

1 MCGUIREWOODS LLP
2 William H. Kiekhofer, III (SBN 94022)
WKiekhofer@mcguirewoods.com
3 Jodie M. Grotins (SBN 261409)
JGrotins@mcguirewoods.com
4 1800 Century Park East, 8th Floor
Los Angeles, California 90067
5 Telephone: (310) 315-8200
Facsimile: (310) 315-8210

6 Attorneys for Esmark, Inc.

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8 UNITED STATES BANKRUPTCY COURT
9 CENTRAL DISTRICT OF CALIFORNIA
10 SAN FERNANDO VALLEY DIVISION

11 In re
12
13 MERUELO MADDUX PROPERTIES, INC.,
et al.,
14 Debtors.

Case No. 1:09-bk-13356-KT
Chapter 11
OBJECTION TO FIRST AMENDED
DISCLOSURE STATEMENT

Disclosure Statement Hearing
Date: March 19, 2010
Time: 9:30 a.m.
Place: Courtroom 301
21041 Burbank Blvd.
Woodland Hills, CA 91367

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20 Esmark, Inc. ("Esmark"), an equity holder of Debtor Meruelo Maddux Properties, Inc.,
21 objects to the Debtors' proposed First Amended Disclosure Statement (the "Disclosure Statement")
22 on the grounds that it does not contain "adequate information" within the meaning of 11 U.S.C.
23 § 1125.

24 The Debtors' Disclosure Statement represents a marginal improvement over the plan
25 described in its initial disclosure statement in that the opportunity to contribute "new value" has been
26 broadened from management to the two hundred largest shareholders. However, the Plan proposes
27 that only the Top 200 Holders (Record Date Holders) are eligible and permitted to subscribe to the
28 NE Interest Rights under the Rights Offering. Esmark objects because the Disclosure Statement

1 describes an unconfirmable and impermissibly discriminatory plan, and the Disclosure Statement
2 fails to articulate any good faith or business justification for such discrimination.

3 A hypothetical reasonable investor could not, based on the Disclosure Statement alone, make
4 an informed judgment concerning the Plan or the rights offering. The limitation of the Rights
5 Offering to the top 200 shareholders is not only unfairly discriminatory, but sows doubt and
6 confusion instead of enlightenment. How is a shareholder to know whether he or she is number 200
7 in size of holding, and able to participate in the Rights Offering, or 201, whose holdings are fated to
8 extinction?

9 The provenance of this structure and the rationale for the share price of the NE Interest Rights
10 and the assumed value of the equity appear to be financial artifacts of the previous new value plan,
11 but all is left to the imagination. These background facts should be disclosed. The Disclosure
12 Statement is inadequate, and approval should be denied.

13
14 **I. OBJECTIONS TO PARTICULAR SHORTCOMINGS IN DISCLOSURE
STATEMENT**

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16 A court may only approve a disclosure statement after concluding that it contains “adequate
17 information”, which is defined as “information of a kind, and in sufficient detail, as far as is
18 reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's
19 books and records . . . that would enable such a hypothetical investor of the relevant class to make an
20 informed judgment about the plan. . . .” 11 U.S.C. §§ 1125(a)(1), (b). The disclosure statement
21 requirement of section 1125 of the Bankruptcy Code is “crucial to the effective functioning of the
22 federal bankruptcy system,” and “the importance of full and honest disclosure cannot be overstated.”
23 *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.*, 81 F.3d 355, 362 (3d Cir. 1996) (citing
24 *Oneida Motor Freight, Inc. v. United Jersey Bank (In re Oneida Motor Freight, Inc.)*, 848 F.2d 414,
25 417-418 (3d Cir. 1988)). “The determination of whether the disclosure statement has adequate
26 information is made on a case by case basis and is largely within the discretion of the bankruptcy
27 court.” *In re A.H. Robins Company, Inc.*, 880 F.2d 694, 696 (4th Cir. 1988). The “adequate
28 information” requirement is designed to help creditors in their negotiations with debtors over the

1 plan. *See Century Glove, Inc. v. First American Bank*, 860 F.2d 94, 100 (3d Cir. 1988). Here, for
2 reasons set forth below, the Disclosure Statement does not satisfy the adequate information standard.

3
4 **A. Objections to the Sufficiency of Disclosures About How The "NE Interest"
Purchase Price Was Calculated and/or Negotiated**

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6 The Disclosure Statement provides that "[t]he purchase price of each share of the NE Interest .
7 . . . sold in the Rights Offering shall be \$20." Redline of Disclosure Statement, 230:23-24, Docket No.
8 1138-6 ("Redline"). "The minimum subscription permitted by any Record Date Holder is \$50,000."
9 Redline, 230:1-6.

10 The Disclosure Statement completely fails to provide any means of calculations as to these
11 sums. A hypothetical investor, and certainly an equity holder, will want to know the basis of the
12 valuation. It is impossible to make any determination of the sums without further information. The
13 Disclosure Statement needs to provide adequate information as to how such figures were calculated
14 or determined in order for the Disclosure Statement to satisfy the full and honest disclosure
15 requirements.

16
17 **B. Objections to the Sufficiency of Disclosures About The Backstop Party**

18 The Disclosure Statement loosely describes "to the extent all the Offered NE Interest . . . is
19 not fully subscribed, . . . , the balance of the shares . . . will be purchased by the Backstop Party, as
20 set forth in the Backstop Purchase Agreement, a copy of which will be attached to the Plan."
21 Redline, 230:18-22.

22 By not identifying or describing the backstop party, the Disclosure Statement fails to provide
23 a full and honest disclosure, and, in regards to a hypothetical investor, well, such investor would
24 know nothing about the capabilities, or even existence, of a backstop purchaser should the Offered
25 NE interests fail to be fully subscribed. At the least, the Disclosure Statement should disclose the
26 identity of the Backstop party.

27 ///

28 ///

1 **C. Additional Objections to the Sufficiency of Disclosures**

2 In addition to the serious lack of disclosure regarding the rights offering, several other matters
3 require additional disclosure:

4 1. The disclosure statement references an \$8.5 million payment to a senior member of
5 management, John Maddux, but does not disclose how the amount was calculated, what the purpose
6 of the payment is, and why he is not treated as a general unsecured creditor.

7 2. The plan projects future monthly cash expenses of \$620,800. This estimate is
8 substantially less than actual expenses for the last 10 months (approximately \$1.4 million per month).
9 The substantial reduction in expenses is not explained in the disclosure statement.

10 3. The disclosure statement does not explain what will happen if the plans for certain
11 debtors are approved but certain others are not.

12 4. This objection does not address other significant defects in the proposed disclosure
13 statement. By omitting other grounds for objection, Esmark does not intend to imply that the
14 proposed disclosure statement is otherwise adequate. Moreover, Esmark reserves the right to object
15 to plan confirmation at the appropriate time.

16
17 **II. THE DISCLOSURE STATEMENT DESCRIBES AN UNCONFIRMABLE PLAN**

18 The Court should not confirm a Disclosure Statement for a Plan which is unconfirmable on its
19 face, as when the proposed plan is so fatally flawed that confirmation is impossible. *In re Pecht*, 57
20 B.R. 137, 139 (Bankr. E.D. Va. 1986); *In re Phoenix Petroleum Co.*, 278 B.R. 385, 394 (Bankr. E.D.
21 Pa. 2001); *In re Cardinal Congregate I*, 121 B.R. 760, 764 (Bankr. S.D. Ohio 1990); *In re Kehn*
22 *Ranch, Inc.*, 41 B.R. 832, 833 (Bankr. D.S.D. 1984). When the plan's inadequacies are patent, they
23 may, and should be addressed at the disclosure statement hearing. *In re Dakota Rail, Inc.*, 104 B.R.
24 138, 143 (Bankr. D. Minn. 1989) ("Allowing a facially nonconfirmable plan to accompany a
25 disclosure statement is both inadequate disclosure and a misrepresentation."); *In re Unichem Corp.*,
26 72 B.R. 95, 100 (Bankr. N.D. Ill. 1987) ("Since this plan . . . is unconfirmable as a matter of law, the
27 court is unable to approve [the] disclosure statement.").

1 Thus, even if this Court should find that the proposed Disclosure Statement meets the
2 informational standard contained in section 1125 of the Bankruptcy Code; this Court is authorized to
3 deny approval of the Disclosure Statement on the grounds that the underlying plan is patently
4 unconfirmable. See e.g., *In re Mahoney Hawkes, LLP*, 289 B.R. 285, 294 (Bankr. D. Mass. 2002)
5 (denying motion to approve disclosure statement, even though the disclosure statement met the
6 informational standards set forth in section 1125, on the grounds that the plan provided for
7 inappropriate releases and injunctions and was, therefore, patently unconfirmable).

8 In determining whether a separate classification under §1122(a) is appropriate the courts must
9 be guided by the mandate of §1129(b)(1) that the plan does not discriminate unfairly with a class of
10 creditors that is impaired under the plan and has not voted to accept the plan. *Id.* The "unfair
11 discrimination" standard under section 1129(b) applies if the combination of separate classification
12 and materially different treatment results in substantially different economic effects between the two
13 classes and the purpose of and effect is other than the debtor's good faith effort to protect its future
14 business operations. *Matter of Jersey City Medical Center*, 817 F.2d 1055 (3rd Cir. 1987); *In re*
15 *Corcoran Hospital District, In re Corcoran Hospital District*, 233 B.R. 449, 456 (Bankr.C.D.Cal.
16 1999).

17 Here, as presently drafted, the Plan is unconfirmable. The Disclosure Statement unfairly
18 discriminates against individuals within the class of Record Date Holders – "in the event that more
19 than 200 Record Date Holders subscribe for NE Interest Rights, only the Top 200 Holders will be
20 eligible and permitted to subscribe for NE Interest Rights." Redline, 229:21-23. The Debtors have
21 failed to provide an inkling of an explanation that would amount to good faith or an appropriate
22 business judgment as to why only the Top 200 Holders will be permitted to subscribe for NE Interest
23 Rights. On the face of the Disclosure Statement, it simply appears that certain Record Date Holders
24 are being unfairly discriminated against, particularly given that the previous disclosures statements
25 had only afforded management an opportunity to contribute "new value". It is incumbent on the
26 Debtors to provide more information as to why it is fair and reasonable to discriminate among the
27 Record Date Holders.

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NOTE: When using this form to indicate service of a proposed order, **DO NOT** list any person or entity in Category I. Proposed orders do not generate an NEF because only orders that have been entered are placed on the CM/ECF docket.

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is: McGuireWoods LLP, 1800 Century Park East, 8th Floor, Los Angeles, CA 90067

The foregoing document described as OBJECTION TO FIRST AMENDED DISCLOSURE STATEMNT will be served or was served **(a)** on the judge in chambers in the form and manner required by LBR 5005-2(d); and **(b)** in the manner indicated below:

I. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (“NEF”) – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s) (“LBR”), the foregoing document will be served by the court via NEF and hyperlink to the document. On March 12, 2010, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following person(s) are on the Electronic Mail Notice List to receive NEF transmission at the email address(es) indicated below:

U.S. Trustee: Attn: Jennifer L. Braun, jennifer.l.braun@usdoj.gov

Attorneys for Debtor: Enid M. Colson, emc@dgdk.com; Aaron De Leest, aed@dgdk.com;

John J. Bingham, jbingham@dgdk.com; Julia W. Brand, jwb@dgdk.com; Michael C. Abel, mca@dgdk.com

Zev Shechtman; zshechtman@dgdk.com

Jennifer L. Nassiri, jennifer.nassiri@dlapiper.com

Michael B. Reynolds, mreynolds@swlaw.com

Natasha L. Johnson, natasha.johnson@dlapiper.com

Service information continued on attached page

II. SERVED BY U.S. MAIL OR OVERNIGHT MAIL (indicate method for each person or entity served):

On March 12, 2010 I served the following person(s) and/or entity(ies) at the last known address(es) in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States Mail, first class, postage prepaid, and/or with an overnight mail service addressed as follows. *Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.*

Via Overnight Mail:

Honorable Kathleen Thompson, U.S. Bankruptcy Court, 21041 Burbank Boulevard, Suite 305, Woodland Hills, CA 91367

Service information continued on attached page

III. SERVED BY PERSONAL DELIVERY, FACSIMILE TRANSMISSION OR EMAIL (indicate method for each person or

entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on _____ I served the following person(s) and/or entity(ies) by personal delivery, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. *Listing the judge here constitutes a declaration that personal delivery on the judge will be completed no later than 24 hours after the document is filed.*

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

March 12, 2010

Date

Dorothea Kiker

Type Name

/s/ Dorothea Kiker

Signature

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I. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (“NEF”) – continued

Creditors Committee Counsel: Asa S. Hami, ahami@sulmeyerlaw.com; Dean G. Rallis, Jr., drallis@sulmeyerlaw.com
Tamar Kouyoumjian, tkouyoumjian@sulmeyerlaw.com; Victor A. Sahn, vsahn@sulmeyerlaw.com
Lewis R. Landau, lew@landaunet.com

Creditor/represented by:

Bank of America, Donald L. Gaffney, dgaffney@swlaw.com
Calex Engineering Company, Kirsten A. Roe, kroe@wthf.com
California Bank & Trust, Brian T. Harvey, bharvey@buchalter.com; Alexandra Kazhokin, akazhokin@buchalter.com;
Daniel H. Slate, dslate@buchalter.com
CanPartners Realty Holding Company IV, LLC, Lance N. Jurich, ljurich@loeb.com
Cathay Bank, Michael G. Fletcher, mfletcher@frandzel.com; Bernard R. Given, bgiven@frandzel.com
Charlestown Capital Advisors, LLC, Christopher E. Prince, cprince@lesnickprince.com
Chinatrust Bank (USA), Steven K. Linkon, slinkon@rcolegal.com
County of Los Angeles Tax Collector, Barry S. Glaser, bglaser@swjlaw.com
East West Bank, Elmer D. Martin, III, elmermartin@msn.com; Iain A. W. Nasatir, inasatir@pszjlaw.com
James Stang, jstand@pszjlaw.com
FNBN-CMLCON I LLC, Stephen Shiu, sshiu@swlaw.com; David E. Leta, dleta@swlaw.com;
Michael B. Reynolds, mreynolds@swlaw.com
Natividad Gonzales, Jeffrey S. Shinbrot, shinbrot@earthlink.net
Imperial Captial Bank, Sara Chenetz, chenetz@blankrome.com
Kennedy Funding, Inc., Howard Camhi, hcamni@ecjlaw.com; Michael S. Kogan, mkogan@ecjlaw.com
Legendary Investors Group No. 1, LLC, Iain A. W. Nasatir, inasatir@pszjlaw.com; James Stang, jstang@pszjlaw.com
Surjit P. Soni, surjit@sonilaw.com
Los Angeles County Metropolitan Transportation Authority, Michaeline H. Correa, mcorrea@jonesday.com
Yoshiake Murakami, Brian L. Davidoff, b davidoff@rutterhobbs.com
PNL Pomona, L.P., Cara J. Hagan, carahagan@haganlaw.org; Tracie L. Spies, tracie@haganlaw.org
Pacific Commerce Bank, Ronald R. Cohn, rcohn@horganrosen.com
Roofcorp of CA, Inc., Jason L. Weisberg, jason@gdclawyers.com
San Bernardino County Tax Collector, Martha E. Romero, Romero@mromerolawfirm.com
Stanford Group LP, Michael H. Raichelson, mhr@cabkattorney.com; Janis G. Abrams (email not listed on Docket)
United Commercial Bank, Elmer D. Martin, III, elmermartin@msn.com
Wells Fargo Bank, N.A., etc., Thomas A. Geher, tmg@jmbm.com; John A. Graham, jag@jmbm.com
Woodland Farms, Inc., James E. Carlberg, jcarlberg@boselaw.com

Courtesy NEF Requested:

Peter Bonfante, peterbonfante@bsalawfirm.com;
Martin J. Brill, mjb@lnbrb.com
Michael I. Gottfried, mgottfried@lblawllp.com
John A. Graham, jag@jmbm.com
Ofer M. Grossman, omglaw@gmail.com
Peter J. Gurfein, pgurfein@akingump.com
David W. Hercher, dave.hercher@millernash.com
William W. Huckins, whuckins@allenmatkins.com
Katherin Lien, katie.lien@sbcglobal.net
Elissa Miller, emiller@sulmeyer.com
Lawrence Peitzman, lpeitzman@pwkllp.com
Craig M. Rankin, cmr@lnbrb.com
Jeffrey S. Shinbrot, shinbrot@earthlink.net
James A. Timko, jtimko@allenmatkins.com
Alan G. Tippie, atippie@sulmeyer.com
Jasmin Yang, jyang@swlaw.com