
Star Valley Ranch Association's "Feasibility Study"

Star Valley Ranch Association Reorganization through Chapter 11 Bankruptcy Funding Option

The purpose of filing for Chapter 11 Reorganization Bankruptcy is to develop a plan that will change the Declarations of Covenants Conditions and Restrictions (DCCRs). The changes to the DCCRs will enable the Board of Directors, with the approval of the Membership, to assess the Members and generate the funds necessary to allow Star Valley Ranch Association to honor its obligations of providing safe drinking water, good roads and the other amenities that are the Association's responsibility to the Membership.

Chapter 11 is often called "reorganization" bankruptcy because it allows the debtor, in this case, Star Valley Ranch Association, to develop a plan of "reorganization" that satisfies the Association's creditors. The creditors of the Association include:

- The Membership
- Wells Fargo Bank
- Local suppliers
- Service and equipment vendors
- Employees

In most cases, while under Chapter 11, Management, referred to as "debtor in possession", continues to run the daily operations and the Bankruptcy Court approves all significant decisions. Star Valley Ranch Association would remain as "debtor in possession" until the Reorganization plan is approved, the case is converted to Chapter 7 liquidation or a Chapter 11 trustee is appointed (if a reorganization plan is not approved). Chapter 7 is unlikely since the reorganization plan is to correct deficiencies in the DCCRs and not to dismiss the financial liabilities, or debts, of the Association.

To qualify for Chapter 11 Reorganization, one of three conditions must exist. They are as follows:

Insolvency – The Association does not have enough cash to pay its bills and financial obligations.

Liabilities exceed assets – The financial obligations or liabilities of the Association exceed the value of the assets owned by Star Valley Ranch Association.

The Association is not able to perform contracted services for the Membership - Although the Association may be technically solvent, Star Valley Ranch Association would have to show it does not have the financial resources or methods to raise the funds necessary to honor its obligations to the Membership for safe and abundant drinking water, safe roads or to maintain the other facilities and services per the DCCRs.

Voluntarily filing for Chapter 11 Reorganization when the Association is solvent would be taking corrective action before the financial condition of the Ranch deteriorates into insolvency and the risk of Chapter 7 Liquidation Bankruptcy.

The current sets of DCCRs, written by attorneys in 1970, represented Leisure Valley Inc. (LVI), the developer of Star Valley Ranch. The DCCRs were written to favor LVI and protected the developer's interest. The DCCRs protected LVI's ability to sell lots and control the Association by making it virtually impossible for the Membership to make constructive changes to the operation of the Ranch. LVI is no longer a major factor in selling lots on the Ranch and the DCCRs should be changed to favor the Membership.

The proposed changes to the DCCRs include:

- 1) Standardize the DCCRs. Currently there are 11 sets of DCCRs for the Ranch. The one that applies to an individual's property depends on where the property is located on the Ranch. One set of governing documents would eliminate the confusion of which set of DCCRs apply and would provide a common reference source to operate the Association.
- 2) Currently, the DCCRs can only be amended every 20 years and require a 70% majority vote of the Membership (Article IX Section 4). Change the provision so that the DCCRs could be amended at anytime with a simple majority vote of the Membership. This would allow the DCCRs to be a "living document" that could change with the times and the desires of the Membership. **The current DCCRs do not allow for the possibility of changes until the year 2012.**
- 3) Amend the process for determining the annual assessment (Article VI Section 3) to allow the following:
 - a. Allow for permanent increases to the annual assessment.
 - b. Remove the automatic cost of living increase adjustment to the annual assessment. The Board of Directors should have to justify all increases in the annual assessments to the Members.
 - c. Amend the DCCRs so it takes a simple majority of the Membership to modify the annual assessment. In our current situation, a two thirds (2/3) majority vote of the Membership allows a minority of the Membership to stop progress at the Ranch. A vote of one third of the voting Members plus one is able to stop any proposed change in assessments. With a simple majority the Board of Directors must still prove its case to the Membership for every assessment increase request.
 - d. Change Article VI Section 3b in the DCCRs that only allows annual assessment increases to be considered in the fourth quarter of the year so they can be considered at any time of the year. This would allow the Board of Directors to present to the Membership assessment increases during the summer season when the most Members are at the Ranch, allowing meetings and discussion at the convenience of the Membership.
- 4) Create a class of fees called "user fees" for services received such as the use of water, and give the Board of Directors the discretion to set the user fees. Currently there are three methods provided by the DCCRs for the Association to collect funds from Members: annual assessments, special assessments, and recreation fees. With the new user fee classification, members who do not use the Association facilities would not be subsidizing others who do use the facilities.

- 5) Change the threshold for approval of a special assessment to a simple majority vote, 50% plus one, of the Membership from the current two thirds (2/3) majority vote (Article VI, Section 4).
- 6) Allow the Board of Directors the authority to assess the Membership for unexpected, or emergency, repairs and maintenance to Association facilities and infrastructure.

The proposed changes to the DCCRs listed above are intended to help the Association serve the Membership better, bring the infrastructure up to regulatory standards, and provide the level of service property owners expect as Members of the Star Valley Ranch Association. The proposed changes in the DCCRs would assure that a simple majority vote, 50% plus one, of the Membership rules on issues affecting the Ranch. The Board of Directors and the Membership would be free to act in the best interests of the majority and not be forced to cater to a minority interest.

To solve the funding shortfall, the Board of Directors, with the approval of the Membership, would be able to realistically utilize the funding sources available through the revised DCCRs. Those options include:

- 1) Increasing the annual assessment to cover the costs of bringing the culinary water and roads up to regulatory standard.
- 2) Borrowing funds and being able to pledge an increase in the annual assessment to repay the funds borrowed.
- 3) Special assessments to finance projects desired by the Membership or imposed by a government mandate, such the Department of Environmental Quality (DEQ).

Again, in every case the Board of Directors would have to justify every assessment increase and ask the Membership for their approval through a majority vote of 50% plus one.

What is the process to file for Chapter 11 Reorganization?

- 1) The process would start with a directive from the Board of Directors to file for Chapter 11 Reorganization Bankruptcy.
- 2) The General Manager would then contact all the Association's vendors, bankers and employees to notify them of the Board's decision to file for Chapter 11 Reorganization.
- 3) The Association would hire a bankruptcy attorney, file a petition in Bankruptcy Court and develop a reorganization plan.
- 4) Acceptance of the petition by Bankruptcy Court is contingent on the following items:
 - a) The contract between the Association and the Members (DCCRs) is an "Executory Contract".
 - i) The bankruptcy code does not offer a definition of "Executory Contract". Courts have interpreted "Executory Contract" to be a contract where there remains substantial performance yet to be completed by both the debtor and the nondebtor at the time bankruptcy is filed. However, it may also be interpreted to include a situation where there remains substantial performance yet to be completed by only one of the parties, or as a contract, which may benefit the estate of the debtor "from performance or breach".

- ii) The legal history of an Executory Contract says it “generally includes contracts on which performance remains due to some extent on both sides.” H.R. Rep. No.195, 95th Congress, 1st session 374(1997).
- b) Without the acceptance of the concept of the DCCRs being an “Executory Contract”, Chapter 11 Reorganization is not possible.

Attorneys consulted for this report suggest that the probability of Bankruptcy Court accepting the DCCRs as an Executory Contract is “better than an even chance”. The petition would state that the Association, operating within the current DCCRs, is not able to perform the contracted services to the Membership. Membership services would include safe and reliable drinking water, well-maintained roads, as well as enforcement of the DCCRs.

- 5) Once a petition is filed and accepted the Association would have 120 days to file a plan of reorganization with the court. If the petition is not accepted by the court there are no legal consequences since the Association is solvent and able to honor its current financial obligations.
- 6) After the reorganization plan is filed with the court the creditors of the Association would have 60 days to review the plan. Approval of the reorganization plan is acceptable to the Bankruptcy Court when creditor groups approve the plan. Considerations include:
 - a. A reorganization plan can be confirmed over the objection of a mortgage lender if such lender is not “impaired”. A mortgage lender will not be deemed to be impaired if the debtor cures an existing payment default, but the debtor is not obligated to pay the unpaid balance of the loan merely because the mortgage lender has accelerated the loan. (11 U.S.C. Section 1129(a)(8)(B)) As long as the Association remains current with the golf course irrigation note and the reorganization plan calls for the full payment within terms, the Association’s creditor, Wells Fargo, cannot object to the plan. Wells Fargo would not be considered an “impaired” creditor.
 - b. The Association reorganization plan would include full payment of all outstanding financial obligations, including local vendors and equipment suppliers. Probably the most notorious provision of the Bankruptcy Code, from the lender’s perspective, is the “cramdown” provision that permits the debtor to propose a reorganization plan, over the objection of a secured creditor and the class to which such creditor belongs, as long as the plan “does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”(11 U.S.C. Section 1129(b) (1)). In other words, if the Association’s reorganization plan pays all creditors in full and within terms, creditors cannot object to the plan.
- 7) There certainly will be legal challenges to the process and to the changes to the DCCRs. However, all court challenges to the reorganization plan will be settled in Bankruptcy Court, which is “sympathetic” to the debtor, Star Valley Ranch Association. The term “sympathetic” is used to describe Bankruptcy Court as an institution where debtors can go to seek protection from creditors and resolve financial problems.
- 8) The process is expected to take eight to twelve months to complete.

What are the costs and risks to Star Valley Ranch Association?

- 1) Legal fees - Most bankruptcy attorneys charge \$25,000 as a down payment. The cost is estimated to be \$50,000 to \$100,000 after all legal claims are settled. If the court rejects the petition for Chapter 11 Reorganization, the Association would be out the attorney's fees to date and filing fees for the petition.
- 2) The Bankruptcy Court must accept the following concepts for Chapter 11 Reorganization to be possible:
 - a) The DCCRs are accepted as an Executory Contract .
 - b) The Association is not able to perform contracted services for the Membership without changes to the DCCRs.

How will Chapter 11 Reorganization affect the Board of Directors?

Assuming the proposed changes to the 34 year-old DCCRs are approved, the Star Valley Ranch Association Board of Directors should be able to direct the affairs of the Association in a more efficient and fair manner.

What are the effects of Chapter 11 Reorganization on individual Members?

While Star Valley Ranch Association is in Chapter 11 Reorganization there would be a great deal of uncertainty about the future of the Association. It certainly could have a negative impact on a Member's property value and their ability to sell their property during reorganization. However, reorganization could also be seen as a positive event since the Association would be taking the necessary steps to secure the financial future of the Ranch.

Members would still be required to pay their annual assessment while the Association is in reorganization.

Once Chapter 11 Reorganization has been completed, Member property values should increase since the Association would have the tools through various assessments to provide safe and reliable drinking water, roads, amenities and the services Members expect of Star Valley Ranch Association.

If an assessment plan proposed by the Board of Directors is approved by a simple majority, 50% plus one vote of the Membership, assessments would be increased to fund the proposed project or operational changes.

Chapter 11 Reorganization will impact the Association in the following areas:

Credit worthiness - At the time of filing, all debts owed by the Association would be "on hold" until the court approves a plan. After reorganization approval, the Association would have to operate on a cash basis until credit worthiness can be reestablished. Since the basic premise of filing for Chapter 11 Bankruptcy is to secure the Association's ability to honor its financial commitments and all creditors of the Association would be paid in full, there should be no lasting impact on the ability of the Association to maintain good credit with its current vendors.

Reputation - Employees would be affected by this action since at the time of filing their salaries would be put on hold. Any plan accepted by the Bankruptcy Court must include compensating employees immediately and paying employees and vendors on a regular basis while the Association is a "debtor in possession". A financially strong Association would help the reputation of the Star Valley Ranch and stabilize property values.

- **Wells Fargo** – Star Valley Ranch Association has a note with Wells Fargo for approximately \$620,000, the Golf Course Irrigation Note. Any plan for reorganization would include full payment of the note per the original note conditions over the next eight years. The Association would continue to make annual payments until the note is paid in full. Representatives from Wells Fargo indicate that filing for Chapter 11 Reorganization would jeopardize future borrowing from the bank.

Bank of Star Valley – Currently the Association has a line of credit with the Bank of Star Valley. It is likely that the bank would suspend the line of credit until Star Valley Ranch Association emerges from Chapter 11. Since any reorganization plan would include full payment of all debts owned by the Association, future borrowing with the Bank of Star Valley would be possible.

Self Governance – The proposed changes to the DCCRs will give the Board of Directors, empowered by the Membership, the tools necessary to manage the affairs of the Association by removing the unmanageable aspects of the protective covenants.

Summary Statement:

The purpose of filing for Chapter 11 Reorganization Bankruptcy is to develop a plan to change the DCCRs and enable Star Valley Ranch Association, with the approval of the Membership, to assess the Members and generate the funds necessary to honor its obligations to the Membership by providing safe drinking water, good roads and other amenities.

It would mean The Board of Directors and the Membership would have the sole responsibility to solve the financial problems of the Association, preserve the Association's independence and be accountable to the Members of Star Valley Ranch Association.