in exchange for an existing claim or
23 interest, except with respect to an entity that is an underwriter. Contrary to the statements in the
24 Disclosure Statement, section 1145 does not apply to all offerees of the stock in this case. The
25 shareholders of NTG who stand to receive shares pursuant to this Plan would not be exchanging any
26 claims or equity interests for stock. These shareholders would be receiving stock solely in exchange
27 for their asset contributions.
28

1 The United States Trustee argues that 11 U.S.C. §1145 does not apply to all stock issued in this
2 case for the additional reason that some of the stock's recipients were likely underwriters. Debtor has
3 conceded this point, and has agreed to restrict the resale of those securities. Because Debtor, in its
4 initial Disclosure Statement, stated that all stock issuances pursuant to its Plan are exempt under
5 Section 1145 of the Bankruptcy Code, which is not the case, the statement is misleading as a matter of
6 bankruptcy law.

7 2. The Scheduled Claims

8 Debtor's Disclosure Statement contains inconsistent information regarding the Class 1 and
9 Class 2 secured claims. A table listing secured claims contains two claims - Classes 1 and 2. They are
10 both listed as impaired, and the properties are described as undersecured. The table further notes that
11 creditors of the two properties are entitled to an unsecured claim equal to the undersecured portion of
12 their claim, in addition to being entitled to the security. In a document later filed with the Court after
13 solicitation, Debtor explained that Classes 1 and 2 have been eliminated because the creditors had
14 foreclosed on their securities, and that applicable anti-deficiency statutes had eliminated the
15 undersecured portions of the secured creditors' claims. The Court agrees these Classes should be
16 eliminated since they appear to have neither a secured or unsecured claims. The Disclosure Statement
17 is misleading for still including these claims.

18 3. Tax Attributes of the Debtor.

19 Debtor states in its Disclosure Statement: "The following disclosure of possible tax
20 consequences is intended solely for the purpose of alerting readers about possible tax issues this Plan
21 may present to the *Debtor* [emphasis added]," but then fails to provide this information. While Debtor
22 describes generally how the tax law works in a few sentences, this is without reference to any actual
23 numbers or any subjective attributes. *Id.* Notably, Debtor vaguely describes the possible tax
24 consequences to *holders of claims*, while making no mention of the tax consequences of the plan to
25 *Debtor*, as it promised to do.

26 On September 9, 2010, Debtor submitted to the Court a declaration by Susan Tollefson, CPA,
27 concerning tax consequences of Debtor's Plan. The declaration discusses with specificity the tax
28

1 consequences of the foreclosures upon the two properties owned by Debtor, and why certain state and
2 federal tax statutes are inapplicable to Debtor and its two properties. Finally, it provides a numerical
3 conclusion regarding Debtor's tax liability arising out of the cancellation of its debt in bankruptcy and
4 the sale of its properties through foreclosure. Indeed, the disposition of these two properties is a
5 central issue in Debtor's Plan. This is precisely the type of information that the creditors could have
6 used in evaluating its position with respect to Debtor's Plan. Debtor did not include this information in
7 its initial Disclosure Statement, which is therefore misleading.

8 **4. Debtor's Relationship With Affiliates**

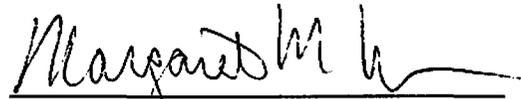
9 The Court will require Debtor to add to the amended Disclosure Statement the information that
10 came out of the testimony in this case. Creditors should be informed that the four previous subsidiaries
11 in which they are receiving stock may never again do business and may never have any value. The
12 possibility of value being received in return for the stock to be issued under the Plan is fully dependent
13 upon Debtor's principal choosing to start new business ventures in these entities, which may be
14 unlikely.

15 **V. Conclusion**

16 The Court finds Debtor's Disclosure Statement inadequate in that it contains inaccurate and
17 misleading statements regarding the securities exemptions, and provides insufficient detail regarding
18 the tax consequences of, and claims to be paid under Debtor's Plan.

19 Accordingly, approval of Debtor's Disclosure Statement is hereby DENIED. Debtor shall file
20 an amended disclosure statement addressing these issues within thirty (30) days of this opinion. The
21 Court will order re-solicitation upon approval of Debtor's amended disclosure statement.

22 Dated: February 25, 2011



23 MARGARET M. MANN, JUDGE
24 United States Bankruptcy Court