

The Honorable Karen A. Overstreet
Chapter 11
Hearing Location: 700 Stewart St., Rm. 7206
Hearing Date: March 27, 2009
Hearing Time: 9:30 a.m.
Response Date: At Time of Hearing

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

In re

KEITH L. SMITH,
Debtor.

Case No. 09-10621 KAO

DECLARATION OF KEITH L. SMITH IN SUPPORT OF
RESPONSE TO LOCKHART'S §363(b) MOTION

KEITH L. SMITH makes the following declaration under penalty of perjury under the laws of
the State of Washington and the United States of America:

1. I am the Debtor in the above captioned case, have personal knowledge of the facts
contained in this declaration, and I am competent to testify thereto.

2. While the instant issue pertains to what expenditures I should be able to make in the
ordinary course, I believe a brief recitation of certain facts underlying the Lockhart claim, certain
assets and my income and expenses may be useful here.

3. The dispute between Zango, Inc., myself and Daniel Todd arises from the fact that
Michael Lockhart who was formerly employed by Zango, obtained a judgment in the amount of
\$4,655,163.11. As this Court is aware, we appealed this judgment, but have been unable to stay its
execution by posting a supersedeas bond or other security. We had reached agreement with Mr.
Lockhart to post \$1 million cash bond in lieu of supersedeas bond in order to pursue the appeal. These

1 funds were being held in reserve by Zango to be deposited into the court's registry and in the eleventh
2 hour after the judgment was entered in early January 2009, Zango's lenders reversed themselves and
3 forbade Zango from posting the cash bond. This move by Zango's lenders was unexpected and
4 resulted in Mr. Lockhart beginning his collection efforts against me as soon as he was able.
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6 4. Unfortunately, given our collective financial condition, none of us (Zango, Daniel Todd
7 and I) individually or collectively have adequate collateral to entice a bond company to post a
8 supersedeas bond that would allow us to pursue the appeal.
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10 5. Again, given my financial condition which I believe is accurately reflected in my
11 bankruptcy petition and schedules, I was left no choice but to file for bankruptcy protection. The
12 same can be said for Daniel Todd whose case was filed on the same day as mine and is pending before
13 Judge Steiner.
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15 6. The bank's action is not all that hard to understand as Zango is in default on debt to it's
16 the banks (a consortium comprised of KeyBank, Silicon Valley Bank, and Comerica Bank) in excess
17 of \$44 million. They have a first-position secured interest in all of Zango's assets, have formally
18 declared Zango's debt in default and in a demand letter dated March 10th informed Zango that they
19 will not provide any further financing or extend their voluntary forbearance unless they are paid in full
20 or there is a firm purchase and sale commitment in place for Zango's assets on terms acceptable to the
21 them within the next couple of days.
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23 7. It is my belief that the potential sale of Zango to any of the parties currently expressing
24 interest in it would generate substantially less than the principal loan amount due to the banks , leaving
25 nothing to satisfy the Lockhart judgment.
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1 8. As to the matter at hand, I think it is worthwhile for the Court to have a deeper
2 understanding of my financial circumstances leading up to my filing. I founded Zango in 1999 and
3 after years of lean times eventually grew the company to a size and scale that interested outside
4 investors. In 2004 I sold a significant portion of my Zango holdings to a private equity investor. My
5 income for 2004 was approximately \$11,000,000, primarily resulting from selling Zango stock. For
6 2005 my income was approximately \$540,000, approximately \$300,000 for 2006, approximately
7 \$550,000 in 2007 and about \$425,000 in 2008.

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10 9. In 2006 and 2007 Zango required cash infusions which I funded by taking out loans
11 secured by my homes totaling about \$3.1 million dollars and investing back into Zango in the form of
12 subordinated loans and preferred stock. Prior to that time, I had purchased my home in Somerset and
13 my recreational property near Lake Kachess (collective purchase price and remodel about \$6.3
14 million) with the cash I received in 2004.

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16 10. My two homes were pledged as security for the loans and the monthly interest
17 payments on these loans are about \$22,000. These monthly interest payments make up the majority of
18 my total monthly expenses. These payments are necessary to protect any equity that I may have in the
19 homes. Moreover, I doubt that my lenders would support Mr. Lockhart's motion that would result in
20 my ceasing payments on these debts on a go forward basis.

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22 11. Again, for additional context, it is important for the Court to understand that when I
23 took out the loans, it was my belief that the value of my remaining equity in Zango exceeded \$20
24 million and that the notes from Zango to me which are due in the first half of this year would be paid
25 in full. My plan was that the payment from Zango would be used to retire the majority of my home
26 loans.
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1 12. Due to deteriorating economic conditions and subsequent poor financial performance
2 from Zango, today, my equity in Zango has no value and my notes are also without value. It wasn't
3 until the last 2 to 4 months that I reached this conclusion, which in large part is due to the horrific
4 economic downturn that was outside of the control of Zango or me. Had this downturn not occurred
5 and the debt from Zango to me been repaid, I in turn could have repaid my mortgages thereby
6 reducing my monthly expenses by about \$22,000.
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8 13. With these Zango notes to me being without value and my future income uncertain
9 presently, I am not entirely sure what actions I will take in the coming month or two. A big factor is
10 whether Zango's assets are liquidated (in or out of a bankruptcy) or sold as a going concern to some
11 third-party. If a going concern sale is effectuated, it is likely that I will continue to have employment
12 with income substantially similar to my current income for some period of time. If on the other hand
13 Zango is liquidated for the benefit of its lenders, I doubt that I will immediately have the sort of
14 income I presently have and a conversion of this case to Chapter 7 may be in the best interest of all
15 concerned.
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17 14. Barring the conversion to Chapter 7, I expect that I will, as I represented to the Court
18 during the Section 105 hearing recently, have to sell the Kachess property. Notwithstanding this
19 conclusion, I don't believe that listing it presently makes sense as I am close to completing a sub-plat
20 of the property. Once that process is complete, there will be four separate saleable parcels as opposed
21 to a single saleable parcel presently. I expect that this will increase the prospects for selling all or part
22 of my interests in the Kachess property thereafter and will increase the overall value of the Kachess
23 property. However, even at such a time, sales are unlikely to happen quickly or all at once and it
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1 remains prudent for me to keep the loans current as I pursue a sale/sales of the Kachess property. Sale
2 of the Somerset house may also be necessary, but I think it is too soon to be sure about this.

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4 15. In the mean time, I have further analyzed my expenses and in addition to my real
5 property related expenses have monthly expenses related to my children which exceed \$6,000. The
6 balance of my monthly expenses for upkeep of the homes, food, clothing, etc. is about \$14,000.

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8 16. I have already made efforts to reduce my monthly expenses by about \$4,000 and upon
9 the sale of the Kachess property, I could save approximately another \$8,000 per month.

10 17. I have provided Mr. Lockhart with copies of appraisals of my two homes as of March
11 2008 which show that the Kachess house was worth \$1,693,000 and the Somerset house was worth
12 \$3,800,000. While the appraisals indicate that there was significant equity in the two houses a year
13 ago (total mortgages of about \$3,750,000), it is difficult to know how much these houses are worth a
14 year later, especially if marketed for a quick sale.

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16 18. In conclusion, I ask the Court consider my circumstances and deny Mr. Lockhart's
17 motion.

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19 DATED this 20th day of March 2009 at Seattle, Washington

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21 /s/ Keith L. Smith
22 Keith L. Smith
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