

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE:

WENDELTA, INC.,

Debtor.

BK #90-22091-WHB
Chapter 11

MEMORANDUM OPINION AND ORDER ON MOTION OF
SECURITY FEDERAL SAVINGS AND LOAN ASSOCIATION
TO ENFORCE PLAN

This confirmed Chapter 11 case was reopened upon the motion of Security Federal Savings and Loan Association ("Security"), pursuant to 11 U.S.C. §350(b), to permit Security to file a motion to enforce plan of reorganization and for other relief. Such a motion was filed, and after discovery between Security and Wendelta, Inc. ("Wendelta") proof on the motion was heard on April 29 and 30, 1993. The Court has now reviewed the proof, including testimony and exhibits introduced at the April 29-30 hearing, and the Court has considered the statement of issues submitted by counsel for the parties after the hearing. This contested motion concerns matters of administration of the estate and interpretation of the order confirming a plan in this case. Therefore, the Court has concluded that this contested motion is a core proceeding under 28 U.S.C. §157(b)(2)(A), (L) and (O). The following contains findings of fact¹ and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

¹ The issues presented are predominantly, if not entirely, factual.

After considerable negotiation, this Chapter 11 debtor succeeded in obtaining an order confirming its second amended Plan, with two modifications, on March 19, 1991. Under Article IX, captioned "Retention of Jurisdiction and Miscellaneous," numerical paragraph 1(l), the Court retained jurisdiction for purposes of both "[e]nforcement and interpretation of the terms and conditions of the plan." Ex. 1, Tab 4.

The primary issues from the pleadings and proof presented to the Court are:

1. The Court must determine if "surplus cash" should be calculated under the plan on a cash basis or on an accrual basis. This involves the ultimate issue for 1991 of whether Security is due any additional "surplus cash."

2. In the determination of "surplus cash," a critical issue involves what items are to be included in administrative or operating expenses. Specifically, for 1991 and years following, Security seeks a determination that travel and automotive expenses should be "general and administrative costs" rather than "normal and customary operating expenses."

3. A determination of the "general and administrative costs" also includes a determination of how the minimum operating capital requirements of \$300,000 must be maintained.

4. A determination of what payments were mandated by the plan is necessary in order to determine whether the debtor has appropriately paid certain creditors in amounts that exceeded originally projected amounts.

5. It must be determined whether Wendelta has committed a default under the plan and, if so, whether Security is entitled to any remedies, including interest and attorney's fees.

These issues are interrelated and will involve sub-issues, and the Court decides these issues after consideration of the plan itself and additional proof that was offered on these issues.

The Court will not recite all of the background facts in this confirmed Chapter 11 case. The pleadings, including the confirmed plan, contain that information. See Exs. 1-7. This bankruptcy was commenced in March, 1990; the first plan was filed in July, 1990; the plan was amended in November, 1990, and in February, 1991; and the second amended plan was further modified prior to a final confirmation hearing on March 19, 1991. Wendelta operates sixteen Wendy's restaurants in Mississippi and Arkansas. Ex. 1. Approximately nine million dollars was owed to Security at the time of filing, and Security's debt was secured by perfected deeds of trusts, security interests, assignments and liens. Ex. 1.

In the confirmed plan Security's claim is treated and allowed as Class 4. The monthly payments called for in the plan have begun as of January 1, 1992, and are continuing, and these ongoing payments are not at issue. Ex. 1, Tab 4, p. 6. At issue is the confirmed plan's provision that for the years 1991 through 1995 Security is to receive all or a portion of "surplus cash." Security's motion states that for 1991 Wendelta paid Security \$60,897.64 in "surplus cash" and Security asserts that this amount was "incorrect and insufficient." Security's Motion To Enforce Plan. On December 31, 1996, all remaining sums due Security will be due. Ex. 1, Tabs 4 & 6. Therefore, for the years 1991 through 1995 the calculation of "surplus cash" is critical. "Surplus cash" is defined in the plan as "cash available and remaining from Net Cash Flow after payment mandated by this Plan to all classes of creditors, as demonstrated by Exhibit 'A' attached hereto and incorporated herein." Ex. 1, Tab 4, Art. I, ¶13.

"Net Cash Flow" is defined in the plan as "all gross collected revenue of the Debtor in each fiscal (calendar) year commencing January 1, 1991, from normal operations, less (1) all general and administrative costs in an amount not to exceed \$893,795.00 for calendar year 1991 [with increasing

caps for years 1992 through 1995], provided Debtor may pay excess insurance claims not to exceed \$25,000.00 in any one year . . . ; (2) amounts necessary to maintain minimum operating capital requirements of \$300,000.00; (3) \$15,000.00 per month in expenditures for capital improvements . . . ; (4) all normal and customary operating expenses. Items included in normal operating expenses and in general and administrative expenses shall be consistent from year to year and shall be subject to the review of the Court upon the motion of a party in interest." Ex. 1, Tab 4, Art. I ¶11. The reference here to "general and administrative expenses" is not a reference to §503 administrative expenses; rather, "general and administrative expenses" is a business term used by Wendelta in its plan.

Article V of the plan contains the "Means of Execution" of the plan. Ex. 1, Tab 4.

Security asserts that it relied upon Wendelta's representations, upon Exhibit A to the plan and upon certain understandings as to the accounting methodology in arriving at its decision to vote for Wendelta's amended and modified plan. Obviously, Security and Wendelta now disagree on what is meant by some of the plan's provisions and on what accounting methodology has been and should be employed. The Court finds that these disagreements arise in large part because accountants were not involved in the drafting of the plan and some of the plan's terminology does not rise to the level of accounting terms of art. In other words, the negotiating parties may have entertained different ideas as to what was meant by certain of the plan terms, but the Court finds no evidence that parties were attempting to mislead each other in the plan negotiation or drafting process. In fact, Security's representative testified that he was not taken advantage of.

Because the proof on the disputes concentrated on 1991, the Court will focus on that year and will discuss the issues in the context of 1991 numbers. The determination of 1991 issues will

determine the issues for other years, as the plan requires application of consistent concepts in years after 1991.

SURPLUS CASH

To arrive at "surplus cash" one first must determine "net cash flow." There is no dispute that Wendelta's gross collected revenue for 1991 was \$14,644,563. There is also no dispute on the amount of the cap on "general and administrative costs" for 1991. The dispute begins with whether Wendelta's supervisory travel expenses should be included in the capped "general and administrative costs," which is Security's position, or has been historically a store operating expense that should be a "normal and customary operating expense" over and above the capped "general and administrative costs," which is Wendelta's position.

John Howard Shows, an attorney and former general counsel and executive vice president for Security, testified that he negotiated the plan terms on behalf of Security. During these negotiations, Security received payments under a consensual adequate protection order. Ex. 1, Tab 1. Mr. Shows received and in part relied upon Wendelta's in-house accounting reports. Ex. 1, Tabs 8-10. He testified that supervisor's travel did not appear on these reports as a part of "store level cash flow." On those reports Wendelta had various accounting "departments" for each of the stores and for administrative expenses. Mr. Shows understood Department 100 to represent general administrative costs that were unrelated to specific stores. Mr. Shows could not recall who had told him this, and Wendelta asserts that Mr. Shows simply misunderstood Department 100. The Department 100 report (Ex. 1, Tab 9) has a line item for "Travel and Auto Adm," which Mr. Shows understood to be the supervisor's travel expenses. The store accounts, Departments 101-116, contained a "Travel and Auto Adm," which he understood to represent travel at the store management level. Ex. 1, Tab 10.

On March 5, 1991, Mr. Shows wrote to the chief financial officer of Wendelta. Ex. 1, Tab 11. In reply, that officer, Lawrence Russell, supplied some information that assisted Mr. Shows in forming his opinion on what would make up "general and administrative costs." Ex. 1, Tab 12. In negotiating Security's acceptance of the plan, a cap was set on "general and administrative costs." Security wished to see Wendelta survive but did not want to leave fat in the administrative budget that would permit Wendelta's parent company to profit from management of Wendelta. Mr. Shows testified that he understood and relied upon his understanding that Wendelta would include supervisor's travel in the capped "general and administrative costs." Mr. Shows admitted that he is not an accountant. The letter from Wendelta in response to Mr. Shows' letter identifies the amount of administrative costs incurred in 1990 and attached a detail of those costs. Ex. 1, Tab 12. Travel and auto expenses of \$114,283.85 appear but neither the document nor Mr. Russell's letter provides back-up explanation of that amount.

Mr. Shows made 1991 calculations based upon his understanding of the plan, his negotiations with Wendelta, and financial information prepared by Wendelta's external accountant, Mr. Balton. Ex. 1, Tabs 14-15. Mr. Shows' calculations used the plan's cap on "general and administrative costs" and included supervisor's travel in that cap. Ex. 1, Tab 18. Considering other disagreements with Wendelta that will be discussed later, Mr. Shows arrived at "surplus cash" for 1991 of \$390,942. Security only received approximately \$60,898 of that amount. Ex. 1, Tab 18. Mr. Shows also attempted to reconcile his calculations of 1991 "surplus cash" with Exhibit A to the plan. Ex. 1, Tab 19.

In contrast to Mr. Shows' understanding of supervisor's travel expense, the Department 100 account for 1990 had an actual "controllable expenses" entry of \$114,283.85 for "Travel & Auto

Adm." Ex. 1, Tab 9. That department reflected actual total administrative expenses of \$992,842.12, which is approximately the same amount referred to in Mr. Show's letter. Ex. 1, Tabs 9 & 11. Mr. Balton's 1990 and 1991 income statement for Wendelta shows "Travel and Auto Adm" as a part of "Other Cost" that were deducted from the "Cost of Sales" before arriving at "Gross Profit." Ex. 1, Tab 15. Although arranged differently, Mr. Balton's income statement number for 1990's administrative travel and auto expense is consistent with the line item administrative expense for Department 100 in 1990. Ex. 1, Tab 15, and Ex. 2. Mr. Shows' understanding of Department 100 was not based upon anything specific that Wendelta's representatives told him, and the Court finds that the parties did not have the same understanding as to Department 100 or as to whether supervisor's travel was to be included in "general and administrative costs."

This did not result from any misrepresentation by Wendelta. Rather, there simply appears to have been prolonged complex negotiation over many matters, and in the process Security made certain assumptions without obtaining specific verification. The disclosure statement and plan do not schedule specific items to be included in "general and administrative costs" or in "normal and customary operating expenses." There is persuasive proof that Mr. Shows' understanding concerning supervisors' travel was not consistent with Wendelta's prior treatment of these expenses.

Rosemarie Stack, the Executive Vice President of Wendelta, testified that Department 100 is not the equivalent of "general and administrative costs" and that it had contained expenses that might later be attributed to individual stores. She understood the plan's cap on "general and administrative costs" to include insurance claims, management fees and Wendelta's charges for accounting services performed for each store. She testified that the 1990 annualized performance budget (Ex. 1, Tab 8)

was for the purpose of establishing a store level cash flow target and that it did not contain a line item for travel and auto expense.

Security's expert witness, Charles McDonald, a certified public accountant, reviewed the plan and related documents and concluded that travel and auto expense should be treated as a part of the capped "general and administrative costs." In reaching this conclusion Mr. McDonald relied upon the letter from Mr. Russell (Ex. 1, Tab 12) and his own interpretation of the plan. Mr. McDonald had no prior accounting or audit experience with restaurants. He admitted that Mr. Balton had treated travel and auto expense as an operating expense, and his interpretation of the plan did not persuade the Court that the plan required supervisors' travel to be included in the capped "general and administrative costs."

As Mr. Dunlap, former attorney for the Chapter 11 debtor, testified, the plan contemplated that the reorganized debtor would continue operation under the same management and in the same manner as the pre-bankruptcy debtor. He understood that Wendelta would maintain its existing accounting methods. He stated that there was much negotiation over the plan but that how one arrived at "store level cash flow" was not an item that received much discussion in the negotiation process. The amount of the plan's "general and administrative cost" cap was the subject of much discussion, and this was attributed to Mr. Shows' concern that the management company should not receive too much money. There was no indication by Mr. Dunlap that the classification of travel and auto expense was a negotiated item. This seems to confirm that Security was understandably concerned about the amount of the "general and administrative cost" cap but that it did not verify what was included in the cap.

In contrast to Mr. McDonald, Wendelta offered a persuasive expert witness, James Ganaway, a certified public accountant, who had accounting experience with restaurants. Mr. Ganaway examined Wendelta's prior financial information and Mr. Balton's work papers, and he met with Wendelta's officers and personnel, including its principal accounting officer. He testified that the external accountant, Mr. Balton, performed an accounting review to "close the books" for the corporation. "Surplus cash" is not a defined accounting term but Mr. Ganaway attempted to follow the plan's language in calculating "surplus cash" for 1991. He testified that travel and auto expenses had been booked by Wendelta in 1989 through 1991 as a "normal and customary operating expense." These expenses were consistently deducted by Wendelta in arriving at net store profit, and Mr. Ganaway stated that it was customary in the industry to charge costs of supervisors to the store level in order to arrive at a store's operating profit.² For example, the Greenville store, Department 101, had a separate line item for travel and auto expense. Ex. 9. The consolidated statement for Departments 110 to 116 treated travel and auto expense in the same manner. Ex. 2. That is, this expense was deducted as a customary and normal expense before determining the stores' net profit.

It appears to the Court that Security essentially is arguing that travel and auto expense is part of the management fees that are capped or that this expense otherwise should be capped so as to prevent the management company from being overly compensated. Security's concern is understandable but the Court must be guided by the proof that convincingly establishes that Wendelta historically had treated travel and auto expense as a store level or a "normal and customary

² There was an objection to this particular testimony; however, it is relevant and helpful as the plan does not specifically address this issue.

operating expense." The plan does not require a change in this treatment, and it appears to actually require that prior accounting methods be maintained so that year-to-year consistency is fostered. The Court finds that travel and auto expense, including supervisors' travel, is to be treated under the plan as a "normal and customary operating expense." As such, it is not a part of the capped "general and administrative costs."

MINIMUM OPERATING CAPITAL:
CASH VS. ACCRUAL ACCOUNTING

The plan requires a minimum operating capital of \$300,000 to be maintained and this amount is to be deducted from "gross collected revenue" in arriving at "net cash flow." Ex. 1, Tab 4, Art. I ¶ 11 and Art. VI ¶ 1. Security points to Wendelta having over \$500,000 in its bank account on December 31, 1991, as evidence that Wendelta is deflating its "surplus cash" by having excessive operating capital. This position is connected to the issue of whether the plan requires Wendelta to use a cash or an accrual accounting methodology.

Mr. Shows testified that he made his calculations of 1991 "surplus cash" on an accrual basis because it was consistent with Wendelta's accountant's review method. Ex. 1, Tab 18. However, he stated that the plan seemed to require a cash rather than accrual method. Because Wendelta was internally on the accrual method, Mr. Shows stated that having \$564,000 in the bank was unnecessary. Security is critical of Wendelta's sixth calculation of 1991 "surplus cash" (Ex. 1, Tab 17), which deducted accrued payables from gross revenue, and Security considers Wendelta to be engaged in duplicative deduction of the accrued payables by using them in a calculation for replenishment of the \$300,000 operating account. Consistent with Security's approach, its expert witness, Mr. McDonald, calculated "surplus cash" using a cash basis approach. Ex. 5. He only

allowed a deduction for a \$300,000 operating account. Mr. McDonald's analysis becomes confusing because he had to convert some accrued items to a cash basis. This strained effort illustrates that reading the plan in the light of Wendelta's historic practice of accrual accounting makes more sense. This negotiated plan does not require either method and the Court will not read the plan that fails to use specific accounting terms to require a new accounting method.

Mr. Dunlap did not recall any discussion in the plan's negotiation about the cash or accrual method. Mr. Ganaway again convincingly testified that the plan did not mandate either method but that reading the plan with a common sense view led to the accrual method. This is illustrated by his analysis of the \$300,000 "minimum operating capital" account, which also is not a defined accounting term nor is it defined in the plan. He calculated that \$401,522 was necessary to replenish the \$300,000 operating account on December 31, 1991, assuming that the cash and accrued payables were taken into account. Ex. 8. Mr. Ganaway looked not merely at Wendelta's cash position but at its net position on that date. He deducted only those accounts currently payable for normal operating expenses and stated that it was appropriate to include the current cost of providing sales, as the gross revenue included all sales revenues. He denied that double deduction had occurred on his analysis. Under the plan, if Security's cash basis were adopted, Wendelta would have been required to pay all current payables as of December 31, 1991, and this would have left the company in the same net position as in Mr. Ganaway's analysis. Moreover, such a course of action would not have been prudent cash management and would have drained Wendelta below the \$300,000 minimum capital. In other words, Security's approach would have forced Wendelta into default at the end of 1991. On the other hand, Mr. Ganaway's analysis is based upon the assumption that the

plan intends Wendelta to have sufficient cash on hand to pay current accrued payables. The latter view is more factually and theoretically sound under the proof presented in this case.

The Court finds that the plan does not mandate a cash accounting and that accrual accounting is appropriate. Further, accrual accounting supports Wendelta's deduction of current payables in a calculation of amounts necessary to replenish the \$300,000 minimum operating capital. See Ex. 8. An interpretation of the plan can not ignore the real world of prudent money management or accounting principles.

SURPLUS CASH:
PAYMENTS TO CREDITORS

Another issue involving "surplus cash" is whether Wendelta has properly deducted payments to administrative, tax, and other claimants before arriving at 1991 "surplus cash." Security points to Exhibit A of the plan as establishing a limit of \$15,000 in expenses and \$70,000 in 1990 real property taxes required to be paid at confirmation. Ex. 1, Tab 4, Exhibit A. In contrast, Wendelta persuaded the Court in its proof, including the testimony of Mr. Dunlap and Mr. Ganaway, that the plan does not limit Wendelta to payment of only these amounts found in Exhibit A to the plan. Article I paragraph 13 of the plan defines "surplus cash" as being "cash available . . . after payment mandated by this Plan to all classes of creditors, as demonstrated on Exhibit A." (Emphasis added). Exhibit A was a demonstration of necessary payment, and the Court is not persuaded that it is anything more than an estimate of amounts needed at confirmation. Ms. Stack testified that she obtained the number of \$15,000 from Mr. Dunlap as being the estimated amount needed at confirmation for the unsecured creditors' attorney and an outstanding check for taxes. Mr. Dunlap had agreed for his fees to be paid monthly rather than lump sum. Mr. Dunlap testified that the accrued 1990 real property taxes were estimated at \$70,000 but that the amount increased and that

Security insisted that the taxes be paid in full. Payment of property taxes, which could prime Security's liens, was beneficial to Security; thus, the fact that tax payments reduced "surplus cash" can not be prejudicial to Security.

The Court finds that Wendelta properly paid the \$70,281 expenses needed at confirmation and the \$100,617 for 1990 real property taxes. See Ex. 8, p. 2.

Security contends, in its post-hearing written submission of the issues, that Wendelta's expert witness admitted that Wendelta exceeded the 1991 maximum "general and administrative costs" cap by \$26,485.³ The Court has reviewed its notes and the documentary proof and has listened to the tape of Mr. Ganaway's testimony. Mr. Ganaway testified that this is the amount by which Wendelta exceeded the "general and administrative costs" cap, but then he testified that Wendelta appropriately reflected only the \$918,795 total cap on its general ledger. See Mr. Balton's March 30, 1992 letter to Mr. Shows, stating that "general and administrative costs" had exceeded the cap by \$26,415, the same amount, approximately, referred to in Mr. Ganaway's testimony and see Mr. Balton's calculation on the second page of only \$25,548 in surplus cash. The Court is persuaded that the excess over the cap was remedied in Wendelta's adjustments to surplus cash. On the other hand, there is persuasive proof that Security has been overpaid rather than underpaid 1991 "surplus cash." However, the Court will not require any disgorgement by Security, as the "surplus cash" payment is applied under the plan to its total note. Ex. 1, Tab. 4. It should be noted that the plan provides that Security shall be paid in full on December 31, 1996. Any minor error, such as the alleged \$26,485, amounts to a deferral of payment until December 31, 1996, or a prepayment, depending upon who is favored by the error. In the meantime, Security is receiving monthly payments of \$45,000 and is

³ The correct number is \$26,385. See Ex. 1, Tab 15, p. 1, \$471,072 less \$444,687 (Ex. 8, Ftn. C) = \$26,385.

accruing interest under the plan and its related note. Ex. 1, Tabs 4 & 20. That is not to say that accuracy is not important, and to prevent future disagreements the Court will order that until Security is paid in full Wendelta shall provide Security with an annual independent audit, as required by the original loan agreement, which was merely modified but not extinguished by the plan. See Ex. 1, Tabs 4 & 20. If the parties can not agree on an auditor, upon motion this Court will select an auditor. The expense of such an audit will be borne by Wendelta. The auditor shall recommend any necessary adjustments in "surplus cash" resulting from the annual audit.

The Court does not find any material default by Wendelta in the plan. As a result, Security is not entitled to its attorney's fees or costs under the note dated March 19, 1991. Ex. 1, Tab 20. Each party shall bear its own fees and costs for this motion. However, Wendelta's fees and costs shall be included in "normal and customary operating expenses" for 1993 or for that year in which this order becomes final.

The foregoing is SO ORDERED this 15th day of July, 1993.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

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