

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2004-004737

04/15/2010

HONORABLE DEAN M. FINK

CLERK OF THE COURT
S. Brown
Deputy

SALT RIVER PIMA MARICOPA INDIAN
COMMUNITY, et al.

W CHARLES THOMSON III

v.

A WAYNE HILLS, et al.

JAMES J FARLEY

ERIC E LYNCH
BRYAN F MURPHY
BENJAMIN REEVES
LAWRENCE C WRIGHT
THOMAS L HUDSON
CHRISTOPHER H BAYLEY

MINUTE ENTRY

Following oral argument on February 18, 2010, the Court took under advisement Gravel Resources's Motion to Lift Stay Following Remand and SRSR's Renewal of Motion to Reduce Bond. Subsequently, the following documents were filed and have now been considered by the Court: Notice of Filing Revised Audited Financial Statement, filed March 4, 2010, the Response to Notice of Filing Revised Audited Financial Statement for 2009, filed February 24, 2010, and the Reply to Response to Notice of Filing Revised Audited Financial Statement for 2009, filed March 2, 2010.

The Court begins its analysis with paragraph 16 of the Court of Appeals' ruling in *Salt River Sand & Rock Co. v. Dunevant*, No. CA-SA 09-0083:

That brings us to the next question: what factors should a court consider in determining alternate security? As we recognized in

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Bruce Church, the purpose of posting a supersedeas bond is to preserve the status quo pending appeal. 160 Ariz. at 517, 774 P.2d at 821. The bond should protect the status quo at the time of judgment because “[a] judgment creditor's right to secure his money judgment during the appeal process is no less important than the judgment debtor's right to be free from execution while exercising his appellate rights.” *Id.* Thus, in determining alternate security, a court must balance the judgment creditor's right to secure the money judgment against the judgment debtor's appellate rights. *See Texaco*, 784 F.2d at 1154 (“[W]hen setting supersedeas bonds courts seek to protect judgment creditors as fully as possible without irreparably injuring judgment debtors.”).

The “must” requires the Court to simultaneously secure Gravel Resources’s money judgment, that is, protect the status quo at the time of judgment, and preserve SRSR’s appellate rights, that is, allow its appeal to go forward without irreparably injuring its ability to function as a going concern – seemingly a straightforward mathematical exercise. Unfortunately, in this case it proves at once as simple and as impossible as squaring the circle.

The primary reason for this difficulty is that SRSR’s assets are declining in value with some rapidity. As Mr. Smith acknowledged a year ago, “the economic downturn has had a negative impact on SRSR’s business.” Declaration of Roger R. Smith Re Salt River Sand and Rock’s Present Financial Condition at 2:8-9 (attached to SRSR’s Renewal of Motion to Reduce Bond). The actual balance sheet shows assets of some \$21.1 million as of January 31, 2009. But the hypothetical trend line of SRSR’s assets, prepared by SRSR, shows total assets declining from some \$20 million in 2009 to \$18 million in 2010 and \$16 million in 2011. This means that, assuming Gravel Resources prevails in the appeal, it will lose \$2 million (or at least a percentage thereof) each year enforcement of the judgment is delayed. The PowerPoint slide containing the trend line is optimistically captioned, “There is no reason to think the required assets will deplete before the appeal is over.”¹ This assessment is based on the assumption that only \$10 million of SRSR’s own assets will have to be surrendered to pay the judgment; the remainder will be covered by a \$5.5 million cash bond and \$5.5 million in property pledged by the Hills parties.

Neither of these can be counted on. The cash for the cash bond has been (or will be) obtained by SRSR from its owner, the Salt River Pima Maricopa Indian Community (the “Community”). It became clear at oral argument that these funds were a loan to SRSR from the

¹ In order to be sure that the Court of Appeals has this power point slide in the event of any special action related to the Court’s ruling, the Court has directed the Clerk to admit a set of three slides provided to the Court as handouts as the Court’s Exhibit 1 to the oral argument on the briefing. This admission is done solely to preserve the record on appeal.

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Community. Thus, the cash bond creates a liability of \$5.5 million on SRSR's balance sheet (or more, if the Community is charging interest). Given that Gravel Resources' judgment is close to, if not in excess of, the book value of SRSR, a \$5.5 million liability is that much for which it must fight other creditors. In turn, to the extent that Gravel Resources ultimately had to look to SRSR for the \$10 million remaining unpaid of its judgment under the plan SRSR proposes, it will have to compete with another creditor, the Community, for at least \$5.5 million of those funds. Further, while there are laws that might otherwise protect any preferences SRSR might give the Community debt over the debt to Gravel Resources (or even fraudulent conveyances of those funds to the Community), here the Community enjoys sovereign immunity and can be sued, if at all, only in its own courts. (SRSR was subject to suit in the Superior Court only because of a clearly and unequivocally expressed waiver of immunity.) Thus, while SRSR would like the Court to view the \$5.5 million in cash as "additional" to the \$10 million it claims it will surely have at the conclusion of the appeal, the Court does not adopt that view. Rather, the Court views the \$5.5 million loan from the Community as potentially reducing SRSR's assets on the books at the end of the appeal by an equivalent amount. And this was the Court's analysis of the facts as they existed prior to receiving SRSR's Notice of Filing Revised Audited Financial Statement for 2009.

The Court's concerns are heightened by the Notice of Filing Revised Audited Financial Statement for 2009. In it, SRSR's independent auditors have revised their previous financial statement to include their conclusion that there is "substantial doubt about the company's ability to continue as a going concern." Revised Fin. Stmt., p. 12. The auditors point to the following as a significant cause of that doubt:

The Company incurred operating losses of \$979,571 and \$474,330 for the years ended September 30, 2009 and 2008, respectively, has negative assets of \$2,880,361 as of September 30, 2009, has negative working capital of \$11,749,791 and \$11,293,790 at September 30, 2009 and 2008, respectively, and used cash in operations of \$528,888 and \$1,020,115 in 2009 and 2008, respectively. The Company has a cash balance of \$1,020,555 as of September 30, 2009.

Id. The auditors then state:

Based on its current operating plan, the Company's existing working capital may not be sufficient to meet the cash requirements to fund its planned operating expenses, capital expenditures, and working capital requirements through September 30, 2010 without additional sources of cash and/or the deferral, reduction, or elimination of significant planned expenditures. The

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Company may need to raise significant additional funds to continue its operations. In the absence of positive cash flows from operations, the future of the Company may be dependent on its ability to obtain debt financing. There can be no assurance that the Company will be able to secure such financing or obtain financing on terms beneficial to the Company. Failure to secure such financing may force the Company to significantly curtail its operations or may result in the Company's inability to continue as a going concern and the impairment of the recorded long lived assets.

Id. While the judgment entered in this case is certainly a cause of concern to SRSR's auditors, it appears that even apart from that judgment, SRSR is in a very precarious financial position that is rapidly deteriorating. As this occurs, Gravel Resources's judgment is losing its potency.

Turning to the pledge of Hills parties' real properties, these are, if anything, even less secure. The same economic trends devastating SRSR's property are also affecting them. Moreover, as became known only at oral argument, several of the Hills properties are encumbered by a joint development agreement that obligates the owner to contribute money toward development. The parties differ on how much the encumbrances detract from their value; but suffice it to say that, in a market awash in cheap land, encumbered land is likely to be substantially less liquid. Contrary to SRSR's gloss of the lesson from the Court of Appeals as being that "alternative security need only protect that amount which the judgment debtor could reasonably expect promptly to collect in the absence of a stay," illiquidity decreases the security of the judgment creditor and increases the quantity of assets needed to adequately guarantee his ultimate recovery. The Court need not accept the 40 percent discount proposed by the Receiver, but as, even in the most optimistic scenario, the value of the Hills parties' realty barely reaches the \$5.5 million for which it is being pledged, the Court has no hesitation in finding that the realty is inadequate to carry the weight SRSR's proposal requires it to bear.

Lest there be any doubt that the Court's conclusions were reached after consideration of the factors set forth by the decision of the Court of Appeals above, the Court specifically discusses them briefly now.

The first factor is "the collectable value of the judgment debtor's assets as of the date of the judgment," an evaluation that "requires the court to consider the liquidity of the judgment debtor's assets and the amount the judgment debtor could immediately pay without suffering undue harm." SRSR's assets, at the time of the judgment, had at a minimum a value of approximately \$21.1 million. (Gravel Resources makes a reasonable argument that this amount is lower than the actual value; however, for the purposes of this analysis, the Court adopts the lower SRSR figure.) While SRSR has made claims that its assets, which are mostly inventory

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and heavy equipment, were by and large not readily subject to liquidation, the Court has not received sufficient credible evidence to determine a specific dollar figure that Gravel Resources could have collected as of the date of judgment. The Court, however, agrees with the argument of Gravel Resources that SRSR overstates the illiquidity of its assets. SRSR's inventory of raw materials (sand, gravel, etc.) and its heavy equipment have a reasonably wide market, and could likely be sold fairly easily, relative to, for example, a semiconductor manufacturer's highly specialized manufacturing equipment. (For example, heavy equipment can be utilized not only in the sand/gravel industry, but in other mining operations, or in construction operations. Some may also be utilized in agricultural or other applications.) Further, there are, in place, procedures for judgment creditors to sell heavy equipment items at auctions when seized. While some effort will be required to liquidate the heavy equipment, such effort is not extraordinary, but rather the type of efforts routinely engaged in by creditors in collection proceedings. Additionally, although demand for SRSR's inventory has decreased, which is partly responsible for its operating losses, SRSR has not yet dropped the price of the inventory.² Thus, the Court has little concern that Gravel Resources could readily liquidate the inventory, but the Court does have concern that if trends don't reverse, the price Gravel Resources may be able to demand for the inventory will decrease.

The second factor requires consideration of "any complexities the judgment creditor would face in pursuing its rights to the security if the judgment is affirmed on appeal." One complexity that exists here is the ability of SRSR to transfer its existing assets to the Community, which has sovereign immunity, thereby placing them beyond the reach (at least the easy reach) of Gravel Resources. This potential problem exists whether the Court grants SRSR's alternative security proposal or not. The Court finds, however, consistent with the discussion above, that the likelihood of such an event increases if a debt of \$5.5 million related to the cash bond SRSR proposes to post is owed to the Community by SRSR. (Additionally, the likelihood that a tribal court might provide some relief to Gravel Resources is likely reduced if a transfer of funds/assets is tied to a debt legitimately owed to the Community from SRSR, such as repayment of the loan for the \$5.5 million cash bond.) Another potential complexity is that, should this judgment be affirmed on appeal, there is a reasonable likelihood that SRSR would seek protection in U.S. Bankruptcy Court. Such action would certainly complicate Gravel Resources' efforts at execution on the judgment. Of course, per the Revised Audited Financial Statement for 2009, a bankruptcy declaration is a possibility even if SRSR is successful on appeal. (Given SRSR's operating losses and current trend, a bankruptcy now may be more beneficial to Gravel Resources than one in a year or two, when there could be substantially more creditors with whom the bankruptcy estate must be divided.)

² "The increase in the net operating loss is primarily due to the continued drop in demand of building materials. Despite the drop in demand, [SRSR] has still been able to maintain its sales price per ton as compared to the prior year." Revised Fin. Stmt., p. 6.

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Third, the Court is directed to consider the provision of “adequate assurances that during the appeal the judgment debtor will conduct its business in the ordinary course and will not jeopardize the alternate security.” The Court believes much of its discussion above addresses this factor. In addition, the Court notes that per the Revised Audited Financial Statement, it appears that a significant factor in SRSR’s struggle is related to the economy and its unquestionable effect on the construction industry. This is a factor beyond the control of SRSR, and the Court cannot fathom any “orders” that can viably address this problem. SRSR had to lay off employees in September 2009, and is struggling to maintain its viability, even separate and apart from the massive judgment that has been rendered against it. Gravel Resources’ judgment continues to earn interest. The principal of the judgment, however, appears to be less valuable today than it was at the time of issuance, because Gravel Resources will not be able to collect as much of the judgment today, as it could have at the time of issuance. As no significant economic rebound is anticipated in the very near future, the judgment will very likely continue down this path of diminution. The alternative security proposed by SRSR (including the alternative proposal cited in oral argument and in the Reply to Notice of Filing Revised Audited Financial Statement for 2009) will not maintain the status quo of the judgment’s worth today, let alone what the judgment was worth at the time it was issued.

The Court acknowledges its discretion to accept the alternative security proposed by SRSR. However, under the circumstances of this case, the Court declines to do so. An attempt to preserve the status quo via alternative security suggested by SRSR, without a full supersedeas bond in place, appears to the Court to be an exercise in futility.

IT IS HEREBY ORDERED denying SRSR’s Renewed Motion to Reduce Bond.

IT IS FURTHER ORDERED granting Gravel Resources’s Motion to Lift Stay subject to the requirements set forth below.

The Court requires that a supersedeas bond (or cash) in the full amount previously determined by Judge Dunevant shall be posted no later than April 29, 2010. Otherwise, the Court intends to execute an order on April 30, 2010 lifting the stay on the execution of Gravel Resources’s judgment effective May 1, 2010. Gravel Resources shall prepare and lodge with the Court a simple form of order for the Court’s signature that accomplishes the lifting of the stay no later than April 21, 2010.

This case is eFiling eligible: <http://www.clerkofcourt.maricopa.gov/efiling/default.asp>