Chapter 11 for the High-Net-Worth Individual.

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CHAPTER 11 AND THE HIGH-NET-WORTH INDIVIDUAL

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Introduction

Bankruptcy practitioners often overlook the distinct and challenging issues posed by Chapter 11 petitions filed by high-net-worth debtors. Over the past few years, the Bankruptcy Courts have faced complex, contentious cases by wealthy individuals like quarterback Michael Vick and actor Stephen Baldwin as well as numerous debtors hurt in the economic downturn of 2009.[1] This Panel will discuss some of the key unresolved issues that regularly arise in Chapter 11 filings by wealthy individuals, addressing both

[1] Chapter 11 bankruptcy filings by wealthy individuals increased 73% in 2009. *See* Jeff Plungis, *Wealthy Families Face Bankruptcy on Real Estate Crash*, BLOOMBERG, Sept. 9, 2009, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aOYQzpAp2o9w.

the practical implications and the policy considerations underlying these bankruptcy cases.

1. *Should non-bankrupt corporate entities wholly owned by the debtor be covered by the automatic stay?*

The courts have not resolved the question of whether, in a Chapter 11 bankruptcy filed by an individual debtor, the automatic stay extends to non-bankrupt corporations and other business entities that are wholly owned by the debtor. This issue is especially important in bankruptcy proceedings filed by high-income individuals, who may own significant ownership interests in one or more corporate entities that are not themselves insolvent or otherwise implicated directly in the bankruptcy proceedings.

11 U.S.C. §362(a) requires the automatic stay of all judicial proceedings and enforcement actions against the debtor and "all entities" of the debtor.[2] The automatic stay allows the debtor temporary relief from collection efforts of creditors in order to

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[2] 11 U.S.C. §362(a):

"Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
(4) any act to create, perfect, or enforce any lien against property of the estate;
(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title."

preserve the debtor's estate and allow the debtor to formulate a viable plan for repayment and reorganization.[3] Typically, the automatic stay does not extend to non-bankrupt co-defendants or other parties that may be affiliated with -- but are legally distinct from -- the debtor.[4]

In *Queenie, Ltd. v. Nygard International*, 321 F.3d 282 (2d Cir. 2003), the U.S. Court of Appeals for the Second Circuit ruled that the automatic stay extends to non-bankrupt corporate entities that are wholly owned by the debtor. In this case, an individual debtor, Marc Gardner, filed a petition for relief under Chapter 11 of the Bankruptcy Code. Gardner subsequently argued that the automatic stay should extend to his wholly owned subsidiary, Queenie, Ltd., so as to prevent Nygard International from collecting on a judgment of approximately $250,000 obtained in a patent infringement suit between Nygard and Queenie, Ltd.[5]

Although acknowledging that as a general rule the automatic stay does not apply to non-bankrupt co-defendants, the Court of Appeals held that the automatic stay in Gardner's personal Chapter 11 case also covered Queenie, Ltd.[6] The Court reasoned that since "adjudication of a claim against the corporation will have an immediate adverse economic impact on Gardner,"[7] the wholly owned corporation should be treated as an

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[3] *See Matter of Holtkamp*, 669 F.2d 505, 508 (7th Cir. 1982); *In re Siciliano*, 13 F.3d 748, 750 (3d Cir. 1994); *In re Frigitemp Corp.*, 8 B.R. 284, 289 (Bankr. S.D.N.Y. 1981).

[4] *See A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 999 (4th Cir. 1986) (noting that the automatic stay "is generally said to be available only to the debtor, not third-party defendants or co-defendants"); *Pitts v. Unarco Indus. Inc.*, 698 F.2d 313, 314 (7th Cir. 1983) ("The clear language of Section 362(a)(1) ... extends the automatic stay provision only to the debtor filing bankruptcy proceedings and not to non-bankrupt co-defendants.").

[5] *Queenie*, 321 F.3d at 287.

[6] *Id.* at 287-88.

[7] *Id.* at 288.

extension of the debtor, rather than its own independent entity. However, over Gardner's objection, the Court refused to extend the automatic stay to another party, Heavenly Fabrics, Inc., which was held liable alongside Queenic, Ltd. in the Nygard International litigation but was not owned by Gardner. The Court concluded that, since Gardner was not the sole shareholder of Heavenly Fabrics, Inc., there was not sufficient identity between this corporate entity and Gardner to justify extending the automatic stay.[8]

Other courts have not adopted the Second Circuit's holding in *Queenie* -- rather, subsequent decisions involving similar facts have limited or distinguished *Queenie*. *See Gucci America, Inc. v. Duty Free Apparel, Ltd.*, 328 F.Supp.2d 439 (S.D.N.Y. 2004) (holding that *Queenie*'s extension of the automatic stay to non-bankrupt entities is an extraordinary remedy that should only be followed where there will be imminent and serious consequences to the debtor's estate); *Trustees of Sickness and Accident Fund of Local One-L v. Philips Winson, Inc.*, No. 00 Civ. 9554, 2005 WL 273017, at *1 (Bankr. S.D.N.Y. Feb. 3, 2005) (refusing to follow *Queenie* where there was no danger of "immediate economic impact on the estate of the debtor"); *In re McCormick*, 381 B.R. 594 (Bankr. S.D.N.Y. 2008) (declining to apply *Queenie* in a Chapter 13 case where the individual debtor argued that his wholly owned contracting business should be covered by the automatic stay).

Nonetheless, *Queenie* remains good law in the Second Circuit, and the issue of whether the automatic stay applies to non-bankrupt corporate entities wholly owned by the individual debtor remains unresolved in other circuits. This issue is particularly relevant to bankruptcy petitions filed by high-net-worth individuals, who are more likely

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[8] *Id.* at 286-88.

to possess significant ownership interests in corporate entities that might impact the reorganization of the debtor's estate. It remains to be seen, however, whether other circuits will follow the Second Circuit in extending the scope of the automatic stay to cover corporate entities wholly owned by the debtor, or whether other courts will take a narrower view of the protections of the automatic stay.

Additionally, high-net-worth debtors with significant ownership stakes in corporate entities may be able to subvert the authority of the Bankruptcy Court by engaging in transactions at the subsidiary level that would be disallowed if the debtor were not shielded by the corporate entity. For example, a debtor who owns a non-bankrupt corporate entity might attempt to circumvent the Chapter 11 process by paying his personal expenses with funds generated by the corporation or may siphon income from rents off of a corporate entity that owns real estate. Since this is not a direct use of the debtor's cash collateral, there may be dispute over whether this conduct warrants the appointment of a Trustee or other corrective action. Regardless, this use of subsidiaries may undermine the Bankruptcy Court's authority to regulate the debtor's finances post-petition.[9]

2. *Should homes and other qualified exemptions be excluded from the estate, regardless of the value of the exempted property?*

The exemption of personal homes and other valuable property from the Absolute Priority Rule is another disputed issue that commonly arises in bankruptcy proceedings

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[9] *Cf. In re Valladares*, 415 B.R. 617 (Bankr. S.D. Fla. 2009) (holding that debtor's failure to disclose the payment of fees to an attorney by a wholly owned subsidiary of the debtor violated §329(a) and Rule 2016 because the wholly owned subsidiary's payment on the debtor's behalf was not equivalent of an altruistic payment by an independent third party); *In re Womble*, 289 B.R. 836, 854 (Bankr. N.D. Tex. 2003) (holding that the transfer between a debtor and a wholly owned corporate entity, where there is the requisite intent to deceive, constituted a fraudulent transfer voidable under §727).

for high-net-worth individuals. The Bankruptcy Courts have reached conflicting decisions on this issue: some courts have ruled that a high-income debtor has the right to keep exempted property regardless of its value, while others have concluded that allowing the debtor to retain such property violates the Absolute Priority Rule.

In *In re Gosman*, 282 B.R. 45 (Bankr. S.D. Fla. 2002), the U.S. Bankruptcy Court for the Southern District of Florida ruled that an individual debtor in a Chapter 11 case could not confirm a plan through the cramdown provisions of §1129(b)(2)(B)(ii) while at the same time retaining a mansion and other valuable personal property. The debtor proposed a plan of reorganization wherein he would liquidate all of his non-exempt assets as payment for his creditors but would retain all of his exempt property, including a $40 million house in Palm Beach, $11 million in artwork, various pieces of antique furniture, and undeveloped real property valued at $7.5 million. The Bankruptcy Court refused to confirm the plan, ruling that allowing the debtor to retain this property, while not providing for payment in full to the creditors, violated the Absolute Priority Rule.[10] The Court based its ruling on the plain language of §1129(b)(2)(B)(ii), which prohibits the confirmation of a plan of reorganization over the unsecured creditors' objection if the holder of a junior claim or interest in "any property" would receive greater compensation than a more senior claim or interest.[11] The Court found no distinction between exempt and non-exempt property in the language of this section of the Code and, accordingly, the Court concluded that the cramdown requirements were "broad enough to cover exempt

[10] *In re Gosman*, 282 B.R. at 48-50.

[11] §1129(b)(ii)(B)(2); *id.* at 48.

property."[12] Additionally, the Court examined legislative intent in its ruling, finding that, "Had Congress intended to protect an individual's right to exempt property [in the context of a cramdown], the 'absolute priority rule' would have been made inapplicable to such property."[13]

In deciding a case with similar facts, however, the U.S. Bankruptcy Court for the Middle District of Florida reached a conflicting result. In *In re Henderson*, 321 B.R. 550 (Bankr. M.D. Fla. 2005), the Bankruptcy Court confirmed a cramdown plan proposed by the debtor even though, under this plan, the debtor retained ownership of several exempt properties (including his home, approximately $100,000 in artwork, and a stake in a minor league baseball franchise). The Middle District of Florida analyzed the debtor's proposed plan under the "best interests of the creditors" test in §1129(a)(7),[14] concluding that the debtor's plan could be confirmed because it would yield equivalent or greater recovery to the unsecured creditors who opposed the plan.[15] The Court further held that the debtor's refusal to contribute his exempt property to the estate did not violate the absolute priority rule.[16] The Court noted that §522 of the Code authorized the debtor to exempt certain property from the reach of his creditors and consequently reasoned that

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[12] *In re Gosman* at 49.

[13] *Id.* at 50.

[14] §1129(a)(7) provides, "With respect to each impaired class of claims or interests --
(A) each holder of a claim or interest of such class --
(i) has accepted the plan; or
(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date . . ."

[15] *In re Henderson*, 321 B.R. at 554.

[16] *Id.* at 557-58.

the unsecured creditors had no right to force the debtor to sell his exempt property.[17] Most significantly, the Court ruled that the value of the exempt property should have no bearing on whether this property was subject to the Absolute Priority Rule: "The fact that the residence of the Debtor in this instance is valued in excess of $3,000,000 should not make any difference."[18]

While most courts have not yet decided this issue, the U.S. Bankruptcy Court for the District of Connecticut has adopted the holding of *In re Henderson* and rejected the Southern District of Florida's ruling in *In re Gosman*. *See In re Bullard*, 358 B.R. 541 (Bankr. Conn. 2007). In *Bullard*, the Connecticut Bankruptcy Court focused on the Code's explicit authorization of exempt property in §522, which the Court took as an indication that the debtor's right to exempt property should not be undermined by the Absolute Priority Rule. Additionally, the Court noted that creditors who are unpleased with the exemption of certain property from the debtor's estate could move the Court to deny confirmation of a cramdown plan on the basis of the good faith requirement of §1129(a)(2).[19]

The issue of what (if any) personal property may be exempted from the debtor's estate in the context of a cramdown confirmation can have significant consequences in a Chapter 11 petition filed by a high-net-worth debtor. As observed by the Court in both *In re Henderson* and *In re Gosman*, a wealthy debtor's house and other personal effects may be considerable assets that are shielded from the reach of unsecured creditors if not

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[17] *Id.* at 558 ("Debtor's right to retain exempt properties is unaffected by Section 1129(b)(2)(B)(ii), because creditors cannot subject a Debtor's exempt property to an involuntary liquidation.").

[18] *Id.* at 560

[19] *In re Bullard*, 358 B.R. at 545.

subject to the Absolute Priority Rule. Consequently, where the Court allows the debtor to claim other valuables as exempt property, the unsecured creditors likely will face diminished recovery at the debtor's benefit. This conflict between the exemption provisions of §522 and the Absolute Priority Rule of §1129 will continue to be a point of contention between high-income debtors and unsecured creditors until resolved conclusively by the appellate courts.

3. *What constitute "reasonably necessary expenses" for a high-net-worth individual?*

Additionally, Chapter 11 petitions filed by high-net-worth debtors can present unique problems for the calculation of the debtor's currently monthly income and the determination of "reasonably necessary expenses" to satisfy the confirmation requirements of §1129. §1129(a)(15) provides that, in a bankruptcy filing by an individual debtor where an unsecured creditor objects to the plan, the individual debtor must show that "the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor," as calculated pursuant to §1325(b)(2).[20] §1325(b)(2) calculates the debtor's projected disposable income as "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended . . . ."[21] The Bankruptcy Code does not explain "reasonably necessary expenses" further, leaving it up to the courts to determine the reasonableness of the debtor's projected expenses on a case-by-case basis. In the case of a bankruptcy filing by a high-net-worth

[20] 11 U.S.C. §1129(a)(15).

[21] 11 U.S.C. §1325(b)(2).

debtor, however, these projected expenses may be significantly higher than in bankruptcy petitions by lower income individuals.

In *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007), the U.S. Bankruptcy Court for the District of Kansas ruled that a debtor's projected monthly expenses should be based on a judicial determination of what expenses are necessary under the debtor's particular circumstances, rather than being based on the average monthly expenses of a family of comparable size. In *Roedemeier*, a creditor objected to the expenses in the debtor's projected monthly income, arguing that the expenses claimed by the debtor far outweighed the average expenses for a one-person family.[22] The Court disagreed with the creditor's assertion that the debtor's projected expenses must be limited by this average figure. After inspecting the Advisory Committee's recommendations in implementing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the Court ruled that the debtor's projected monthly expenses should not be capped by this average: "[T]he Court concludes that in calculating an individual Chapter 11 debtor's projected disposable income, §1129(a)(15)(B) must be read to allow a judicial determination of the expenses that are reasonably necessary for the support of the debtor and his dependents."[23]

While other courts echo the conclusion that the reasonableness of a debtor's projected expenses is a matter subject to judicial determination on a case-by-case basis, some courts have imposed more stringent restrictions on the high-income debtor's "reasonably necessary expenses" under a Chapter 11 plan. In *In re Gray*, No. 06-927,

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[22] *In re Roedemeier*, 374 B.R. at 272.

[23] *Id.* at 272-73. *See also* 7 COLLIER ON BANKRUPTCY §1129.03[15][a]

2009 WL 2475017, at *1 (Bankr. N.D. W. Va. Aug. 11, 2009), the U.S. Bankruptcy Court for the Northern District of West Virginia disallowed several items in the debtor's projected budget. The Court ruled that the debtor's projected expense of $750 per month for the care of fifteen dogs was "unreasonable and unnecessary" because these pets "provide no necessary service to the Debtor."[24] The Court also disallowed as "unreasonably and unnecessary" the debtor's expenses of $149 per month for cable and $250 per month in cellular phone costs.[25] In the same opinion, however, the Court approved monthly expenses of approximately $1600 for medical costs and other expenses for the debtor's live-in girlfriend, noting that the debtor and girlfriend constituted a "family unit" and thus that these costs were reasonably necessary.[26]

In the case of a high-net-worth individual, Bankruptcy Courts are more likely to see extensive lists of purportedly "necessary" expenses required to maintain the debtor's lifestyle. The Code provides little guidance on what particular expenses may be included in the debtor's calculation, leaving considerable discretion to the Court to approve or deny certain proposed expenses. Items such as boats, pets, and entertainment costs may be considered reasonable and necessary in one case, but deemed unnecessary and extravagant in another.

Conclusion

Chapter 11 petitions by high-net-worth debtors provide unique and challenging problems for the Bankruptcy Court. While the Bankruptcy Code addresses well the

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[24] *In re Gray*, 2009 WL 2475017, at *3.

[25] *Id.*, at *4.

[26] *Id.*, at *3.

differences between individual and corporate bankruptcies, the Code does not provide clear guidance for many of the special problems posed by the bankruptcy petition of a high-income debtor.

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United States Court of Appeals,
Second Circuit.
QUEENIE, LTD., Plaintiff-Counter-Defendant-Appellant,
Marc Gardner, Heavenly Fabrics, Inc., and Joseph Heaven, Counter-Defendants-Appellants,
v.
NYGARD INTERNATIONAL, Defendant-Counter-Claimant-Appellee.
Docket Nos. 02-7158, 02-7162(CON).

Argued: Dec. 10, 2002.
Decided: Feb. 25, 2003.

Women's clothing manufacturer sued competitor for infringement of fabric design copyrights. Competitor counterclaimed for tortious interference with prospective economic advantage. The United States District Court for the Southern District of New York, Naomi Reice Buchwald, J., entered judgment on jury verdict for competitor, and designer appealed. The Court of Appeals, Jon O. Newman, Circuit Judge, held that: (1) appeal was stayed only as to appeals of appellant who had filed bankruptcy petition and his wholly owned corporation, and (2) counterclaim defendants waived claim that punitive damages were unavailable in absence of proof of some compensable harm by failing to move for judgment as matter of law on that issue prior to jury verdict.

Affirmed.

Sotomayor, Circuit Judge, concurred in judgment and filed opinion.

See also 2002 WL 31496202.

West Headnotes

[1] Bankruptcy 51 ⚿2395

51 Bankruptcy
51IV Effect of Bankruptcy Relief; Injunction and Stay
51IV(B) Automatic Stay
51k2394 Proceedings, Acts, or Persons Affected
51k2395 k. Judicial Proceedings in General. Most Cited Cases

Bankruptcy 51 ⚿2396

51 Bankruptcy
51IV Effect of Bankruptcy Relief; Injunction and Stay
51IV(B) Automatic Stay
51k2394 Proceedings, Acts, or Persons Affected
51k2396 k. Co-Debtors and Third Persons. Most Cited Cases
Judgment debtor's filing of bankruptcy petition stayed his appeal and that of his wholly owned corporation, but not that of co-defendants who were found separately liable in underlying action, even though decision on appeal might establish precedent adverse to debtor. Bankr.Code, 11 U.S.C.A. § 362(a)(1).

[2] Federal Courts 170B ⚿641

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(D) Presentation and Reservation in Lower Court of Grounds of Review
170BVIII(D)2 Objections and Exceptions
170Bk639 Motions Presenting Objections
170Bk641 k. Taking Case or Question from Jury in General; Direction of Verdict. Most Cited Cases
Tortious interference defendants waived claim that punitive damages were unavailable in absence of proof of some compensable harm by failing to move for judgment as matter of law on that issue prior to jury verdict; although parties had agreed to let court decide amount of compensable damages after jury returned verdict on issue of punitive damages, existence of some level of compensable harm was element of claim which jury decided. Fed.Rules Civ.Proc.Rule 50(a), 28 U.S.C.A.
***283** Marc Bogatin, New York, N.Y., for Plaintiff-Counter-Defendant-Appellant Queenie, Ltd., and Counter-Defendant-Appellant Marc Gardner.

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(Cite as: 321 F.3d 282)

Wayne M. Greenwald, Greenwald & Rimberg, L.L.P., New York, N.Y., for Counter-Defendants-Appellants, Joseph Heaven and Heavenly Fabrics, Inc.

John F. Triggs, Greenberg & Traurig, LLP, New York, N.Y., for Defendant-Counter-Claimant-Appellee Nygard International.

Before: NEWMAN, SACK, and SOTOMAYOR, Circuit Judges.

JON O. NEWMAN, Circuit Judge.

This appeal illustrates the pitfalls that can be encountered in the complexities of even routine litigation. Sometimes those complexities result in the forfeiture of a defense that arguably has merit. When that occurs, an appellate court faces a choice between enforcing the forfeiture or burdening parties, witnesses, jurors, and ***284** the trial court with a retrial. That choice confronts us on this appeal by Queenie Ltd. ("Queenie") and its president and sole shareholder, Marc Gardner ("Gardner"); and Heavenly Fabrics, Inc. ("Heavenly") and its president and sole shareholder, Joseph Heaven ("Heaven"), from the January 25, 2002, amended judgment of the District Court for the Southern District of New York (Naomi Reice Buchwald, District Judge) in litigation that began as a suit for copyright infringement. The judgment awards Nygard International ("Nygard") attorney's fees for successfully defending a copyright infringement claim and punitive damages on its counterclaim for tortious interference with prospective economic advantage. The punitive damages award is challenged on appeal. Gardner is currently a debtor in a bankruptcy proceeding. We conclude that the automatic bankruptcy stay applies to Gardner and to Queenie, his wholly owned corporation, but not to the other judgment-debtors, Heavenly or Heaven. We also conclude that, in the procedural context of this case, Heavenly and Heaven have forfeited their arguable defense that punitive damages are unavailable for lack of an award of compensatory damages, and we therefore affirm

Background

In October 1999, Queenie sued Nygard (and others no longer parties to the litigation), alleging infringement of two registered copyrights for fabric designs. In March 2001, Nygard counterclaimed against Queenie, Gardner, Heavenly, and Heaven (collectively "Counterclaim Defendants"). Nygard claimed tortious interference with prospective economic advantage, alleging that the Counterclaim Defendants falsely registered both copyrights and wrongfully prosecuted their infringement claims against Nygard.

Because this appeal concerns primarily procedural aspects of the litigation, we summarize rather briefly the facts that the jury was entitled to find. Queenie is a distributor of women's garments. It obtains fabric designs from a variety of sources, including print mills, design studios, and fabric wholesalers. Queenie uses these designs in creating its clothing, which is manufactured in independent fabric mills overseas, primarily in Korea. Heavenly is a textile importer. It contracts for the manufacture of fabrics for women's apparel and provides designs to its clients, who in turn purchase fabric from Heavenly for the purpose of creating garments that use these designs. Queenie and Heavenly have done business together for approximately eight years. Nygard manufactures and distributes women's apparel.

According to the Counterclaim Defendants, in early 1996, Heaven showed Gardner two fabric designs that Heaven claimed had been created by Heavenly's former employee, Dong Mi Chung. Heavenly assigned what it claimed were its rights in the two designs to Queenie. In August 1997, Heavenly registered copyrights for both designs in the name of Queenie, naming Heavenly as the author of the designs. However, Ms. Chung, the alleged designer, testified that she had not created the two designs. In fact, according to testimony of an executive of Saehwa, a Korean textile print mill, both designs had been created by third parties who had brought the designs to Saehwa in October 1996.

Nygard bought fabric imprinted with the two designs from Saehwa and used them in its manufactured garments. That use precipitated Queenie's suit against Nygard for copyright infringement. Nygard defended on the ground that Queenie had obtained its copyrights by fraud on the ***285** Copyright Office. Nygard's theory, evidently accepted by the jury, was that Queenie had somehow learned that Nygard was going to use the Saehwa designs on its products and then fraudulently obtained copyright registrations in order to sue Nygard when its products came on the

market. Nygard counterclaimed against Queenie for tortious interference with prospective economic advantage and named as additional counterclaim defendants Gardner, Heavenly, and Heaven. The theory of the counterclaim was that Nygard had been damaged in its relationships with its customers by the threatened and ultimately filed copyright infringement suit. Nygard sought damages including its attorney's fees in defending against the infringement claim.

Litigation procedure. Prior to trial, the parties agreed to a somewhat unusual bifurcation of issues, one that would plant the seeds for the principal issue on this appeal. They agreed that, if the jury found in favor of Nygard on its counterclaim, the amount of compensatory damages would be determined by the Court and the amount of any punitive damages would be determined by the jury.[FN1] As far as we can tell from the rather imprecise way the parties proceeded at trial and their equally imprecise briefs on appeal, this agreement stemmed from the parties' shared understanding that attorney's fees in defense of the infringement claim would count as compensatory damages on the tortious interference counterclaim and Nygard's position that such fees were the only item of *quantifiable* compensatory damages that it could prove. Apparently, the parties believed that determining the amount of such fees would be appropriate for the Court.

> FN1. We have previously suggested that an appropriate bifurcation would be to defer the determination of the amount of punitive damages until determinations have been made as to liability, the amount of compensatory damages, and whether to award any punitive damages. *See Smith v. Lightning Bolt Productions, Inc.*, 861 F.2d 363, 374 (2d Cir.1988).

As a result of the agreed bifurcation, Nygard did not present any evidence of the amount of its compensatory damages, but did present evidence to show the fact that it had sustained some damages. Nygard pointed to the attorney's fees it had incurred in defending against the infringement claim and testimony from a Nygard employee, Fiona Duncan, that Nygard had changed the way it did business as a result of the tortious conduct of the Counterclaim Defendants. Duncan acknowledged that she could not put a dollar value on the impact of Nygard's changed business practices.

After both sides rested, no party moved for judgment as a matter of law ("JMOL") under Rule 50 of the Federal Rules of Civil Procedure.

The jury charge correctly explained the elements of tortious interference with prospective economic advantage, including the element "that Nygard sustained damages as a result of" the tortious conduct of the Counterclaim Defendants. The jury was told that, if it found in favor of Nygard on its counterclaim, the jury need not determine the amount of compensatory damages; the amount of these damages would be determined later by the Court. The jury was also told that, if it found that the Counterclaim Defendants were liable for Nygard's injuries, it could award punitive damages and determine their amount.

During its deliberations, the jury sought clarification of the meaning of "economic advantage" with respect to the tortious interference counterclaim, specifically asking whether this phrase "pertain[s] to legal fees, loss of sales and settlements."

***286** Judge Buchwald responded to the jury's inquiry as follows:

> The answer to the question is that it could refer to all of those things, but as this case has been structured, you have not been asked to place a dollar value on those damages or losses. I will do that if you find that Nygard prevails on its counterclaim of tortious interference.
>
> What you have been asked to do-again, if you find that Nygard has proven its counterclaim of tortious interference-is to determine whether punitive damages are appropriate in that context and, if so, for how much.
>
> Does that clarify what you need to know? Your job is the punitive damage side, if you find liability. Mine is the actual damage side. OK?

The Counterclaim Defendants did not object to any of the relevant instructions.

The jury rejected Queenie's copyright infringement claim and found the Counterclaim Defendants liable

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to Nygard for tortious interference with economic advantage. The jury awarded punitive damages of $250,000 each against Queenie and Heavenly and $500,000 each against Gardner and Heaven.

The Counterclaim Defendants moved for JMOL, for a new trial, and for remittitur of the jury's punitive damages award.[FN2] Recognizing that, because of the bifurcation, Nygard was to present its evidence as to the amount of compensatory damages to the Court, the Counterclaim Defendants argued in support of JMOL that Nygard had not submitted proof that it had incurred any damages. Still under the impression that attorney's fees in defense of the infringement claim were compensable as tort damages, the Counterclaim Defendants argued that it was "not outside the realm of possibility" that the lawyer defending Nygard at trial "would work for free." No mention was made of Duncan's testimony concerning the changes in Nygard's business practices. A new trial was sought on the ground that the District Court should not have permitted Nygard to call Chung as a rebuttal witness because she had not been included on Nygard's witness list. The punitive damages award was challenged for lack of proof of actual damages and because the tortious conduct had not been aimed at the general public. Nygard opposed these motions and sought attorney's fees.

> FN2. The motion was apparently made by a letter dated October 22, 2001. Neither the letter nor a formal motion is reflected in the docket entries, but the District Court entertained the motion as if it had been properly filed.

The District Court rejected the motions for JMOL, a new trial, and remittitur of the punitive damages award. The JMOL request was denied on the grounds that the bifurcation agreement waived the Counterclaim Defendants' challenge to the sufficiency of proof as to compensatory damages and that the absence of a pre-verdict Rule 50(a) motion precluded a post-verdict Rule 50(b) motion. A new trial was denied on the grounds that Queenie, having subpoenaed Chung as a witness, could not claim surprise, and that barring her testimony would have enabled the Counterclaim Defendants "to expand a fraud upon the United States Copyright Office to a fraud upon the Court." The challenge to the punitive damage award was rejected on the grounds that there had been no objection to the jury charge permitting the jury to award punitive damages and that the bifurcation agreement had waived the contention that punitive damages could not be awarded in the absence of compensatory damages.

With respect to Nygard's claim for attorney's fees, the Court ruled that attorney's***287** fees were not compensable as actual damages on the counterclaim, citing *Coopers & Lybrand v. Levitt*, 52 A.D.2d 493, 496-97, 384 N.Y.S.2d 804, 806-07 (1st Dep't 1976),[FN3] but awarded Nygard its fees in the amount of $221,099 and costs of $39,918.41 as a prevailing defendant in a copyright infringement suit. *See* 17 U.S.C. § 505.

> FN3. The correctness of this ruling, *cf. McNamara v. Powell*, 256 A.D. 554, 559, 11 N.Y.S.2d 491, 497 (App. Div. 4th Dep't 1939) (holding that "plaintiff is entitled to recover the [attorney's] fees and expenses expended and incurred by him in defending his right to the invention and to letters patent thereon"), is not challenged by Nygard on this appeal, and we express no opinion on it.

On November 14, 2002, Gardner filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.

Discussion

I. The Automatic Stay

[1] Preliminarily, we consider whether the automatic stay, 11 U.S.C. § 362(a), which requires a stay of this appeal with respect to Gardner, applies to the appeals of the other Appellants. We requested the parties' views on the stay issue, and, as with many aspects of this litigation, have received somewhat unexpected responses. Atty. Greenwald, who represented Heavenly and Heaven ("the Heavenly Appellants") at trial, advised that he represents Gardner in his bankruptcy case but not on this appeal, and continues to represent the Heavenly Appellants on this appeal. Atty. Greenwald urges, on behalf of Gardner, that the bankruptcy stay should apply to all four Appellants, but, in his capacity as counsel for the Heavenly Appellants, he reports that they take no position with respect to the stay issue. No one representing Queenie has responded to our request. Atty. Triggs,

representing Nygard, responded that he did not believe it "makes sense to oppose the application of the automatic stay to all parties to this proceeding." Thus, Gardner, the bankruptcy debtor, wants the stay to apply to himself, his corporation, and to the Heavenly Appellants; Nygard, the judgment-creditor on this appeal, does not oppose application of the stay to all parties; the Heavenly Appellants, who are judgment-debtors on this appeal, explicitly take no position; and Queenie, also a judgment-debtor, is silent on the issue.

We conclude that the automatic stay, which unquestionably applies to Gardner, *see* Koolik v. Markowitz, 40 F.3d 567, 568-69 (2d Cir.1994) (stay of appeal by debtor of judgment entered against it on counterclaim), applies to his wholly owned corporation, Queenie, but not to the Heavenly Appellants. "[A] suit against a codefendant is not automatically stayed by the debtor's bankruptcy filing." 3 *Collier on Bankruptcy* § 362.03[3][d] (15th ed.2002); *see* Croyden Associates v. Alleco, Inc., 969 F.2d 675, 677 (8th Cir.1992); *Teachers Insurance and Annuity Ass'n v. Butler*, 803 F.2d 61, 65 (2d Cir.1986) ("It is well-established that stays pursuant to § 362(a) are limited to debtors and do not encompass non-bankrupt co-defendants."); *Wedgeworth v. Fibreboard Corp.*, 706 F.2d 541, 544 (5th Cir.1983); *cf.* 11 U.S.C. § 1301(a) (stay in Chapter 13 proceeding applicable against "any individual that is liable on [a] debt with the debtor"). The automatic stay can apply to non-debtors, but normally does so only when a claim against the non-debtor will have an immediate adverse economic consequence for the debtor's estate. Examples are a claim to establish an obligation of which the debtor is a guarantor, *McCartney v. Integra National Bank North*, 106 F.3d 506, 510-11 (3d Cir.1997), a claim against the debtor's insurer, ***288** *Johns-Manville Corp. v. Asbestos Litigation Group (In re Johns-Manville Corp.)*, 26 B.R. 420, 435-36 (Bankr.S.D.N.Y.1983) (on rehearing), and actions where "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant ...," *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th Cir.1986).

Under these principles, the stay applies to Queenie because it is wholly owned by Gardner, and adjudication of a claim against the corporation will have an immediate adverse economic impact on Gardner. Gardner contends that the stay should also apply to the Heavenly Appellants because "[i]f this Court decides the pending appeal of the non-debtor co-judgment debtors, it is effectively deciding Mr. Gardner's stayed appeal." [FN4] In essence, Gardner seeks to apply the stay to the Heavenly Appellants to avoid the later use against himself and his corporation of offensive collateral estoppel arising from a ruling on this appeal adverse to these Appellants or at least to guard against the precedential effect of such a ruling.

> FN4. The Heavenly Appellants are "co-judgment debtors" only in the sense that they have been adjudicated liable for specified sums in the same judgment that adjudicates the separate liability of Gardner and Queenie for specified sums. Each Counterclaim Defendant is individually liable for the separate sums awarded against it.

We have not located any decision applying the stay to a non-debtor solely because of an apprehended later use against the debtor of offensive collateral estoppel or the precedential effect of an adverse decision. If such apprehension could support application of the stay, there would be vast and unwarranted interference with creditors' enforcement of their rights against non-debtor co-defendants.

Gardner's reliance on *Lomas Financial Corp. v. Northern Trust Co. (In re Lomas Financial Corp.)*, 117 B.R. 64 (S.D.N.Y.1990), is unavailing. That district court decision affirmed a bankruptcy court's injunction staying a suit against a debtor corporation's two key officers, who were accused of fraudulently causing a creditor to make a loan to the corporation. Although the district court's opinion mentions possible collateral estoppel, the ruling is primarily explained by the existence of the debtor's indemnity obligation to the corporate officers. *See id.* at 68. Moreover, the bankruptcy court's authority to stay the litigation was invoked not only under section 362(a) but also under section 105 of the Bankruptcy Code, which grants broader authority, *see In re Baldwin-United Corp. Litigation*, 765 F.2d 343, 348 (2d Cir.1985). Gardner cites three other decisions for the proposition that "[s]ome courts conclude that 11 U.S.C. § 362(a)(1) applies to third parties automatically." This argument exceeds the bounds of responsible advocacy. In two of the cited decisions the stay was granted primarily because the debtor corporation

was obligated to indemnify the non-debtor defendant, *see North Star Contracting Corp. v. McSpedon (In re North Star Contracting Corp.)*, 125 B.R. 368, 369, 371 (S.D.N.Y.1991); *Maxicare Health Plans, Inc. v. Centinela Mammoth Hospital (In re Family Health Services, Inc.)*, 105 B.R. 937, 941-43 (Bankr.C.D.Cal.1989), and in the third decision the stay was denied, *General Dynamics Corp. v. Veliotis (In re Veliotis)*, 79 B.R. 846, 848 (Bankr.E.D.Mo.1987).

We will stay this appeal only with respect to Gardner and Queenie, and proceed to consider the merits of the appeal with respect to the Heavenly Appellants.

II The Merits

[2] On the merits of the appeal, as it affects Nygard and the Heavenly Appellants,***289** we agree with the District Court that the absence of a pre-verdict Rule 50(a) motion and the agreement to the bifurcation of damage issues combine to constitute a forfeiture of the Counterclaim Defendants' arguable defense that punitive damages are unavailable in the absence of compensatory damages (or perhaps at least nominal damages). A party is barred from challenging the sufficiency of evidence on an issue "unless it has timely moved in the district court for judgment as a matter of law on that issue." *Kirsch v. Fleet Street, Ltd.*, 148 F.3d 149, 164 (2d Cir.1998). Had the Counterclaim Defendants contended before the jury's verdict that Nygard's proof of the fact of compensatory damage was insufficient, Nygard would have had an opportunity to remedy the alleged deficiency with further evidence from Duncan or others as to the adverse economic impact of the tortious interference. It appears that the Counterclaim Defendants considered Nygard's evidence sufficient because they thought, as Nygard did, that Nygard's attorney's fees qualified as an item of compensable damages. But even if that assumption was incorrect, a party's misapprehension of law is an unlikely basis for excusing the absence of a timely Rule 50(a) motion. This case, involving a blatant fraud on the Copyright Office, does not remotely present a situation where relief from Rule 50(a) requirements is warranted to avoid "manifest injustice." *Weissman v. Dawn Joy Fashions, Inc.*, 214 F.3d 224, 232 (2d Cir.2000).

The Counterclaim Defendants contend that they did not fail to make a timely Rule 50(a) motion because the issue of compensatory damages was to be decided by the Court and they asserted the absence of proof of such damages before that issue was submitted for the Court's decision. However, it was an element of Nygard's claim before the jury that it suffered some compensatory damages, and if Nygard's evidence was insufficient to show the fact of such damages, that objection had to be presented before the case went to the jury. [FN5] The jury resolved that issue in Nygard's favor, either on the questionable theory, not objected to at trial, that attorney's fees were compensable damages, or on the clearly valid theory, arguably supported by Duncan's sketchy testimony, that Nygard had suffered some adverse economic consequences.

> FN5. Judge Sotomayor's concurring opinion suggests that we are faulting the Heavenly Appellants for failing, before the case went to the jury, to make a Rule 50 motion "on the issue whether compensatory damages are required to support an award of punitive damages." 321 F.3d at 291. That is not our position. The Rule 50 motion was needed to preserve the claim that Nygard had not presented sufficient evidence to prove the fact of at least some compensable harm, a fact that was an element of Nygard's counterclaim. Absent the Rule 50 motion, the Heavenly Appellants forfeited any complaint that Nygard had not proved the fact of at least some compensable harm. With that fact decided in Nygard's favor by the jury's verdict and with the bifurcation leaving only the amount of compensatory damages to be decided by the Court, the Heavenly Appellants lost the opportunity to complain that the punitive damages award was defective for lack of a compensatory damages award.

Once the Counterclaim Defendants agreed to the unusual bifurcation of damage issues, allowing punitive damages to be determined before any consideration of compensatory damages, they forfeited their arguable defense that punitive damages required some award of compensatory (or perhaps nominal) damages. They agreed to have the jury determine whether and in what amount punitive damages were to be awarded, without any condition that the Court would subsequently determine some quantifiable amount of compensatory***290** damages. Had they asserted be-

fore the case went to the jury the ground now raised on appeal for objecting to punitive damages, Nygard would have had the opportunity to reconsider the wisdom of the bifurcation of damage issues, and might well have both shored up its evidence of compensatory damages and submitted the determination of the amount of such damages to the jury.

Moreover, even on the Counterclaim Defendants' theory, advanced on appeal, that they timely complained of insufficient proof of compensatory damages before that issue was submitted to the Court, they did not contend in the District Court that attorney's fees were not compensable damages. Their submission to the District Court assumed that such fees were compensable, and they argued only that Nygard's lawyer might have worked without compensation. Nygard, also apparently sharing the view that fees were compensable damages, saw no need to do more than submit to the Court evidence of its fees. The Court, for its part, ruled that fees were not compensable damages and saw no need to do anything more than award the fees under the Copyright Act. Had the Counterclaim Defendants contended in the District Court that punitive damages required not merely the jury's determination of the fact of compensatory damages but the assessment of some quantifiable amount by the District Court, the Court could then have considered whether to make some slight award of compensable damages, or, if not, whether an award of nominal damages is necessary as a predicate for punitive damages. But the Court was not faced with this contention, and simply awarded under the Copyright Act the only dollar amount Nygard sought from the Court.

In short, the Counterclaim Defendants, either misapprehending the law or thinking that they had secured a tactical advantage by the bifurcation of damage issues, forfeited whatever arguable defense they might have had to the award of punitive damages.

The Counterclaim Defendants' challenge to the amount of the punitive damages is also unavailing. This challenge is based on the absence of an award of compensatory damages, but in this case that absence is primarily due to the procedure agreed to by all the parties and to the fact that the only quantifiable compensatory damages sought by Nygard were awarded to it as statutory attorney's fees. The Counterclaim Defendants challenged the punitive award in the District Court on the ground that "the jury was without any basis to assess an award of punitive damages in relationship to any actual damages suffered by [Nygard]." However, that is precisely the way the Counterclaim Defendants permitted the jury to consider the punitive damage issue. Nor can the award of punitive damages be deemed excessive in relation to the financial resources of Heavenly and Heaven in the absence of any evidence from these parties as to their financial condition. *See* Zarcone v. Perry, 572 F.2d 52, 56 (2d Cir.1978).

Finally, the claim of the Counterclaim Defendants that a new trial should have been ordered because Chung was permitted to testify as a rebuttal witness for Nygard was properly rejected.

Conclusion

The appeal is stayed as to Appellants Gardner and Queenie, pending further order of the Bankruptcy Court or this Court,[FN6] and the judgment in favor of Nygard***291** and against Heavenly and Heaven is affirmed.

> FN6. Gardner shall promptly notify this Court in the event that the Bankruptcy Court grants relief from the section 362 stay with respect to this appeal, or the stay lapses. *See Koolik*, 40 F.3d at 569.

SOTOMAYOR, Circuit Judge, concurring.

The majority holds that (1) the automatic bankruptcy stay, 11 U.S.C. § 362(a), applies to bankrupt debtor Marc Gardner and his wholly owned corporation, Queenie Ltd., but not to the remaining Counterclaim Defendants, Joseph Heaven and Heavenly Fabrics, Inc. (the "Heavenly Appellants"),[FN1] and (2) the Heavenly Appellants have waived the potential defense that compensatory or nominal damages are required to support an award of punitive damages. I agree with both of these holdings. I write separately to clarify exactly when I believe the Heavenly Appellants' waiver occurred.

> FN1. While I applaud counsel's rhetorical turn of phrase, I note that, given the serious nature of the claims against the Counterclaim Defendants, including perpetrating a fraud on the United States Copyright Office, the appellation may be less than appropriate. Not lacking a sense of irony, however, I too

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refer to these parties as the "Heavenly Appellants."

I would hold the Heavenly Appellants responsible only for failing to make their motion before Judge Buchwald rendered her decision as factfinder on compensatory damages. It is not completely clear from the record whether, under the parties' agreed bifurcation, the judge was simply to find the amount of compensatory damages, or was to be the factfinder with respect to compensatory damages in general, or even what this distinction might mean. Judge Buchwald instructed the jury both that she would "place a dollar value" on the compensatory damages Nygard suffered if the jury found the Counterclaim Defendants liable and that "[y]our job is the punitive damages side, if you find liability. Mine is the actual damages side." Given the ambiguity in the record, I disagree with the majority that the Heavenly Appellants are responsible for failing to make a Rule 50 motion before the jury trial on the issue whether compensatory damages are required to support an award of punitive damages.

In its submission for compensatory damages to Judge Buchwald, Nygard relied solely upon its argument that attorney's fees were compensable damages in a claim for tortious interference with prospective economic advantage. Had the Heavenly Appellants argued in their Rule 50 motion, filed after the jury verdict but before Judge Buchwald's determination of compensatory damages, that attorney's fees were not compensable damages and therefore Nygard had demonstrated no compensatory damages to the relevant factfinder (that is, Judge Buchwald), the motion would have been timely and the Heavenly Appellants would have properly raised the potential defense that compensatory damages must support a punitive damages award. By neglecting to make this argument in the district court, the Heavenly Appellants have waived it. *See Tolbert v. Queens Coll.*, 242 F.3d 58, 76 (2d Cir.2001).

I note that because the Heavenly Appellants raised this argument for the first time on appeal, Nygard did not have the opportunity to provide additional evidence to the district court regarding compensatory damages, or to request nominal damages in an attempt to cure any potential problem. Avoiding such an inequity is precisely the purpose of Rule 50's requirement that a motion be made before the issue is submitted to the factfinder. *See id.* at 76-77 ("[T]he motion must be sufficient to inform the opposing party of the precise issue as to which more evidence is ***292** needed in order to warrant its submission to the jury."); *see also* Fed.R.Civ.P. 50 advisory committee note (1991 Amendment).

Thus, I am in agreement with the majority that the Heavenly Appellants' waiver disposes of this appeal, but have a different view of what actually constituted the waiver.[FN2] I would not impose upon the Heavenly Appellants an obligation to raise the compensatory damages defense before the close of the jury trial, because it was not clear that the jury was the factfinder on the issue of compensatory damages. Parties may shape litigation in a variety of ways, including various bifurcation methods. One hopes that in so doing, they think through the implications of their choice. Given the ambiguity in the record, the Heavenly Appellants may have relied upon a reasonable, albeit different, understanding of the parties' agreed bifurcation than the majority assumes. I would not hold the Heavenly Appellants bound by their choice when the record does not provide a clear answer regarding what that choice was. *Cf. City of New York v. Minetta*, 262 F.3d 169, 181 (2d Cir.2001) (finding waiver in the context of a *deliberate* choice to remain silent).

FN2. The majority suggests that I misread their position on the Heavenly Appellants' waiver. I read the majority as finding two separate waivers that combine to defeat the Heavenly Appellants' arguments. First, the Heavenly Appellants waived their argument that Nygard did not present sufficient evidence of compensatory damages to the jury by failing to make a Rule 50 motion before the end of the jury trial. Majority Op. at 289. Second, the Heavenly Appellants agreed to a bifurcation procedure that forfeited their arguable defense that an award of punitive damages is only proper if some form of compensatory damages is awarded. Majority Op. at 289-90. The first waiver is not relevant to the Heavenly Appellants' argument on appeal, as they no longer argue that Nygard failed to present sufficient evidence of compensatory damages to the *jury*. I do not agree that the second waiver was, in fact a waiver, *see supra*, because the parties' bifur-

> cation of compensatory and punitive damages did not automatically sever the legal link between compensatory and punitive damages. Nonetheless, for the reasons stated above, I believe that the Heavenly Appellants have waived their argument that some amount of compensatory damages are required to support an award of punitive damages.

I do, however, hold the Heavenly Appellants bound by their failure to alert Judge Buchwald to the failure of Nygard's proof with respect to compensatory damages, and therefore concur that the judgment in favor of Nygard and against the Heavenly Appellants should be affirmed.

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United States Bankruptcy Court,
S.D. Florida,
West Palm Beach Division.
In re Abraham David GOSMAN, Debtor.
No. 01-30953-BKC-PGH.

July 30, 2002.

Official committee of unsecured creditors objected to confirmation of debtor's amended Chapter 11 plan of liquidation by means of cramdown. The Bankruptcy Court, Paul G. Hyman, Jr., J., held that debtor could not confirm his plan by means of cramdown over dissenting class of unsecured creditors while at same time retaining some or all of exempt property.

Objection sustained.

West Headnotes

[1] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
If unsecured creditors do not receive payment in full on their allowed claims, then no holder of a claim or interest junior to those of the unsecured creditors may retain any property under the plan; this provision is commonly referred to as the "absolute priority rule." Bankr.Code, 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[2] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
Chapter 11 debtor, who owned interest in exempt property, was holder of interest that was junior to claims of unsecured creditors, for purpose of application of absolute priority rule.

[3] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
Chapter 11 debtor, who did not propose to pay all of his unsecured creditors in full under his plan of liquidation, could not confirm his plan by means of cramdown over dissenting class of unsecured creditors while at same time retaining some or all of exempt property; plan could be confirmed only if debtor contributed all of his exempt property to plan for benefit of his creditors, since debtor's retention of any property, even exempt property, would have constituted violation of absolute priority rule. Bankr.Code, 11 U.S.C.A. §§ 522(b), 1123(c), 1129(b)(2)(B)(ii).

[4] Bankruptcy 51 ⚿2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In General. Most Cited Cases
The interpretation of the Bankruptcy Code first begins with the language itself; if the language is plain and unambiguous, then the court must enforce the Bankruptcy Code according to its terms.

[5] Bankruptcy 51 ⚿2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In General. Most Cited Cases
The term "property," while not defined under the Bankruptcy Code, is meant to be broad in scope and all encompassing.

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(Cite as: 282 B.R. 45)

[6] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
In the context of an individual Chapter 11 proceeding, if the debtor were to retain certain property of the estate, i.e., non-exempt property, then the debtor would be in violation of the absolute priority rule if the dissenting class of unsecured creditors are not paid in full because he would be the holder of a "junior interest" retaining property at the expense of unsecured creditors. Bankr.Code, 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[7] Statutes 361 ⚿181(2)

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k180 Intention of Legislature
361k181 In General
361k181(2) k. Effect and Consequences. Most Cited Cases

Statutes 361 ⚿188

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k188 k. In General. Most Cited Cases
Under limited circumstances, the plain meaning of a statute controls unless the language leads to an absurd result.

[8] Bankruptcy 51 ⚿3251

51 Bankruptcy
51X Discharge
51X(A) In General
51k3251 k. In General. Most Cited Cases

Bankruptcy 51 ⚿3271

51 Bankruptcy
51X Discharge
51X(B) Dischargeable Debtors
51X(B)1 In General
51k3271 k. In General. Most Cited Cases
A discharge of one's debts is a privilege, not a right afforded by Congress; a debtor who voluntary seeks bankruptcy relief must be expected to meet the requirements of the Bankruptcy Code.

[9] Statutes 361 ⚿184

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k180 Intention of Legislature
361k184 k. Policy and Purpose of Act. Most Cited Cases
Policy arguments cannot displace the plain language of a statute.

***46** Paul J. Battista, Miami, FL.

Charles W. Throckmorton, Miami, FL.

MEMORANDUM DECISION AND ORDER SUSTAINING THE OBJECTION BY THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO CONFIRMATION OF THE DEBTOR'S AMENDED CHAPTER 11 PLAN BY MEANS OF CRAMDOWN

PAUL G. HYMAN, Jr., Bankruptcy Judge.

THIS MATTER came before the Court on June 5, 2002 upon one of the objections raised by the Official Committee of Unsecured Creditors (the "Committee") to the approval of the Debtor's Amended Disclosure Statement. The specific issue before the Court (the "Cramdown Issue") concerns the Debtor's ability, as a matter of law, to confirm his Amended Plan of Liquidation (the "Debtor's Plan") by means of cramdown under 11 U.S.C. § 1129(b)(2)(B)(ii) without contributing all of his exempt property under such Plan.

The Court, considering the arguments of the parties, the Memorandum of Law by the Committee in Support of Its Objection to Confirmation of The Debtor's Amended Chapter 11 Plan by Means of Cramdown Under Section 1129(b) of The Bankruptcy Code, the Memorandum of Law filed by the Debtor in connec-

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tion with the Cramdown Issue, the record and pleadings filed in this case and otherwise being fully advised in the premises, hereby makes the following findings of fact and conclusions of law.

FINDINGS OF FACTS

On March 2, 2001, the Debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code. The Committee was formed by the Office of the United States Trustee on April 9, 2001. Thereafter, the meeting of creditors, pursuant to 11 U.S.C. § 341, was held on April 19, 2001.

Under the Debtor's Plan, the Debtor proposes to liquidate all of his non-exempt assets for the benefit of his creditors and at the same time partially retain his interests in several items of valuable exempt property, including without limitation, a mansion on the ocean in Palm Beach, Florida valued on the Debtor's schedules at $40 million, a collection of artwork valued on the Debtor's schedules at approximately $11 million, a valuable collection of antique furniture and an interest in a corporation *47 that owns a piece of undeveloped real property in Palm Beach valued on the Debtor's schedules at $7.5 million (collectively, the "Exempt Property").

Under the Debtor's Plan, the Debtor would retain the Exempt Property, but would contribute the proceeds from a portion thereof to the unsecured creditors, the amount of which depended on certain conditions under the Debtor's Plan. The Cramdown Issue arises because the Debtor's Plan did not provide that the Debtor would contribute *all* of the Exempt Property to pay unsecured creditors.

On March 13, 2002, the Court conducted a hearing on the approval of the competing disclosure statements filed by the Debtor and the Committee. In connection with such hearing, the Committee filed an extensive objection to the Debtor's disclosure statement. The Debtor also filed an extensive objection to the Committee's disclosure statement. In the Committee's objection, the Committee raised several issues concerning the legal structure of the Debtor's Plan and argued that because the Committee believed that the Debtor's Plan was not confirmable on its face, the Debtor's disclosure statement should not be approved.

At the March 13, 2002 hearing, the Court resolved certain of the objections raised by both parties to the other's disclosure statement, but instructed the parties to submit legal memoranda on the Cramdown Issue, namely, whether the Debtor, who does not propose to pay all of his unsecured creditors in full under the Debtor's Plan, was able, as a matter of law, to confirm the Debtor's Plan, which is a plan of liquidation, by means of a cramdown under Section 1129(b) of the Bankruptcy Code over a dissenting class of unsecured creditors while at the same time retain some or all of the Exempt Property.

In its pleadings on the Cramdown Issue, the Committee objected to the Debtor's Plan on the ground that it violated the absolute priority rule under the Bankruptcy Code. The Committee argues that the Debtor's attempt to retain Exempt Property under the Debtor's Plan is not authorized by the plain language of the Bankruptcy Code, namely Section 1129(b)(2)(B)(ii), or the case law thereunder unless the Debtor is able to obtain the acceptance of the class of unsecured creditors under the Debtor's Plan.[FN1] Thus, according to the Committee, the Debtor cannot confirm the Debtor's Plan by means of cramdown under Section 1129(b)(2)(B)(ii) of the Bankruptcy Code unless he contributes all of the Exempt Property to the Debtor's Plan for the benefit of creditors on the basis that the Debtor's retention of any property (even Exempt Property) would constitute a violation of the absolute priority rule.

> FN1. Because of the composition of the Committee, whose members potentially hold allowable unsecured claims in excess of $210 million, and the pendency of the Committee's plan of liquidation, it is unlikely that the Debtor will obtain the acceptance of the class of unsecured claims, which is an impaired class under the Debtor's Plan. Therefore, confirmation of the Debtor's Plan is probably only possible through the cramdown provisions of the Bankruptcy Code.

The Debtor disagrees with the Committee and argues that there is ample case law supporting the proposition that a debtor may retain exempt property via the cramdown provisions of the Bankruptcy Code. The Debtor also relies on bankruptcy policy, arguing that an unfavorable ruling would deny individual debtors effective relief under Chapter 11.

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CONCLUSIONS OF LAW

The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334(b), ***48** 157(b)(1) and 157(b)(2)(L). This is a core proceeding in accordance with 28 U.S.C. § 157(b)(2)(L).

[1] In order to obtain confirmation of a Chapter 11 plan, a debtor must meet the requirements of 11 U.S.C. § 1129(a). In connection therewith and subject to the exception contained in Section 1129(a)(8), all impaired classes under the plan must vote in favor of and accept the plan. In the event one impaired class votes to reject the plan, then the debtor is left with the alternative of achieving confirmation of the plan through the means of the cramdown provisions of 11 U.S.C. § 1129(b). In order to achieve a cramdown against a dissenting class of unsecured creditors, a debtor must satisfy the "fair and equitable" requirement of Section 1129(b)(2)(B)(ii) as to such dissenting class of unsecured creditors. This section provides:

> With respect to a class of unsecured creditors-
>
> ...
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest **any property**.

(emphasis added). As such, if unsecured creditors do not receive payment in full on their allowed claims, then no holder of a claim or interest junior to those of the unsecured creditors may retain any property under the plan. This provision is commonly referred to as the "absolute priority rule."

[2][3] There can be no question that the Debtor in this case is a "holder of an interest that is junior" to the claims of unsecured creditors. The Debtor owns an interest in the Exempt Property. *See In re Unruh v. Rushville State Bank*, 987 F.2d 1506 (10th Cir.1993); *In re East*, 57 B.R. 14 (Bankr.M.D.La.1985). Further, it is "generally held that a debtor's ownership interest in property is 'junior' to the claims of unsecured creditors." *In re Fross*, 233 B.R. 176, 1999 WL 26886 *9, 1999 Bankr.LEXIS 15, *26 (10th Cir. BAP 1999)(unpublished decision); *See also In re Drimmel*, 108 B.R. 284 (Bankr.D.Kan.1989); *In re Knutson*, 40 B.R. 142 (Bankr.W.D.Wis.1984); *In re Tomlin*, 22 B.R. 876 (Bankr.M.D.Ala.1982). Lastly, the Debtor is proposing to retain property, namely Exempt Property, on account of such junior interest. In fact, it is the Debtor's "ownership interest in the home that gives [him] any exemption rights under [Section] 522(b) and [state] law at all." *Fross*, 233 B.R. 176, 1999 WL 26886 at *9, 1999 Bankr.LEXIS at *25.

I. The Plain Language of § 1129(b)(2)(B)(ii)

As a result of the above, the core dispute in this matter centers on whether the term "any property" as used in Section 1129(b)(2)(B)(ii) encompasses property which is "exempt property." The Committee contends that the statutory section is clear and unambiguous on its face and therefore should be afforded its plain meaning. The Court agrees.

[4] The interpretation of the Bankruptcy Code first begins with the language itself. *See In re Griffith*, 206 F.3d 1389, 1393 (11th Cir.2000); *United States v. Ron Pair Enters.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989). If the language is plain and unambiguous, then the Court must enforce the Bankruptcy Code according to its terms. *Id.*

[5] Here, the Court looks no further than the words "any property." The term "property," while not defined under the Bankruptcy Code, is meant to be broad in scope and all encompassing. *See* ***49***Norwest Bank of Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 969, 99 L.Ed.2d 169 (1988) ("as that term is used in § 1129(b) ... Congress' meaning was quite broad."). No distinction is made between intangible and tangible property. In addition, no distinction is also made between valuable and valueless property.

Notwithstanding this lack of distinction, the Debtor would have this Court conclude that Congress intended to make a distinction between exempt and non-exempt property in Section 1129(b)(2)(B)(ii) when it chose to use the word "property." The Debtor's position is simply not supported by the four corners of the text in Section 1129(b)(2)(B)(ii). *See In re Fross*, 233 B.R. 176, 1999 WL 26886, 1999 Bankr.LEXIS 15 (10th Cir. BAP 1999); *In re Ashton*,

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107 B.R. 670, 674 (Bankr.D.N.D.1989); *Matter of Yasparro*, 100 B.R. 91, 95 (Bankr.M.D.Fla.1989); *In re Johnson*, 101 B.R. 307, 309 (Bankr.M.D.Fla.1989).

[6] In the context of an individual Chapter 11 proceeding, there is no dispute that if the Debtor were to retain certain *property of the estate*, i.e., non-exempt property, then the Debtor would be in violation of the absolute priority rule if the dissenting class of unsecured creditors are not paid in full because he would be the holder of a "junior interest" retaining property at the expense of unsecured creditors. *See* Ahlers, 485 U.S. at 209, 108 S.Ct. 963 (individual debtors' retention of their interests in the non-exempt family farm was improper). The foregoing result is no different where the Debtor proposes to retain exempt property as opposed to non-exempt property.

Had Congress intended to exclude exempt property from the effect of the "absolute priority rule," then the term "property" would not have been used under Section 1129(b)(2)(B)(ii), rather Congress would have used "non-exempt property" or "property of the estate." Congress could also have used any other qualifying word to indicate its desire to provide a distinction between exempt and non-exempt property. For example, Congress could have referenced 11 U.S.C. § 522 if it meant to exclude exempt property. Instead, Section 1129(b)(2)(B)(ii) uses the term "property" and such term is modified by the word "any," a word which, by any definition, sets no boundaries. "Any" does not refer to certain things and not others. "Any" means "every" and "all." It is unlimited. By having the word "any" modify "property," there is no reason, or implication, whatsoever to support the Debtor's argument that Section 1129(b)(2)(B)(ii) is limited to non-exempt assets.

In fact, the Supreme Court in *Bank of America National Trust and Savings Assoc. v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999) concluded that the word "property" as used in Section 1129(b)(2)(B)(ii) was broad enough to cover even the exclusive opportunity to propose a plan in a Chapter 11 bankruptcy. *Id.* at 455, 119 S.Ct. 1411. As such, it is certainly broad enough to cover exempt property.

II. Structure of the Bankruptcy Code

In drafting the Bankruptcy Code, Congress was meticulous with its choice of words. This is demonstrated through the use of the phrase "property of the estate," which is repeatedly used throughout the Bankruptcy Code. In Sections 541, 1207 and 1306 of the Bankruptcy Code, all appropriately entitled "Property of the Estate," Congress defined what it meant by the term "property of the estate." As such, Congress leaves no doubt that a reader of the Bankruptcy Code must refer to these sections whenever "property of the estate" is used in other provisions.

***50** Given the foregoing construct, the omission of any reference to "property of the estate" in Section 1129(b)(2)(B)(ii) can only mean one thing, namely that the omission was intentional by Congress. If Congress had intended to limit the term "any property" to "property of the estate", it would have done so. There can be no doubt that Congress knew the difference. Accordingly, the Court must give effect to each and every word chosen by Congress, as well as to each and every omission.

The Supreme Court in *203 North LaSalle Street Partnership* was faced with a similar task of statutory construction in interpreting Section 1129(b)(2)(B)(ii). There, the Supreme Court had to determine the meaning of the term "on account of." Disagreeing with the debtor's reading that "on account of" means "in exchange for," the Supreme Court stressed that the phrase "in exchange for" already appears in Section 1123(a)(5)(J). The Supreme Court stated: "It is unlikely that the drafters of legislation so long and minutely contemplated as the 1978 Bankruptcy Code would have used two different forms of words for the same purpose." *LaSalle*, 526 U.S. at 450, 119 S.Ct. 1411. Simply put, Congress does not choose words in a vacuum. The same can be said in the present case, where Congress chose the term "any property," instead of "property of the estate." There is no reason to believe that the Supreme Court in *LaSalle* would rule differently in this context, especially where the term "property of the estate" is used abundantly throughout the Bankruptcy Code. "Any property" is simply not equivalent to "property of the estate."

III. Legislative History

While Chapter 11 is a publicly perceived form of bankruptcy relief for companies, Congress made Chapter 11 equally available for individuals. There-

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fore, Congress was fully aware of the impact that the "absolute priority rule" may have on an individual debtor at the time Section 1129(b)(2)(B)(ii) was drafted. Only an individual debtor can exempt property. Had Congress intended to protect an individual's right to exempt property, the "absolute priority rule" would have been made inapplicable to such property.

The foregoing result is further bolstered by the legislative history behind the "absolute priority rule." *In re Fross* provides an excellent discussion on this topic, illustrating how and why the provisions of Section 1129(b)(2)(B)(ii) were enacted by Congress. 233 B.R. 176, 1999 WL 26886 at *3-5. To summarize, the "absolute priority rule" was once a creature of common law, which prohibited an individual or corporate debtor from retaining property, no matter the form. Because Congress believed that this rule was frustrating bankruptcy policy, the Bankruptcy Act, when amended in 1952, was modified to exclude the application of the "absolute priority rule" in all bankruptcy cases, including those involving individual debtors. Thus, for a significant period of time, the "absolute priority rule" played no role under the then applicable bankruptcy law. However, the "absolute priority rule" came into existence through the enactment of the Bankruptcy Code in 1978.

Fross concluded that Congress' decision in 1978 in making the "absolute priority rule" applicable to both individual and corporate Chapter 11 cases was not inadvertent or a mere scrivener's error. Citing to *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), the court explained that Congress is presumed to know of former practices, in particular the former law exempting individuals from the "absolute priority rule." *Id.* at *5. The court went on to rule that such an extensive**51** history shows, in addition to the plain meaning of the term "any property," that the "absolute priority rule" is not limited to property of the estate by of virtue an individual debtor utilizing the Chapter 11 provisions.

Although *Fross* is an unpublished opinion, the analysis set forth in that decision is extensive and compelling. If this Court were to conduct a similar investigation on the history of the "absolute priority rule," the result would be the same. The language of Section 1129(b)(2)(B)(ii) is plain, clear and unequivocal, and legislative history does not suggest otherwise.

IV. The Debtor's Case Law Supporting His Argument.

The Debtor has cited five cases in support of his contention that the "absolute priority rule" does not extend to exempt property. *See In re Haas*, 195 B.R. 933 (Bankr.S.D.Ala.1996); *In re Rocha*, 179 B.R. 305 (Bankr.M.D.Fla.1995); *In re Harman*, 141 B.R. 878 (Bankr.E.D.Pa.1992); *In re Egan*, 142 B.R. 730 (Bankr.E.D.Pa.1992); and *In re Custer*, 1993 WL 7965, 1993 Bankr.Lexis 20 (E.D.Pa. January 7, 1993).

Of the five cases, three were decided by the Honorable David A. Scholl, U.S. Bankruptcy Judge for the Eastern District of Pennsylvania. The fact that Judge Scholl in three separate occasions stated that the "absolute priority rule" only applies to a debtor's retention of non-exempt assets does not make the Debtor's argument in this case any more persuasive or correct. In fact, the issue at hand was only addressed and discussed at some length by Judge Scholl in *Egan*. Judge Scholl's statements in *Harman* and *Custer* were purely dicta, involving conclusory statements. *Harman* and *Custer* add nothing to the analysis of whether the term "any property" incorporates exempt property.

The same can be said of *Rocha*, which merely states: "[S]ince the unsecured creditors have rejected the Plan, the Debtors must pay their claims in full, before they retain any non-exempt property." The issue of exempt property was not before the Court in *Rocha*, mainly because the Chapter 11 debtor there sought to retain his interest in non-exempt property, as opposed to exempt property. As a result, *Rocha* is not persuasive authority.

What remains are the discussions in *Egan* and *Haas*. There, both courts provide the same explanation by focusing on the nature of exempt property. According to them, because the retention of exempt property is an absolute right already afforded to a debtor by way of 11 U.S.C. § 522, the "absolute priority rule" does not come into play. Essentially, the argument is that Section 522 trumps Section 1129(b)(2)(B)(ii). *See Egan*, 142 B.R. at 733; *Haas*, B.R. at 941.

What *Egan* and *Haas* fail to recognize, however, is that Section 522 is a provision of general applicability pursuant to 11 U.S.C. § 103. It is a canon of statu-

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tory construction that provisions of general applicability within a statute prevail, unless they are contradicted by or are inconsistent with a specific provision. *See In re McKeon*, 86 B.R. 350, 376 (Bankr.D.N.J.1988) ("This court accepts the tenet of statutory construction which provides that regardless of the inclusiveness of the general language of a statute, it does not apply or prevail over matters specifically dealt with in another part of the same enactment."). Accordingly, the provisions set forth in Section 522 prevail in Chapters 7, 11, and 13, unless otherwise contradicted by a specific provision. Here, the specific provision is Section 1129(b)(2)(B)(ii). As noted, the reference to "any property" means any and all property, including property of the estate. Such a broad term ***52** clearly overrides the mandate of Section 522 or any other provisions relating to exemptions. For *Egan* and *Haas* to ignore the foregoing construct of the Bankruptcy Code calls into question the persuasiveness of these decisions.

Furthermore, the courts in *Egan* and *Haas* did not undertake the thorough analysis that was conducted in *Fross* and *Yasparro*. For whatever reason, perhaps because the issue was not hotly contested by the parties, *Egan* and *Haas* fall short, in particular failing to address the plain meaning of "any property" in Section 1129(b)(2)(B)(ii).

As result of the foregoing, the Court will follow the holdings of those cases cited by the Committee. The Court finds them to be more persuasive in their reasoning.

At the hearing, the Debtor also argued that his position that he could retain the Exempt Property in the context of a cramdown was supported by the provisions of Section 1123(c) of the Bankruptcy Code. Section 1123(c) provides that "[i]n a case concerning an individual, a plan proposed by an entity other than the debtor may not provide for the use, sale, or lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale, or lease." The Court disagrees. In fact, the Court finds that this provision actually supports the position asserted by the Committee in that Congress was clearly aware of the issue of exempt versus non-exempt property under the Bankruptcy Code for an individual debtor and as such could have qualified the term "property" in Section 1129(b)(2)(B)(ii) if it chose to do so.

V. Consequences of the Absolute Priority Rule

[7] Under limited circumstances, the plain meaning of a statute controls unless the language leads to an absurd result. *See In re Fretz*, 244 F.3d 1323 (11th Cir.2001). Here, the application of the "absolute priority rule" may prevent an honest individual Chapter 11 debtor from obtaining effective relief through confirmation of a plan. As a result, an individual Chapter 11 debtor may be forced to proceed under Chapter 7. If so, is such a scenario so abhorrent as to justify a rewrite of the clear mandate of Congress?

[8] Chapter 7 relief is just as effective as providing adequate relief to a debtor in financial straits, although certain debtors would prefer to proceed under Chapter 11 to retain certain property. It is well established that a discharge of one's debts is a privilege, not a right afforded by Congress. *See Matter of Juzwiak*, 89 F.3d 424 (7th Cir.1996); *In re Broughton*, 6 B.R. 1011 (N.D.Ga.1980). A debtor who voluntary seeks bankruptcy relief must be expected to meet the requirements of the Bankruptcy Code. Here, for the Debtor to obtain a reorganization of his financial affairs, certain conditions of confirmation must be satisfied. *See Fross*, 233 B.R. 176, 1999 WL 26886 at *7. In addition, the Debtor has proposed a plan of liquidation in this case. He has chosen to pursue liquidation in a Chapter 11 rather than in Chapter 7. As a result, he is required to satisfy the requirements of Chapter 11; Section 1129(b)(2)(B)(ii) being one of them.

Just because the Debtor in this case is unhappy with the plain meaning of the "absolute priority rule," this Court should not conclude in favor of an absurd result. As discussed, Congress was well aware of the distinction between exempt and non-exempt property when drafting Section 1129(b)(2)(B)(ii). If the Court were to re-write the Code every time a debtor was dissatisfied with a specific provision of the Bankruptcy Code, there would be no Bankruptcy Code.

***53** [9] Even if the Debtor is correct in arguing that the consequence of the "absolute priority rule" is poor bankruptcy policy, policy arguments cannot displace the plain language of a statute. *Cf. In re TechDyn Systems Corp.*, 235 B.R. 857 (Bankr.E.D.Va.1999). The Court must presume that Congress means what it says and says what it means through the passage of legislation. If bad bankruptcy

policy results therefrom, then the Debtor must raise his concerns to another forum that is better equipped in addressing public policy matters, namely, the halls of Congress.

ORDER

In light of the foregoing, and with the Court being otherwise fully advised in the premises, it is hereby **ORDERED AND ADJUDGED** that:

1. The Committee's Objection in relation to the Cramdown Issue is **SUSTAINED**.

2. The disclosure statement in relation to the Debtor's Plan is Denied without prejudice.

3. The Debtor cannot confirm a Chapter 11 plan by means of cramdown over a dissenting class of unsecured creditors under Section 1129(b)(2)(B)(ii) of the Bankruptcy Code unless the Debtor's Plan provides for a contribution of all of the Exempt Property to and for the benefit of unsecured creditors.

Bkrtcy.S.D.Fla.,2002.
In re Gosman
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United States Bankruptcy Court,
M.D. Florida,
Fort Myers Division.
In re James Bronce HENDERSON, III, Debtor.
No. 9:02-BK-16887-ALP.

Jan. 26, 2005.

Background: Debtor sought confirmation of third amended Chapter 11 plan. Some creditors objected.

Holdings: The Bankruptcy Court, Alexander L. Paskay, J., held that:
(1) plan was in best interest of creditors and provided not less than amount that creditors would have received if debtor were liquidated under Chapter 7, and
(2) total liquidation of all of debtor's assets was not required in order for plan to be fair and equitable to dissenting creditors who were subject to cramdown, and thus plan did not violate absolute priority rule.

Ordered accordingly.

West Headnotes

[1] Bankruptcy 51 ⚿3560

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3560 k. Provisions for Satisfaction of Claims; Relation to Recovery in Liquidation. Most Cited Cases
Alternative to third amended, individual wage earner, Chapter 11 plan, as modified, which included sale of debtor's minority interest in minor league baseball team and all net recovery from debtor's lawsuit against his former business associates, was in best interest of creditors and provided not less than amount that creditors would have received if debtor were liquidated under Chapter 7, where each holder of allowed claim would receive dividend of between 35 and 40 percent under plan, and under Chapter 7 they would not have received any dividend whatsoever. Bankr.Code, 11 U.S.C.A. § 1129(a)(7), (b)(2).

[2] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
Total liquidation of all of debtor's assets was not required in order for third amended, individual wage earner, Chapter 11 plan to be fair and equitable to dissenting creditors who were subject to cramdown, and thus plan did not violate absolute priority rule, even though debtor intended to retain non-exempt property, where debtor submitted sufficient new value, in form of cash contribution from non-debtor spouse, which exceeded value of non-exempt properties retained. Bankr.Code, 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[3] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
The absolute priority rule requires that a plan cannot be confirmed over the objection of a dissenting class unless a debtor is able to persuade the court that a plan is fair and equitable. Bankr.Code, 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[4] Bankruptcy 51 ⚿2794.1

51 Bankruptcy
51VI Exemptions
51k2794 Claim of Exemption or Lien Avoidance
51k2794.1 k. In General. Most Cited Cases

Bankruptcy 51 ⚿2799.1

51 Bankruptcy
51VI Exemptions
51k2799 Objections
51k2799.1 k. In General. Most Cited Cases
If a debtor claims an exemption, in the absence of any objection to the claim, the exemption is allowed as a matter of law.

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[5] Bankruptcy 51 ⚿2223

51 Bankruptcy
51III The Case
51III(B) Debtors
51k2222 Who May Be a Debtor
51k2223 k. Reorganization Cases. Most Cited Cases
Individual debtors are eligible for relief under Chapter 11.

[6] Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
The absolute priority rule has three components: (1) the identification of junior claims or interests; (2) the identification of any property retained by the holders of such claims or interests; and (3) the determination whether the property is retained "on account of" a junior claim or interest, where the term "interest" in this context means equity interest. Bankr.Code, 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[7] Bankruptcy 51 ⚿2537

51 Bankruptcy
51V The Estate
51V(C) Property of Estate in General
51V(C)2 Particular Items and Interests
51k2537 k. Exempt or Fresh Start Property. Most Cited Cases

Bankruptcy 51 ⚿2793

51 Bankruptcy
51VI Exemptions
51k2793 k. Operation and Effect. Most Cited Cases
Once exemptions are allowed, exempt property is no longer part of the debtor's estate, and the debtor does not retain property on account of such interest, because he retains it as a matter of right by virtue of recognition of his right to exemptions. Bankr.Code, 11 U.S.C.A. § 522(c).

[8] Bankruptcy 51 ⚿2793

51 Bankruptcy
51VI Exemptions
51k2793 k. Operation and Effect. Most Cited Cases
A debtor's interest in exempt property can never be junior to the interest of creditors, including the claim of dissenting unsecured creditors, because unsecured creditors cannot reach exempt property outside of bankruptcy, and such properties are immune and not subject to liquidation. Bankr.Code, 11 U.S.C.A. § 522(c).

[9] Bankruptcy 51 ⚿2793

51 Bankruptcy
51VI Exemptions
51k2793 k. Operation and Effect. Most Cited Cases
An individual debtor does not have to forfeit exemption rights to which the debtor is otherwise entitled in all operating Chapters of the Bankruptcy Code as a price of obtaining confirmation of his or her plan of reorganization.
***551** Asher Rabinowitz, Tampa, FL, for Debtor.

552 *AMENDED ORDER ON CONFIRMATION OF THE THIRD AMENDED PLAN, AS MODIFIED
(Amending Doc. No. 528)

ALEXANDER L. PASKAY, Bankruptcy Judge.

THIS IS the next chapter in a seemingly endless battle between James Bronce Henderson, III (Debtor), and Van Buren Industrial Investors, LLC, and 6700 Development Associates, LLC, (the Objectors). To illustrate the history of this Chapter 11 case which was filed in this Court on August 29, 2002, the docket thus far has 519 entries, disregarding the notice entries; ninety percent of the entries relating to this Chapter 11 case are litigations between the Debtor and the only two antagonists of the Debtor, the Objectors. It should be helpful to briefly recap the underlying factual basis relevant to the commencement of this Chapter 11 case and the positions of the Objectors, vis-a-vis the Debtor.

At the time relevant, the Debtor was the president of DCT, Inc., (DCT), an automotive supply company in the metropolitan Detroit area. The Debtor as president of DCT guaranteed most, if not all, the major obligations of DCT, including two long-term leases entered into by DCT with the Objectors. In February 2002, DCT was placed into an involuntary Chapter 7 bankruptcy. In due course, the Bankruptcy Court in Detroit entered its Order for Re-

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lief and appointed a Trustee who has been, and still is, representing the estate of DCT in Detroit.

On August 29, 2002, the Debtor, faced with increasing collection pressures based on his guaranties of the primary obligations of DCT, filed for relief under Chapter 11 of the Bankruptcy Code in this Court. Shortly after the commencement of the case the Debtor sought the entry of an Order to fix the bar date to file claims, which was granted, and the Court fixed the bar date at December 16, 2002. The Objectors filed their respective Proofs of Claim. The Debtor promptly challenged the claims of both the Objectors, and filed his motions for summary judgment. Both motions for summary judgment were denied. In July 2003, this Court overruled the Debtor's objections to the claims of the Objectors but limited the amounts of each to the statutory cap provided by Section 502(b)(6) of the Bankruptcy Code. The Debtor properly filed a notice of appeal of this Court's decisions to the United States District Court for the Middle District of Florida. The Objectors also appealed contending that this Court erred in applying the statutory cap to their claims. Both these appeals are still pending before the District Court and, therefore, the parties are waiting for the decision.

During this Chapter 11 case the Debtor, with the help of his non-Debtor wife, Joann Henderson (Mrs. Henderson), has repaid all secured claims, totaling over $4,000,000. These claims include those of Homeside Lending (first mortgage on the condominium in Naples), Private Bank (first mortgage on the Heron Ridge house), Comerica Bank (second mortgage on the Naples condominium and on the Heron Ridge house, and the first mortgage on the Niblick Lane Homestead), and Betty G. Henderson Trust (third mortgagee on the Heron Ridge House).

The Debtor, notwithstanding the pendency of the appeals described earlier, filed several Disclosure Statements and Plans of Reorganization. Ultimately, on May 11, 2004, the Debtor filed the Third Amended Chapter 11 Plan of the Debtor (Doc. No. 374). On September 7, 2004, shortly before the scheduled confirmation hearing, the Debtor also filed his Modifications to Third Amended Chapter 11 Plan ***553** of the Debtor (Doc. No. 460), which is what is presently under consideration (Third Amended Plan, as modified). Needless to say, the Objectors wasted no time and immediately challenged the Third Amended Plan, as modified.

The Debtor's Third Amended Plan, as modified, has 10 classes of creditors and parties of interest. They are as follows:

(1) Class 1: Comerica Bank, secured.

(2) Class 2: Private Bank, secured.

(3) Class 3: Secured claim of Oakland County Tax Collector.

(4) Class 4: Betty Henderson Trust, secured.

(5) Class 5: Claim of Theodora Henderson, the Debtor's ex-wife, unsecured.

(6) Class 6: Claim of Van Buren and 6700 Development, unsecured.

(7) Class 7: Administrative convenience claims with a cap of $20,000, unsecured.

(8) Class 8: Claims of ex-employees of DCT, unsecured.

(9) Class 9: Other general unsecured creditors.

(10) Class 10: Debtor's interest in properties.

As noted earlier, the Debtor settled all secured claims, thus, there are no longer any secured claims dealt with under the Plan. The claim of Theodora Henderson in Class 5 is unimpaired. The claims set forth in Class 6 (Van Buren and 6700 Development), Class 7 (Convenience class), Class 8 (Ex-employees of DCT), and Class 9 (Other unsecured creditors), are all impaired under the Plan.

The Debtor obtained an affirmative vote of acceptance of the Third Amended Plan, as modified, by all impaired classes except the Objectors. At that time, the Plan submitted to unsecured creditors in Class 8 provided a dividend of 10% on their allowed claims. The latest modification to the Plan has reduced the Class 8 dividend to 5%. The modification to the Plan was not formally submitted to the affected creditors, thus, did not allow them the opportunity to consider the change provided for by the modification. However, it is now represented to this Court by counsel for the Debtor that he has obtained a unanimous acceptance of this change from the attorney repre-

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senting the creditors in Class 8. On December 27, 2004, counsel for the Debtor electronically filed an email exchange between himself and the attorney representing the creditors in Class 8, indicating that the members of the class accepted the modified treatments of their claims by reducing the dividend from 10% to 5%.

The Objectors, who are in Class 6, were originally offered two alternative treatments of their claims. Under Alternative (A) of the Third Amended Plan, as modified, Mrs. Henderson offered to transfer title to a residential home described as the Heron Ridge property located in Michigan, and a land contract with the current occupants of the residence identified as the Abrahams, to the Objectors. Under Alternative (A), the Objectors will have to pay the sum of $2 million to Mrs. Henderson and, in turn, the Objectors will receive title to the Heron Ridge property and the assignment of Mrs. Henderson's rights under the land contract to sell the property to the Abrahams for $2.7 million within one year. In addition, the Debtor also offered to pay to the Objectors $150,000 one year after the effective date of the Plan.

It should be noted that at one time the Objectors indicated their willingness to purchase the Heron Ridge property for the sum of $2,800,500. The Objectors rejected Alternative (A) due to the highly ***554** speculative premise that the Abrahams will exercise their option to purchase the Heron Ridge property and will pay to the Objectors $2.7 million. The rejection of this proposition is fully justified.

In the Third Amended Plan, as modified, Alternative (B) offered the Objectors $800,000 cash subject to an escrow arrangement until all appeals involving this Court's Orders on allowances of the claims of the Objectors are exhausted. In short, the $800,000 will be kept in escrow and not released to the Objectors until the Debtor loses the appeal and, thus, the claims of the Objectors are allowed with finality. In addition, under Alternative (B) the Debtor offers 40% on the net proceeds he hopes to receive from litigation brought by the Debtor against J.E. Myles, Inc., J.E. Myles and Scott Myles his former business associates. The Objectors have also rejected Alternative (B) of the Third Amended Plan.

FEASIBILITY OF THE THIRD AMENDED PLAN, AS MODIFIED

[1] In order to meet the requirement of Section 1129(a)(11) of the Code as to feasibility of the Third Amended Plan, as modified, the Debtor offered to contribute funds he may receive from the sale of his 16.39% interest in the Fort Wayne Wizards, a minor league baseball team. However, the Debtor is willing to contribute his interest only to the extent that such payment is needed to meet the payment of $800,000 under Alternative (B) which will be held in escrow.

In addition, the Debtor proposed that he will borrow $490,000 from Comerica Bank and grant a mortgage to Comerica on his Niblick Lane Homestead as security on this loan and use the loan proceeds to partially fund Alternative (B). The Debtor will also use the $271,000 which is currently in escrow and earmarked for the payment of allowed unsecured claims and some administrative expenses, other than the allowed claims of the Objectors, to partially fund Alternative (B). In this connection, it should be noted that the Debtor does not propose to pay the administrative expenses in full because the administrative claimants agreed to the reduction of their claims and also agreed to take their payments over time. The payment due to the administrative claimants under the Plan will be secured by a second mortgage on the Niblick Lane Homestead. As additional funding for the Plan, Mrs. Henderson agreed to contribute 75% of the $700,000 in funds she expects to receive under the land contract from the Abrahams on August 31, 2005, for a total of $525,000 to fund the Plan.

At the conclusion of the confirmation hearing, this Court announced that based on the evidence it was satisfied that the Third Amended Plan, as modified, met the requirements of Section 1129(a)(1)(2)(3) and (11) of the Code. However, due to the total lack of persuasive evidence to establish the extent of the Debtor's interest in the Wizards, this Court stated that it was impossible to determine, based on this record, whether the Plan meets the requirements of Section 1129(a)(7)(the best interest test). This Court also indicated that the corollary of this issue which involves the new value to be contributed to the finding of the Plan by Mrs. Henderson, is sufficient to meet the requirements of the best interest test of Section 1129(a)(7).

SECTION 1129(a)(7) (BEST INTEREST OF CREDITORS)

The Debtor intends to retain his interest in the following non-exempt assets.

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(Cite as: 321 B.R. 550)

ASSET VALUE	*FMV*	*LIQUIDATION*
Wizards (16.39%)(D)1	$200,000	$100,000
K & G Note (D)2	$ 50,000	$ 10,000
Technology Partners (D)3	$ 10,000	$ 5,000
Golf Membership. Oakland Hills Country Club(D)4	$ 31,000	$ 31,000
State of Michigan. Tax Refund (J)5	$ 23,500	$ 23,500
Art Work (J)6	$ 50,000	$ 20,000
Stock in First Internet Bank(D)7	$ 20,000	$ 10,000
Park Place in Beaver Creek, Colorado(J)8	$ 10,000	$ 5,000
Jewelry9	$ 6,000	$ 3,000
2000 Ford F-150 **Truck (D)**	**$ 10,100**	**$ 5,000**
Totals	**$410,600**	**$212,500**

*555 Assuming that the Debtor's interest in the Wizards is $100,000 the total liquidation value of the non-exempt assets are approximately $212,500. On the other hand if the Debtor's interest in the Wizards is as high as $800,000, the total liquidation value of the non-exempt assets, is approximately $912,500.

As noted earlier, under Alternative (B) the Debtor proposed to contribute to the Plan some funds from the proceeds he will receive upon the sale of the Wizards. However, this contribution is limited to the amount needed to meet the requirement to pay $800,000 into the Plan.

In order to properly evaluate the Debtor's interest in the Wizards, a brief recap of the Debtor's involvement with the Wizards should be helpful. The Fort Wayne Wizards, LLC, (LLC) is a limited liability company in which the Debtor holds a 16.39% interest. The LLC acquired the minor league franchise team for $4,750,000. The purchase price of the team was partially financed by a loan obtained from Comerica and partially paid for by cash invested by the members in the LLC. The Debtor paid $500,000 for his fractional interest in the LLC. The Comerica loan was secured by the members of the LLC with pledges of their respective ownership interest in the LLC

as collateral for the loan. The term of the loan was for five years and the current balance is approximately $940,000.

Since the formation of the LLC, there has been only one change in the membership when one of the members, Mr. Cherney, sold his 8.2% interest to Mr. Montrose. The membership interest was sold "as is" subject to the security interest of Comerica. Mr. Cherney received all proceeds of the sale. Contrary to the intimation of the Debtor that if his membership interest is sold in the LLC he will not receive any net proceeds because of the outstanding security interest of Comerica, this is not supported by the record nor would it make any economic sense.

Andrew Appleby (Appleby), who holds a fractional membership interest in the Fort Wayne Wizards, LLC, manages the team. The Debtor testified that his valuation of his interest in the LLC was based on an offer he allegedly received to sell his interest to the "majority owner for $100,000." The underpinning of the valuation of the Debtor of his interest in the LLC is none for the following reasons. First, the so-called offer was received not from a majority owner but from Appleby, whose interest in the LLC was even less than the percentage of the fractional interest of the Debtor. Secondly, there are no majority owners and the fact of the matter is that the Debtor's 16.39% is the largest fractional interest in the LLC. Lastly, Appleby denies that he made any offer to purchase the Debtor's interest and stated in his deposition that the amount discussed was merely mentioned as part of a non-specific general conversation concerning the possible sale of the entire team. Appleby denied that he made a firm offer to purchase the Debtor's interest for $100,000 and the number was merely a range they discussed when valuing the Debtor's interest in the LLC.

Appleby considered the possible sale of the team. In this connection, Appleby mentioned he received two letters of intent indicating an offer to purchase the franchise***556** for a purchase price of $6 million to $7 million. However, neither of the offers has been consummated since neither potential buyer had the necessary financing. Whether they would be able to obtain the needed financing is an unanswered question. Appleby conceded the possible sale of the team is just a hope, an expectation, and a fervent wish which he hopes might turn into reality, possibly within six months. He further stated that if the team is sold the Debtor might receive approximately $800,000 for his interest. Appleby conceded that this is speculation at this time.

The Objectors, relying on the $800,000 estimate of the Debtor's interest in the LLC, contend that unless the Debtor is willing to devote all proceeds the Debtor receives for his interest of the sale of the Wizards to the funding of his Third Amended Plan, as modified, the Plan of Reorganization cannot be confirmed.

While there is no hard evidence in this record to support either the $100,000 value placed on the Debtor's fractional interest by the Debtor or the $800,000 estimated value of that interest by Appleby, in either case, the Debtor's proposal to deal with this non-exempt asset as currently proposed is unacceptable because it fails to meet the requirement of Section 1129(a)(7). Thus, unless the Debtor is willing to modify Alternative (B) by providing for the contribution to the Plan of all net proceeds he might realize from the sale of the Wizards the Plan as currently structured cannot be confirmed.

Be that as it may, it appears that there is a possibility that the Wizards will be sold and the Debtor certainly would receive a monetary return for his membership interest. This interest is non-exempt, and there is no reason or justification why the total amount the Debtor will receive for his interest of the sale of the Wizards consummated prior to the closing of the estate, should not be devoted to fund the Plan.

The Objectors also point out that the Debtor intends to retain 60% of the proceeds hopefully to be realized from a suit filed by the Debtor against his former business partners. The value of this lawsuit is more questionable than the value of the Wizards discussed earlier. First, there is nothing in this record which sheds any light on a likelihood of success of this litigation. Secondly, there is no evidence to establish the ability to collect on a judgment if the Debtor prevails in this litigation. Thus, the Debtor's willingness to contribute 40% of the net proceeds from this litigation to fund the Plan is just as meaningless as the Objector's charge that the Debtor's failure to contribute all proceeds of the lawsuit to fund this Plan is an additional ground to deny confirmation.

The next non-exempt asset the Debtor intends to retain is his interest in artwork. The Debtor valued his interest in the artwork at $50,000 to $100,000. The Objectors place great reliance on the fact that the Debtor transferred part of his interest in the artwork to his wife postpetition without leave of Court. This, according to the Objectors, was a voidable transfer under Section 549 of the Code.

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To consider the significance of the transfer in a vacuum certainly would permit the conclusion that the transfer is voidable under Section 549. However, to view this transfer holistically and not in a vacuum, the transfer assumes a far less significance than attributed to it by the Objectors. This is so because if the transfer is voided and the artwork in question is put back in the estate of the Debtor, the value of the artwork will be included in the non-exempt properties which the Debtor intends to retain, which then will only be relevant when one considers the best interest of ***557** creditors test. On the other hand, if the wife retains the artwork transferred by the Debtor and pays an amount equal to the value of the artwork in question, the postpetition transfer is of no consequence. Whether a Trustee could realize that amount in Chapter 7 liquidation is highly questionable. This Court knows from experience that the results generally obtained by Trustees in Chapter 7 sales are only a fraction of the true value of the property sold.

In the present instance, the total amount of allowed priority administrative claims is greater than what a Trustee in a Chapter 7 could realize from the sale of the non-exempt assets involved.

Based on the foregoing, this Court is satisfied that the Alternative (B) of the Third Amended Plan, as modified, more than meets the requirements of Section 1129(a)(7)(A)(ii) provided, however, the Debtor is willing to devote all proceeds that he might obtain from the sale of the Wizards to the funding of the Plan. This is so because under the Plan each holder of an allowed claim will receive a dividend of between 35 and 40 percent and under a Chapter 7 they will not receive any dividend whatsoever. Thus, this Court is satisfied that Alternative (B) of the Third Amended Plan, as modified, with the additional change concerning the Debtor's interest in the sale of the Wizards, meets the requirements of Section 1129(a)(7) and it is in the best interest of the creditors. Accordingly, this Court is satisfied that if Alternative (B) is further modified by the Debtor to provide that the Debtor will contribute all net recovery from the sale of his interest in the Wizards and all net recovery from the lawsuit described earlier filed by the Debtor against his former business associates, that the Plan is fair and equitable and it meets the requirements of Section 1129(b)(2).

In addition to the foregoing, there is a more overriding and crucial issue that has to be resolved which relates to the Plan which, according to the Objectors, violates the "absolute priority rule" set forth in Section 1129(b)(2)(B)(ii).

ASSET VALUE	*FMV*	*LIQUIDATION*
Niblick		
Homestead(D)I	$3,400,000	$2,000,000
Cash Value of Insurance in a Second to Die Policy (J)II	$ 22,000	$ 22,000
Individual Retirement Account (D)III	$ 115,000	$ 115,000
Total	$3,536,	$2,137,000

ABSOLUTE PRIORITY RULE § 1129(b)(2)(B)(ii)

[2] In order to overcome the last and, obviously, the major obstacle to confirmation of the Plan is the fact that the Debtor intends to retain substantial amounts of exempt properties valued at $3,536,000 fair market value, with a liquidation value of $2,137,000. This, according to the Objectors, violates Section 1129(b)(2)(B)(ii), the absolute priority rule of the Bankruptcy Code.

It is without dispute that the Debtor intends to retain his interest in the following properties which he claims to be exempt.

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[3] It is the contention of the Objectors that the Debtor's unwillingness to contribute his exempt properties to the Plan as much as necessary to fully satisfy their claims means that the Plan cannot be confirmed because it violates the absolute priority rule. This Rule requires that a plan cannot be confirmed over the objection of a dissenting class unless a Debtor is able to persuade the Court that a plan is fair and equitable. Section 1129(b)(2)(B)(ii) of the Code defines the term fair and equitable and provides:

(C) With respect to a class of unsecured claims-

> (ii) the holder of any claim or interest that is junior to the claims of such class ***558** will not receive or retain under the plan on account of such junior claim or interest any property.

[4] It is without question, as noted earlier, in the present instance that the Debtor intends to retain all properties he claims as exempt. It is equally clear that if a Debtor claims an exemption, in the absence of any objection to the claim, the exemption is allowed as a matter of law. *See Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992). Since the unsecured dissenting class does not receive a full satisfaction of their claims under the Third Amended Plan, as modified, and the Debtor retains all of these exempt properties, it appears that under a strict interpretation of Section 1129(b)(2)(B)(ii), this Plan cannot be confirmed as it violates the absolute priority rule. *See, In re Yasparro*, 100 B.R. 91 (Bankr.M.D.Fla.1989); *In re Johnson*, 101 B.R. 307 (Bankr.M.D.Fla.1989); *In re Gosman*, 282 B.R. 45 (Bankr.S.D.Fla.2002).

In order to overcome the impact of the decision supporting this approach and representing the controlling legal principles and the proper representation of law in this District, the Debtor contends that the absolute priority rule should not be applicable in a case of an individual in a Chapter 11 case, and should be limited and applied only to the retention of equity interest in entities. In support of this proposition, the Debtor contends that Section 1129(b)(2)(B)(ii) does not apply to individual Debtors for the following reasons.

> (1) A contrary conclusion is antithetical to the purpose of exemptions;
>
> (2) There is no such thing as an "interest" in an Individual;
>
> (3) The Debtor's Interest in Exempt Property is Senior to Interests of Creditors;
>
> (4) Exemptions are not "on account of" Debtor's Interest;
>
> (5) A Chapter 11 Debtor should bear no greater burden than a Chapter 13 or Chapter 7 Debtor.

[5] The Debtor's right to claim exemptions is governed by Section 522 of the Code. This Section is applicable to all operating Chapters including a Chapter 11 case, if the Debtor is an individual. It is beyond peradventure that individual Debtors are eligible for relief under Chapter 11. *See Toibb v. Radloff*, 501 U.S. 157, 166, 111 S.Ct. 2197, 2202, 115 L.Ed.2d 145 (1991). It is equally clear the Debtor's right to claim exemption under Chapter 11 is expressly recognized by 11 U.S.C. § 1123(c) of the Code. This Section provides that, "... a plan proposed by an entity other than the debtor may not provide for a use, sale, and lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale or lease."

It is clear from the foregoing that the Debtor's right to retain exempt properties is unaffected by Section 1129(b)(2)(B)(ii), because creditors cannot subject a Debtor's exempt property to an involuntary liquidation. However, it is contended that to impose the condition on a Debtor to forfeit some or all of his exempt properties is warranted because if a Debtor were permitted to retain exempt properties without giving maximum satisfaction to the impaired creditors, it would violate the absolute priority rule. Therefore, to give up the exempt properties voluntarily is a price that the Debtor has to pay at times in order to be able to use the cramdown provisions to obtain confirmation of a plan.

It is the contention of the Debtor, notwithstanding the holdings of the cases cited above that, in any event, Section 1129(b)(2)(B)(ii) does not apply to a case of an individual in a Chapter 11 case for the following reasons.

***559** In order to support the proposition that the absolute priority rule does not apply to a case of an individual in a Chapter 11, the Debtor equates his Chapter 11 case with

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non-profit entity cases and relies on an approach of two Courts of Appeal who are faced with application of the absolute priority rule as applied to non-business entities who are seeking confirmation of plans of reorganization. *In re General Teamsters, Warehousemen and Helpers Union Local 890*, 265 F.3d 869, 872 (9th Cir.2001)(*Teamsters*) and *In re Wabash Valley Power Assoc'n, Inc.*, 72 F.3d 1305, 1313 (7th Cir.1995), *cert. denied*, 519 U.S. 965, 117 S.Ct. 389, 136 L.Ed.2d 305 (1996)(*Wabash*).

In *Wabash*, the Seventh Circuit discussed the origin and current application of the absolute priority rule and stated as follows:

The most significant obstacle to confirmation of the Wabash Plan is the question of its compliance with the "absolute priority rule." As codified for the first time in the Bankruptcy Code, the rule provides that, in order for a bankruptcy plan to be approved in the face of the refusal of an unsecured creditor to accept it ("a cramdown"), the holder of any claim or interest junior to that of the dissenter may not "receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii).

[6] The rule thus stated has three components: (1) the identification of junior claims or interests; (2) the identification of any property retained by the holders of such claims or interests; and (3) the determination whether the property is retained "on account of" a junior claim or interest. The term "interest" in this context means equity interest....

In adopting the rationale of *Wabash*, the Ninth Circuit, in *Teamsters, supra*, at 873-84 stated:

> The absolute priority rule is generally applied to for-profit corporations facing bankruptcy, where an equity owner seeks to retain property, often represented by stock.... The only apparent circuit decisions to deal directly with the issue of whether entities affiliated with not-for-profit organization have equity interest for purpose of the absolute priority rule held that they did not because the essence of an equity interest was an owner or an interest in the organization's profits. *See Wabash*, 72 F.3d at 1318-19.

The Debtor and Mrs. Henderson urge the word "interest" means only an equity interest in the Debtor's estate. The Debtor further states that the term "interest" refers to "equity security holders," and not an individual ownership of "any property," as used throughout Chapter 11. *See Wabash* at 1313 ("[t]he term 'interest' in this context means equity interest").

[7] By logic one cannot refer to as the ownership of the interest of the Debtor in his exempt property as an interest in his estate. Once the exemptions are allowed the properties are no longer part of the Debtor's estate, and the Debtor does not retain property on account of such interest because he retains it as a matter of right by virtue of recognition of his right to exemptions. While it may be contended that if exempt property is not subject to the absolute priority rule this rule should equally apply to other properties of an individual Debtor. The difficulty with the logic of this argument should be evident when one considers the axiomatic fact that exempt property, once allowed, is no longer property of the Debtor's estate, but nonexempt properties are properties of a Debtor's estate.

[8] The ordinary meaning of the term "junior" means a claim or interest that is ***560** subordinate to other claims or interests which enjoy a higher rank. The word "junior" defined in Black's Law Dictionary, at p. 851 (6th Ed.1990), as "[a] legal right which is subordinate to another's right as applied to property..." The same meaning of "junior" is applied throughout the entire Bankruptcy Code. It is clear that the Debtor's interest in exempt property can never be junior to the interest of creditor's including the claim of dissenting unsecured creditors. This is so because unsecured creditors could never reach exempt property outside of bankruptcy, and such properties are immune and not subject to liquidation under any of the operating Chapters of the Code.

Section 522 (c) of the Code provides, in pertinent part, "...property exempted under this Section is not liable during or after the case for any debt of the debtor that arose ...before the commencement of the case...." Giving unsecured creditors in a dissenting class veto power over a plan requiring exempt property to be given to such creditor's, is an incorrect reading of the Bankruptcy Code.

The Objectors point out, however, that it is unconscionable to permit an individual Debtor like the Debtor in this case to retain substantial exempt properties, close to $4,000,000, without offering a full satisfaction of allowed claims of unsecured creditors, particularly the claims of the Objectors. To carry this argument to its logical extreme would mean that no individual Debtor could retain

any exempt property unless he or she were willing to forfeit all right to exemptions, including exemption for the family home and, as a result, be thrown into abject poverty in order to get confirmation and a fresh start in life unencumbered and freed from the financial vicissitude of his pre-filing past. The fact that the residence of the Debtor in this instance is valued in excess of $3,000,000 should not make any difference.

In sum, the bottom line is that it could not have been and was not the intention of Congress in enacting the absolute priority rule to compel a Debtor to forfeit his exemption rights, notwithstanding that they are uniformly recognized throughout all operating Chapters of the Code. While this result might be appalling in certain instances, the creditors are not without remedy. They could seek a denial of confirmation of a plan proposed by the Debtor whose plan is an attempt to abuse the system by obtaining a denial of confirmation on the basis that the plan failed to comply with Section 1129(a), which requires confirmation of a plan that is proposed in good faith.

Even assuming without conceding that the absolute priority rule applies to Chapter 11 cases involving individuals, the "new value" exception has been recognized by Courts that considered the application of the absolute priority rule. *See Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607(1999); *In re Elmwood, Inc.*, 182 B.R. 845(D.Nev.1995);

Thus, in reorganization of a "business," old equity still may succeed in keeping hold of the corporation, partnership, LLC or presumably, the sole proprietorship. These kinds of equity security holders, by providing new value in the form of money or money's worth necessary for the Debtor to survive, and reasonably equivalent to the participation of the equity security holder's interest in the venture, may retain an interest therein. Any confirmable plan would have to include some exempt property to be better than Chapter 7 liquidation.

In an individual wage earner Chapter 11 case, there is more reason to permit the ***561** individual Debtor "new value" to achieve a cramdown over a dissenting class. An individual Chapter 11 Debtor who is not a sole proprietor should be able to confirm a plan that is "fair and equitable" to dissenting creditors, without a total liquidation of all his assets.

In the present instance, as noted earlier, the Debtor intends to retain non-exempt property and this provision would no doubt violate the absolute priority rule and would prevent confirmation of the Third Amended Plan, as modified, unless the Debtor submits sufficient "new value" to match or exceed the value of the non-exempt properties retained. As noted earlier, Mrs. Henderson, the non-Debtor wife, would contribute 75% of the proceeds to the Land Contract payment due from the Abrahams on August 31, 2005, in the amount of $525,000 to fund the Plan. The value of the total of the non-exempt assets to be retained by the Debtor is approximately $410,600 at fair market evaluation and has an approximate liquidation value of $212,500. These amounts include the valuation placed by the Debtor on the Wizards and, of course, an amount substantially less than the possible $800,000 value of interest placed on the Wizards by Appleby.

Since this Court already stated that the Debtor must devote all the proceeds from the sale of the Wizards to fund the Plan, the actual value of the Wizards is not relevant. Further, the new value cash contribution by Mrs. Henderson clearly exceeds the value of the non-exempt properties the Debtor intends to retain.

[9] This Court in not unmindful that a Judge of this District in the case of *In re Yasparro, supra,* that if an individual debtor retained exempt property under the plan, the plan violates the absolute priority rule unless all creditors receive full and complete satisfaction of their claims. *See also, In re Gosman, supra.* This Court is constrained to reject the holdings of both *In re Yasparro,* and *In re Gosman,* and is satisfied that the individual debtor does not have to forfeit his exemption rights to which the debtor is otherwise entitled to in all operating Chapters of the Code as a price of obtaining confirmation of his or her plan of reorganization. See *In re Egan*, 142 B.R. 730, 733 (Bankr.E.D.Pa.1992); *In re Shin*, 306 B.R. 397, 404 n. 17 (Bankr.Dist.Col.2004).

Based on the foregoing conclusions, this Court is satisfied that Alternative (B) of the Third Amended Plan, as modified, with the requirements of the further modification, does meet all the requirements of Section 1129(a), and it does not violate the absolute priority rule. Therefore,

Alternative (B) of the Third amended Plan, as modified, if it includes the provision of devoting the Debtor's entire interest in the Wizards, meets all requirements of Section 1129(a) of the Code, and it is fair and equitable and therefore, shall be confirmed, notwithstanding the dissenting vote of the creditors in Class 6, Van Buren Industrial In-

vestors, LLC and 6700 Development Associates, LLC.

Accordingly, it is

ORDERED, ADJUDGED AND DECREED that the Alternative (B) of the Third Amended Plan, as modified, be, and the same is hereby, confirmed provided that the Debtor is willing to contribute all of the proceeds, if any, in the sale of his interest in the Wizards to the funding of the Plan, and that the Debtor is willing to contribute the net proceeds, if any, to the funding of the Plan from the lawsuit filed against his former business associates, J.E. Myles, Inc., J.E. Myles, and Scott Myles (Adversary No: 04-504)

Bkrtcy.M.D.Fla.,2005.
In re Henderson
321 B.R. 550, 54 Collier Bankr.Cas.2d 65, 18 Fla. L. Weekly Fed. B 139

END OF DOCUMENT

358 B.R. 541, 47 Bankr.Ct.Dec. 183, Bankr. L. Rep. P 80,836
(Cite as: 358 B.R. 541)

C

United States Bankruptcy Court,
D. Connecticut.
In re Daniel A. BULLARD, Debtor.
No. 06-30051(LMW).

Jan. 16, 2007.

Background: After converting his case from one under Chapter 7, debtor filed proposed Chapter 11 reorganization plan.

Holdings: The Bankruptcy Court, Lorraine Murphy Weil, J., held that:
(1) debtor's postpetition income and vehicle fell within purview of statute identifying property that could be retained by individual debtor seeking plan confirmation despite failure of impaired class of unsecured creditors to accept plan, and
(2) plan could be confirmed despite debtor's retention of exempt property.

Plan confirmed.

West Headnotes

[1] Bankruptcy 51 ⚿3548.1

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3548 Requisites of Confirmable Plan
51k3548.1 k. In General. Most Cited Cases
Income acquired from Chapter 11 debtor's postpetition business activities as life insurance agent and automobile acquired by debtor postpetition fell within purview of statute identifying property that could be retained by individual Chapter 11 debtor seeking plan confirmation notwithstanding failure of impaired class of unsecured creditors to accept plan, and therefore debtor's retention of income and vehicle was not impediment to plan confirmation. 11 U.S.C.A. §§ 1115(a), 1129(b)(2)(B)(ii).

[2] Bankruptcy 51 ⚿3565

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3563 Fairness and Equity; "Cram Down."
51k3565 k. Unsecured Creditors and Equity Holders, Protection Of. Most Cited Cases
Chapter 11 plan could be confirmed notwithstanding failure of impaired class of unsecured creditors to accept plan, pursuant to Bankruptcy Code's "cram-down" provisions, even though debtor retained his property claimed as exempt, inasmuch as such retention was not "on account of" debtor's junior interest in property. 11 U.S.C.A. § 1129(b)(2)(B)(ii).
***541** Carl T. Gulliver, Esq., Coan, Lewendon, Gulliver & Miltenberger LLC, New Haven, CT, Attorney for the Debtor.

Holley L. Claiborn, Esq., Office of the United States Trustee, New Haven, CT, Attorney for the United States Trustee.

***542 MEMORANDUM OF DECISION RE: SATISFACTION OF 11 U.S.C. § 1129(b)(2)(B)(ii)**

LORRAINE MURPHY WEIL, Bankruptcy Judge.

The matter before the court is confirmation of the above-referenced debtor's (the "Debtor") First Amended Plan of Reorganization (Doc. I.D. No. 77, the "Plan").[FN1] The court has jurisdiction over this matter as a core proceeding pursuant to 28 U.S.C. §§ 157 and 1334 and that certain Order dated September 21, 1984 of the District Court (Daly, C.J.).[FN2] This memorandum constitutes the findings of fact and conclusions of law mandated by Rule 7052 of the Federal Rules of Bankruptcy Procedure (made applicable herein by Rule 9014 of the Federal Rules of Bankruptcy Procedure).

FN1. References herein to the docket of this case appear in the following form: "Doc. I.D. No.____."

FN2. That order referred to the "Bankruptcy Judges for this District" "all cases under Ti-

358 B.R. 541, 47 Bankr.Ct.Dec. 183, Bankr. L. Rep. P 80,836
(Cite as: 358 B.R. 541)

tle 11, U.S.C., and all proceedings arising under Title 11, U.S.C., or arising in or related to a case under Title 11, U.S.C...."

1. *BACKGROUND*

This case was commenced as a chapter 7 case on January 20, 2006.[FN3] The Debtor filed a full set of schedules and a Statement of Financial Affairs with his chapter 7 petition. (*See* Doc. I.D. No. 1, collectively, the "Original Schedules.") [FN4] The Debtor filed a motion to convert the case to a chapter 11 reorganization on February 28, 2006 (*see* Doc. I.D. No. 15) and an order so converting the case was issued on March 6, 2006 (*see* Doc. I.D. No. 19).

FN3. Accordingly, the amendments to the Bankruptcy Code effectuated by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") apply to this case.

FN4. The Original Schedules have been amended twice: once on January 27, 2006 (with service of the same on January 29, 2006) (*see* Doc. I.D. Nos. 11, 13) and again on October 30, 2006 (with service on the same date) (*see* Doc. I.D. Nos. 103, 104). No objection to the Original Schedules (as so amended, collectively, the "Amended Schedules") have been filed and the exemptions claimed therein are deemed effective. *See* Fed. R. Bankr.P. 4003(b).

The Debtor filed the First Amended Disclosure Statement and the Plan on August 15, 2006. (*See* Doc. I.D. Nos. 76, 77.) The referenced disclosure statement was approved by an order issued on August 24, 2006. (*See* Doc. I.D. No. 85.) The Plan provides for seven classes of "creditors": four classes of secured creditors; two classes of unsecured creditors and an "equity" class composed of the Debtor himself. Class 5 is a "convenience class" of unsecured creditors. Class 6 is the balance of the class of general unsecured creditors. (*See* Doc. I.D. No. 77).[FN5] The Plan proposes to treat Class 5 and 6 as follows: Class 5 creditors are to receive their pro rata share of $3,350.00 (about a 10% dividend); Class 6 creditors are to receive their pro rata share of $24,840.00 over three years (about an 11.9% dividend). The Plan contemplates that the Debtor would retain income (the "Postpetition Income") from his postpetition business activities,[FN6] an automobile (the "Automobile") acquired postpetition and assets (the "Exempt Assets") claimed as exempt pursuant to the Amended Schedules. (*See* Doc. I.D. No. 105 (Debtor's Support Brief) ***543** at 9.) [FN7]

FN5. Class 5 is comprised of approximately $33,500.00 in face amount of claims and Class 6 is comprised of approximately $208,895.00 in face amount of claims. (*See* Doc. I.D. No. 77 (Plan, Article V).)

FN6. The Debtor is an independent life insurance agent. (*See* Doc. I.D. No. 76 at 4.)

FN7. Under the circumstances present here, neither the nature nor the value of the personal property comprising the Exempt Assets suggest that the Debtor is not in good faith with respect to the Plan.

The classes of secured creditors either voted in support of the Plan or were deemed to have so voted pursuant to Bankruptcy Code § 1126(f). (*See* Doc. I.D. No. 107 (Revised and Corrected Report on Ballots and Administrative Expenses).) Neither Class 5 nor 6 voted to accept the Plan. (*See id.*) No objections to Plan confirmation were filed. A hearing (the "Hearing") on Plan confirmation was held on October 11, 2006. The Debtor testified at the Hearing in support of Plan confirmation.

At the conclusion of the Hearing, the court concluded that all requirements for Plan confirmation had been satisfied pursuant to Bankruptcy Code § 1129(a) except for Section 1129(a)(8) (because there were two nonaccepting impaired classes). The court took under advisement whether the Debtor could "cram down" Classes 5 and 6 under Section 1 129(b)(2)(B) and requested the Debtor's counsel to brief the issue.[FN8] That brief has been submitted and the matter is ripe for decision.

FN8. Unlike Section 1129(a)(15) which is triggered only if a creditor objects to plan confirmation, Section 1129(b) requires a court to find compliance therewith even if a nonaccepting class of impaired creditors does not object to plan confirmation.

358 B.R. 541, 47 Bankr.Ct.Dec. 183, Bankr. L. Rep. P 80,836
(Cite as: 358 B.R. 541)

II. ***ANALYSIS***

The "absolute priority rule" long has been one of the bedrock principles of reorganization law. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988). With respect to a class of unsecured creditors, the "absolute priority rule" now is codified at Section 1129(b)(2)(B). Under Section 1129(b)(2)(B) (as amended by BAPCPA), if at least one class of impaired creditors has accepted the proposed plan, that plan can be confirmed notwithstanding the failure of an impaired class of unsecured creditors to accept the plan if:

> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of [Section 1129]....

11 U.S.C.A. § 1129(b)(2)(B) (West 2007). The Plan does not propose to treat Classes 5 or 6 in accordance with Section 1129(b)(2)(B)(i). Accordingly, the Plan can be confirmed only if Section 1129(b)(2)(B)(ii) is satisfied.

A. ***Section 1115***

[1] A stated exception (added to Section 1129(b)(2)(B)(ii) by BAPCPA, the "BAPCPA Exception") to the general rule of Section 1129(b)(2)(B)(ii) is that "in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of [Section 1129]." [FN9] Section 1115 provides in relevant part as follows:

> FN9. Section 1129(a)(14) requires a debtor to be current on his postpetition domestic support obligations and is not at issue here.

> ***544** (a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541-
>
> (1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and
>
> (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.
>
> 11 U.S.C.A. § 1115(a) (West 2007).

The court finds and/or concludes that the Postpetition Income and the Automobile are within the purview of Section 1115(a) and that the Debtor's retention of the same is not an impediment to Plan confirmation under Section 1129(b)(2)(B)(ii).

B. ***The Exempt Property***

[2] At the Hearing, the Debtor's counsel suggested that the BAPCPA Exception constituted a waiver of the "absolute priority rule" in its entirety for chapter 11 cases of individuals and, in light of that waiver, the Debtor's retention of the Exempt Property was not a bar to confirmation under Section 1129(b).[FN10] The Debtor now has abandoned that position and relies instead on the proposition that Section 1129(b)(2)(B)(ii) permits a debtor to retain his exempt property and still confirm a plan under Section 1129(b)'s "cram-down" provisions. For the reasons discussed above, this court agrees.

> FN10. At least one commentator has so suggested:
>
> The absolute priority requirements imposed by Code 1129(b)(2)(B)(ii) were waived by permitting a debtor to retain property included in the estate under 1115. Although 1115 was added by the 2005 Amendments to include post-

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> petition property and earnings, it also incorporates property of the estate under 541, and accordingly it is assumed that the debtor shall be entitled to retain property under 541 as well. A more narrow interpretation would cause this amendment to have little effect.
>
> 4 William L. Norton, Jr., *Norton Bankruptcy Law and Practice* § 84A:1 (2d ed.2006). The court expresses no opinion on that point. *But compare* 11 U.S.C. §§ 1129(a)(15), 1129(b)(2)(B)(ii) (post BAPCPA versions) *with In re Flor*, 166 B.R. 512 (Bankr.D.Conn.1994), *aff'd*, No. 3:94CV 1130, slip. op. (D.Conn. March 24, 1995), *appeal dismissed*, 79 F.3d 281 (2d Cir.1996) (In a case to which BAPCPA did not apply, individual could not fund his chapter 11 plan with future personal services income.)

There is disagreement among the cases concerning whether a chapter 11 debtor may retain his exempt property and still comply with Section 1129(b)(2)(B)(ii). Cases such as *In re Gosman*, 282 B.R. 45 (Bankr.S.D.Fla.2002), hold that Section 1129(b)(2)(B)(ii)'s prohibition against the debtor's retention of "any property" means that the debtor cannot comply with that subsection if he retains his exempt property. *See Gosman*, 282 B.R. at 48-52. The better line of authority holds that the debtor's retention of his exempt property does not offend Section 1129(b)(2)(B)(ii) because such retention is not "on account of ... [the debtor's] junior interest ..." in property:

> Once the exemptions are allowed the properties are no longer part of the Debtor's estate, and the Debtor does not retain property on account of such interest because he retains it as a matter of right by virtue of recognition of his right to exemptions....
>
> ***545** The ordinary meaning of the term "junior" means a claim or interest that is subordinate to other claims or interests which enjoy a higher rank. The word "junior" defined in Black's Law Dictionary, at p. 851 (6th Ed.1990), as "[a] legal right which is subordinate to another's right as applied to property ..." The same meaning of "junior" is applied throughout the entire Bankruptcy Code. It is clear that the Debtor's interest in exempt property can never be junior to the interest of creditor's [sic] including the claim of dissenting unsecured creditors. This is so because unsecured creditors could never reach exempt property outside of bankruptcy, and such properties are immune and not subject to liquidation under any of the operating Chapters of the Code.
>
> Section 522(c) of the Code provides, in pertinent part, "... property exempted under this Section is not liable during or after the case for any debt of the debtor that arose ... before the commencement of the case...." Giving unsecured creditors in a dissenting class veto power over a plan requiring exempt property to be given to such creditor's [sic], is an incorrect reading of the Bankruptcy Code.

. . . . .

While this result might be appalling in certain instances, the creditors are not without remedy. They could seek a denial of confirmation of a plan proposed by the Debtor whose plan is an attempt to abuse the system by obtaining a denial of confirmation on the basis that the plan failed to comply with Section 1129(a), which requires confirmation of a plan that is proposed in good faith.

In re Henderson, 321 B.R. 550, 559-60 (Bankr.M.D.Fla.2005), *aff'd*, 341 B.R. 783 (M.D.Fla.2006).[FN11] This court approves and adopts the foregoing rationale. Accordingly, the court concludes that the Plan can be confirmed notwithstanding that the Debtor retains the Exempt Property.

> FN11. As a respected publication observed:
>
> > When one examines the text of the statute, according to the *Gosman* court, "the core dispute ... centers on whether the term 'any property' as used in Section 1129(b)(2)(B)(ii) encompasses property which is 'exempt property.' " To ask the question in this manner, of course, is to preordain the answer (by asking the wrong question)....
> >
> > *Absolute Priority and An Individual Chapter 11 Debtor's Exempt Property:*

> *Who is Junior to Whom?*, West Bankruptcy Law Letter (October 2002) (citation omitted). Moreover, the debtor does not receive or retain exempt property "under a plan" within the purview of Section 1129(b)(2)(B)(ii) but, rather, pursuant to Bankruptcy Code § 522.

III. *CONCLUSION*

For the foregoing reasons the court concludes that the Bankruptcy Code's requirements for confirmation of the Plan have been satisfied. An order will enter confirming the Plan.

Bkrtcy.D.Conn.,2007.
In re Bullard
358 B.R. 541, 47 Bankr.Ct.Dec. 183, Bankr. L. Rep. P 80,836

END OF DOCUMENT

374 B.R. 264, 48 Bankr.Ct.Dec. 196
(Cite as: 374 B.R. 264)

United States Bankruptcy Court,
D. Kansas.
In re Jahn Eldredge ROEDEMEIER, Debtor.
No. 06-20292-11.

Aug. 16, 2007.

Background: Creditor objected to individual Chapter 11 debtor's proposed plan and disclosure statement based, inter alia, on debtor's alleged failure to satisfy "projected disposable income" requirement.

Holdings: The Bankruptcy Court, Dale L. Somers, J., held that:
(1) disclosure statement submitted by individual Chapter 11 debtor with a one-dentist dental practice did not have to provide same level of disclosure that would be warranted in medium to large Chapter 11 reorganizations in order to be approved;
(2) "projected disposable income" requirement did not apply in absence of timely objection;
(3) "means test" applied in Chapter 13 cases filed by above-median-income debtors was inapplicable in bankruptcy case filed by individual Chapter 11 debtor, for purpose of deciding whether debtor's proposed plan complied with "projected disposable income" requirement; and
(4) exception to "absolute priority rule" in Chapter 11 cases filed by individual debtors had to be interpreted broadly as permitting debtor to retain his interest in dental practice despite fact that unsecured creditors would receive only a 3% distribution on their claims.

Objections overruled; disclosure statement approved; plan confirmed.

West Headnotes

[1] Bankruptcy 51 ⚿3539.1

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3539 Disclosure and Solicitation
51k3539.1 k. In General. Most Cited Cases

Disclosure statement submitted by individual Chapter 11 debtor with a one-dentist dental practice did not have to provide same level of disclosure that would be warranted in medium to large Chapter 11 reorganizations in order to be approved, and where debtor's disclosure statement described debtor's business and its history, contained financial information, outlined contents of plan and facts respecting its execution, contained liquidation analysis, identified management and its compensation and any transactions with insiders, and described tax consequences of plan in manner sufficient to allow unsecured creditors to make an informed judgment about plan, disclosure statement did all that was required under the Code and would be approved.

[2] Bankruptcy 51 ⚿3564

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3563 Fairness and Equity; "Cram Down."
51k3564 k. Secured Creditors, Protection Of. Most Cited Cases
Creditor whose claim was not secured by any property of individual Chapter 11 debtor or his dental practice did not have to be treated as secured creditor in debtor's plan, though creditor's claim may have been secured by other property.

[3] Bankruptcy 51 ⚿3565

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3563 Fairness and Equity; "Cram Down."
51k3565 k. Unsecured Creditors and Equity Holders, Protection Of. Most Cited Cases

Bankruptcy 51 ⚿3566.1

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3566 Confirmation; Objections

51k3566.1 k. In General. Most Cited Cases
"Projected disposable income" requirement enacted, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), for individual Chapter 11 debtors did not apply in absence of timely objection by unsecured creditor to such an individual debtor's proposed Chapter 11 plan. 11 U.S.C.A. § 1129(a)(15)(B).

|4| Bankruptcy 51 ⚿3565

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3563 Fairness and Equity; "Cram Down."
51k3565 k. Unsecured Creditors and Equity Holders, Protection Of. Most Cited Cases
"Means test" applied in Chapter 13 cases filed by above-median-income debtors, to determine the reasonably necessary expenses that such debtors are entitled to deduct in calculating the "projected disposable income" available for payment of unsecured creditors under their plans, was inapplicable in bankruptcy case filed by individual Chapter 11 debtor, for purpose of deciding whether debtor's proposed plan complied with "projected disposable income" requirement, even assuming that unsecured creditor had timely objected to debtor's plan and thereby triggered this "projected disposable income" requirement; reasonably necessary expenses for individual Chapter 11 debtor and debtor's dependents had to be judicially determined, without resort to the "means test" that would have been applicable in case filed under Chapter 13. 11 U.S.C.A. § 1129(a)(15)(B).

|5| Bankruptcy 51 ⚿3552

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3548 Requisites of Confirmable Plan
51k3552 k. Equality of Treatment Within Classes. Most Cited Cases
Requirement, as prerequisite to the "cramdown" of Chapter 11 plan over the objection of a dissenting, impaired class, that plan not discriminate unfairly was concerned only with differing treatment among classes of same priority, and was satisfied by proposed Chapter 11 plan that placed all general unsecured creditors in a single class and thus did not discriminate at all, either fairly or unfairly. 11 U.S.C.A. § 1129(b)(1).

|6| Bankruptcy 51 ⚿3561

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3561 k. Preservation of Priority. Most Cited Cases
Exception to "absolute priority rule" in Chapter 11 cases filed by individual debtors, as adopted in the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), had to be interpreted broadly as permitting such debtors to retain both pre- and post-petition assets of estate, so as to permit individual Chapter 11 debtor to retain his interest in dental practice despite fact that unsecured creditors would receive only a 3% distribution on their claims. 11 U.S.C.A. § 1129(b)(2)(B).
***266** Joanne B. Stutz, Thomas M. Mullinix, III, Evans & Mullinix PA, Shawnee, KS, for Debtor.

OPINION APPROVING THE DEBTOR'S DISCLOSURE STATEMENT, AND CONFIRMING HIS PLAN

DALE L. SOMERS, Bankruptcy Judge.

This matter was before the Court on April 5, 2007, for a combined hearing on approval of the Debtor's disclosure statement and confirmation of his plan of reorganization. The Debtor appeared by counsel Thomas Mullinix and Joanne Stutz. Creditor Bankers Healthcare Group did not object to the plan, but did object to (1) the disclosure statement, (2) the consolidation of the hearings on approval of the disclosure statement and confirmation of the plan, and (3) the Debtor's summary of balloting. Bankers appeared by counsel Elizabeth A. Carson. Late in January 2007, the Court issued an order consolidating the hearings on approval of the disclosure statement and confirmation of the plan. On April 5, the Court heard evidence concerning the disclosure statement and the plan. On April 10, the Court issued an order resolving the balloting dispute and directing the parties to submit written closing arguments on approval of the disclosure statement and confirmation of the plan, which they have done. The Court is now ready to rule on those matters.

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(Cite as: 374 B.R. 264)

FACTS

The Debtor has been a practicing dentist since graduating from dental school in 1979. Until 1996, his practice included at least one partner-dentist, and from 1982 until 1996, the practice operated at two locations. When the Debtor's co-owner severed their relationship in 1996, the Debtor assumed all the debts of the Roedemeier-Quattrochi DDS, P.C. ("R-Q"), and continued to use its name until 2005.

R-Q had done business as College Boulevard Dental Care, first on College Boulevard and later on Antioch Road, both in Overland Park, Kansas. While that practice was doing well, the Debtor hired another dentist in June 2003 to work three days a week, and arranged for another to start working in July 2004. The Debtor also obtained a loan commitment from the Small Business Administration to move the practice to a location on Metcalf Avenue in Overland Park and to pay off the R-Q debts. When a malpractice suit was filed against him, however, the Debtor lost the SBA financing and the two other dentists left his practice. He still moved his practice, and ultimately won the malpractice suit.

In April 2005, trying to recover from the damage to R-Q's practice caused by the lawsuit, the Debtor formed Deer Creek Family Dental Care, L.L.C., and began operating his practice through that entity. A company that had financed R-Q's equipment vigorously pursued the Debtor to collect on his guarantee of R-Q's debt, and he filed a Chapter 11 bankruptcy petition in March 2006. According to the Official Bankruptcy Form 22B the Debtor completed, his "current monthly income" for the six months before he filed his petition averaged $4,953 per month.

On January 8, 2007, the Debtor filed a disclosure statement, a Chapter 11 plan, and a motion to consolidate the hearing on approval of the disclosure statement and confirmation of the plan. Bankers Healthcare Group, Inc., one of R-Q's creditors whose debt the Debtor had guaranteed, filed two objections, one objecting to the disclosure statement and the other objecting***267** to the consolidation motion.[FN1] Significantly, Bankers did not object to the Debtor's plan. The Court signed an order approving the consolidation motion, setting the consolidated hearing for April 5, 2007.

FN1. The objection to the consolidation motion is described on the docket in such a way that it appears to be an objection to the disclosure statement and plan, rather than to the consolidation motion, although the phrase "consolidation of" does appear just before Bankers Healthcare is identified as the party filing the objection. *See* Docket No. 89.

Later, the Debtor filed a "Summary of Balloting," reporting that only two votes had been received, one by the Class 4 creditor and the other by one of the Class 5 creditors, the class of general unsecured creditors. Bankers objected to the summary, claiming it had never received a ballot and asking to have the summary withdrawn or stricken from the record. This issue was taken up at the April 5 hearing, along with the questions whether to approve the Debtor's disclosure statement and whether to confirm his plan. In an order issued a short time after the hearing, the Court resolved Bankers' objection to the Debtor's balloting summary by treating Bankers as having voted against the plan, leaving Class 4 as the only impaired class that had accepted the plan. The Court noted that its ruling meant the confirmation requirement established by 11 U.S.C.A. § 1129(a)(10) that at least one impaired class accept the plan had been satisfied. In the same order, the Court gave the Debtor and Bankers time to submit written closing arguments explaining their positions about approval of the Debtor's disclosure statement, and confirmation of his plan. The parties have now submitted their arguments. The Court will make additional findings as it discusses the parties' claims.

At the hearing on April 5, 2007, the Court allowed Bankers to start the presentation of evidence, even though the Debtor had the burden to prove his disclosure statement should be approved and his plan should be confirmed. During the hearing, Bankers never objected that any of the evidence the Debtor presented was going beyond the scope of Bankers' own presentation. In its closing argument, however, it argues the Debtor "failed to present any evidence whatsoever except on rebuttal" and that this failure alone justifies denying approval of the disclosure statement and denying confirmation of the plan, citing no authority for this claim. Federal Rule of Evidence 611(a) [FN2] gives the Court broad discretion to control the presentation of evidence, and the Court is

aware of no authority suggesting that evidence presented without objection at any stage of a trial is less worthy of consideration or entitled to less weight than any other evidence. In a criminal case, the Tenth Circuit ruled that evidence submitted during rebuttal was sufficient to establish an essential element of a crime and support a conviction, even though at the close of the government's case-in-chief, the trial court had deferred ruling on the defendant's motion for acquittal. [FN3] Clearly in this civil matter, the Debtor's evidence can be sufficient to support granting the relief he is seeking even if it should be considered to have been submitted during rebuttal rather than during his case-in-chief.

FN2. *See* Fed. R. Evidence 101 & 1101 (Federal Rules of Evidence apply in proceedings before bankruptcy judges).

FN3. *United States v. Smurthwaite*, 590 F.2d 889, 891 (10th Cir.1979).

The Debtor's proposed plan of reorganization is not complicated. He wants to continue to run his dental practice through ***268** the Deer Creek entity. Deer Creek will pay its operating expenses, including payroll taxes and taxes imposed on personal property it has, and will assume obligations the Debtor incurred to National Bank of Kansas City for certain pieces of equipment, but treat the transactions as financing agreements rather than leases. Deer Creek will pay the Debtor a salary, which he will use to pay: (1) his living expenses, including first and second mortgages on his home, (2) the administrative expenses of his bankruptcy case (including his attorney fees, though Deer Creek may also pay them), (3) priority tax claims of about $73,000, and (4) five annual payments of $6,000 to be distributed pro rata among his general unsecured creditors. According to the Debtor and his expert witness, Tom J. McCann, Jr., Deer Creek will be able to generate sufficient income to allow the plan to succeed so long as it can increase its business enough to occupy two dental hygienists full time, instead of having one work full time and another part time, as the company has been doing. The Debtor is optimistic that the business can accomplish that goal and perhaps even add another dentist. Mr. McCann testified that the financial projections for Deer Creek that were attached to the disclosure statement were conservative and, based on the dental practice's history, should be achievable.

DISCUSSION

The evidence presented at the April 5 hearing left the Court with the initial impression that the Debtor's disclosure statement adequately described his plan of reorganization, and that he could be successful under the plan so long as he can continue to produce the same level of income for Deer Creek with his own services, and increase the practice enough to occupy two dental hygienists full time. There is a good chance he would be able to expand the practice more than that, making performance of the plan even easier and more certain. But Bankers raises a number of questions requiring more detailed analysis. The Debtor's request to evaluate the plan under the cramdown provisions of § 1129(b) also requires more discussion.

1. Should the Debtor's disclosure statement be approved, despite Bankers' objections?

[1] In its objection to the Debtor's disclosure statement, Bankers raised five issues: (1) the Debtor asserted an improper homestead exemption in the case; (2) the Debtor claimed to own equipment that belonged to R-Q; (3) the disclosure statement does not state what becomes of the equipment the Debtor appropriated (apparently referring to equipment that belonged to R-Q) or how that is dealt with; (4) the disclosure statement does not disclose how the Debtor plans to compensate R-Q's secured creditors or explain why those creditors should not be separately classified; and (5) the Debtor proposes to treat some of R-Q's creditors separately but not all of them, and does not indicate that this is what his plan would do. The first issue was resolved by an agreed order submitted by the Debtor and Bankers, and the second issue was resolved by the Court's order ruling the equipment still belonged to R-Q.

In Bankers' third issue, assuming it was referring only to the equipment that belonged to R-Q, Bankers has correctly pointed out that the disclosure statement does not explain what became of that equipment. The disclosure statement indicates that when he filed his Chapter 11 petition, the Debtor claimed to own the equipment, but does not indicate what happened to the equipment after the Court ruled R-Q still owned it. At the hearing, the Debtor explained that after the Court's ***269** ruling, Matsco, the R-Q creditor with a

first lien on the equipment, foreclosed on it, a friend of the Debtor's bought it at the foreclosure sale, and Deer Creek then leased or bought the equipment from the friend. Under these circumstances, the Court believes the disclosure statement should have explained the Debtor lost on his claim to own the property and Deer Creek wound up leasing it; in fact, the disclosure statement might have been more clear if it had simply left out the Debtor's ultimately unsuccessful assertion that he owned the equipment. Nevertheless, the Court does not believe this shortcoming is sufficient to make the disclosure statement inadequate.

[2] Bankers' fourth and fifth issues are not relevant to the Debtor's reorganization efforts. R-Q was a separate entity, and the Debtor has proposed dealing with its creditors only to the extent he is personally liable to them for R-Q's debts. For example, he is personally liable to the Internal Revenue Service for payroll withholding taxes ("941 taxes") that R-Q failed to pay, and he is proposing to pay that liability through his plan. Matsco's foreclosure on R-Q's equipment would have extinguished Bankers' second lien on that property, and Bankers has not identified any other property that either the Debtor or Deer Creek has that ever secured R-Q's debt to Bankers or secured the Debtor's personal guaranty of that debt. Since Bankers' claim is not secured by any property of the Debtor or Deer Creek, the fact the claim might have been secured by R-Q's property does not mean the Debtor is obliged to treat it as a secured claim in his plan. The Debtor is only required to deal with his own liabilities in his plan, not with any of R-Q's debts that he is not liable for.

While some courts have provided long lists of various types of information that they feel should be included in a disclosure statement, [FN4] a leading bankruptcy treatise notes that the lists have appeared in cases involving medium to large reorganizations, often where securities would be issued in connection with the plan.[FN5] The treatise suggests that for a smaller business like the Debtor's, the minimum information a disclosure statement should contain includes:

> FN4. *E.g.*, *In re Cardinal Congregate I*, 121 B.R. 760, 764-66 (Bankr.S.D.Ohio 1990).
>
> FN5. 7 *Collier on Bankruptcy*, ¶ 1125.02[2] at p. 1125-12 (Resnick & Sommer, eds.-in-chief, 15th ed. rev.2007).

-a description of the business;

-its history;

-financial information;

-description of the plan;

-facts respecting its execution;

-a liquidation analysis;

-identification of management and its compensation;

-transactions with insiders; and

-tax consequences of the plan.[FN6]

> FN6. 7 *Collier on Bankruptcy*, ¶ 1125.02[2] at pp. 1125-12 to 1125-13 (citing *In re Malek*, 35 B.R. 443 (Bankr.E.D.Mich.1983)).

The Court believes the Debtor's disclosure statement supplies adequate information about all these matters for unsecured creditors like Bankers to make an informed judgment about the plan, all that is required under the Bankruptcy Code.[FN7]

> FN7. *See* 11 U.S.C.A. § 1125(a)(1) & (b).

In its closing argument brief, Bankers complains for the first time that the disclosure statement did not include any valuation of Deer Creek or information about its assets and liabilities. It is true the liquidation analysis attached to the disclosure ***270** statement [FN8] did not include any liquidation value for Deer Creek, but the Debtor testified that he thought the company had no value. As one of the Debtor's attorneys pointed out at the hearing, a professional practice has no liquidation value in the absence of the professional's covenant not to compete, a promise the Debtor cannot be required to make if Deer Creek is forcibly liquidated. In addition, under the Debtor's liquidation analysis, a sale of Deer Creek would have to net more than $105,000 before any money would

become available to be distributed to general unsecured creditors like Bankers.

FN8. Exhibit E to the Disclosure Statement.

The only effort Bankers made to present evidence of Deer Creek's value was to ask the Debtor about a statement of R-Q's financial position that he gave to Bankers in 2003, presumably in connection with a new loan, renewal of an existing loan, or Bankers' review of R-Q's debt to it. The Debtor pointed out that R-Q was a different company at a different location, and claimed that its business deteriorated significantly between 2003 and 2005, when it ceased operating. The liquidation analysis attached to the Debtor's disclosure statement is just that, an analysis of the Chapter 7 liquidation value of the Debtor's assets, while the financial information the Debtor gave Bankers in 2003 would presumably have been valuing R-Q as a going concern. The going concern value of a one-dentist dental practice is obviously tied almost completely to that dentist, and any sale of the practice without that dentist's participation, cooperation, and promise not to compete with the ongoing practice-a Chapter 7 liquidation sale, for example-would almost certainly bring a very low price, assuming it could produce any buyer at all. Bankers presented no evidence to refute this assessment of Deer Creek's value.

Considering all the circumstances of this case, the Court concludes the Debtor's disclosure statement contains the "adequate information" required by § 1125(a) and (b) of the Bankruptcy Code, and overrules Bankers' objection to it. The disclosure statement is hereby approved.

2. Should the Debtor's plan be confirmed?

Even though the only objection to the Debtor's plan has been resolved, the Court is obliged to review the plan to ensure it complies with the confirmation requirements of § 1129.[FN9] Most of those requirements are found in subsection (a) of that statute. The Court has reviewed the various provisions of subsection (a) and evaluated the Debtor's plan under them. Paragraphs (1), (2), (3), (4), and (5) of subsection (a) have clearly been met. Paragraph (6) does not apply in this case. Paragraph (7) has been met because the Debtor is proposing to pay his secured creditors in full, except for one whose collateral was sold subject to its lien to a buyer who assumed full responsibility to pay the creditor's claim, and the Debtor is proposing to pay his unsecured creditors $30,000 over five years, which is more than they would receive in a Chapter 7 liquidation. Paragraph (8) has not been met because to resolve Bankers' assertion it never received a ballot for voting on the plan, the Court accepted the Debtor's suggestion to treat Bankers as having voted against the plan, which means the class of unsecured creditors must be deemed to have rejected the plan. The administrative claims and allowed priority tax claims are to be paid as permitted by paragraph (9). Paragraph (10) has been met because ***271** the Class 4 creditor, National Bank of Kansas City, is impaired and has accepted the plan. The evidence presented has established to the Court's satisfaction that confirmation of the plan is not likely to be followed by the need for liquidation or further reorganization, so paragraph (11) has been met. The plan provides for the payment of quarterly fees to the United States Trustee as required by paragraph (12), so that requirement has been met. Paragraphs (13) and (14) do not apply in this case. According to a leading bankruptcy treatise, paragraph (16), added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, applies only to nonprofit entities,[FN10] and the Court concludes it does not apply in this case.

FN9. 7 *Collier on Bankruptcy,* ¶ 1129.02[5].

FN10. 7 *Collier on Bankruptcy,* ¶ 1129.03[16].

Because resolution of Bankers' argument that paragraph (15) has not been met requires a more detailed analysis, it will be discussed below. Although one class of impaired creditors has voted against the Debtor's plan, he has asked the Court to consider confirming the plan anyway, as allowed by § 1129(b), an option commonly referred to as "cramdown." That request raises questions about the absolute priority rule, which will also need more extensive discussion.

a. Does the Debtor's plan satisfy the projected disposable income requirement of § 1129(a)(15)(B)?

[3] The main argument Bankers makes in its brief opposing approval of the Debtor's disclosure statement and confirmation of his plan is based on § 1129(a)(15) of the Bankruptcy Code, a provision added to Chapter 11 by the Bankruptcy Abuse Pre-

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vention and Consumer Protection Act of 2005. For the Chapter 11 plan of an individual debtor to be confirmed, this paragraph establishes the following new requirements:

> (15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan-
>
> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

Before going any further, the Court must point out that this provision applies only when the holder of an allowed unsecured claim objects to confirmation, which Bankers did not do in this case. Consequently, while the Debtor's plan would not pay Bankers in full under subparagraph (A), the plan is also not required to satisfy the requirements of subparagraph (B), even though Bankers now argues the Debtor failed to show that his plan calls for the distribution of property with a value equal to five years' worth of his projected disposable income.

[4] The Court is convinced the Debtor's plan would satisfy § 1129(a)(15)(B) even if Bankers had objected to the plan. The provision refers to § 1325(b)(2) for the definition of "projected disposable income." Section 1325(b)(2) says:

> For purposes of this subsection, "disposable income" means current monthly income received by the debtor ... less ***272** amounts reasonably necessary to be expended-
>
> (A)(i) for the maintenance or support of the debtor or a dependent of the debtor ...; and
>
> (ii) for charitable contributions ... in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made.

After the BAPCPA was enacted, three new Official Bankruptcy Forms (22A, 22B and 22C) concerning "current monthly income" were created for individuals to complete and file in Chapter 7, 11, and 13 cases. Bankers suggests the Debtor failed to complete a form 22 to support his effort to show he will be distributing the value of his projected disposable income under his plan. However, a completed Form 22B, the form required for an individual Chapter 11 debtor, appears as the last two pages of the attachments to the Debtor's voluntary petition, and shows his "current monthly income" was $4,953 per month.

Bankers contends the Debtor's "current monthly income" as of the date he filed his petition was greater than the median income for a family of one in Kansas, so under § 1325(b)(3), the expense side of his "projected disposable income" is controlled by the Chapter 7 means test. Since § 1325(b)(3) specifies that the expense portion of the calculation of projected disposable income under § 1325(b)(2) for an above-median-income debtor must be determined according to the Chapter 7 means test, this is a plausible way to interpret § 1129(a)(15)(B)'s incorporation of § 1325(b)(2). The Court cannot agree, however, that it is the correct interpretation of the new provision.

The Advisory Committee on Bankruptcy Rules that drafted the Interim Bankruptcy Rules and Forms to implement the BAPCPA disagreed with Bankers' reading of § 1129(a)(15)(B), and omitted the Chapter 7 means-test expenses from Official Form 22B, the one that individual Chapter 11 debtors are supposed to complete. The Committee explained:

> The Chapter 11 form is the simplest of the three [22A, 22B, and 22C], since the means-test deductions of § 707(b)(2) are not employed in determining the extent of an individual Chapter 11 debtor's disposable income. Section 1129(a)(15) requires payments of disposable income "as defined in section 1325(b)(2)," and that paragraph allows calculation of disposable income under judicially-determined standards, rather than pursuant to the means test deductions, specified for higher income Chapter 13 debtors by § 1325(b)(3). However, §

1325(b)(2) does require that CMI be used as the starting point in the judicial determination of disposable income, and so the Chapter 11 form requires this calculation (in Part I of the form), as described above, together with a verification (in Part II).[FN11]

FN11. Section D.2. of 2005 Committee Note to Official Bankruptcy Forms 22A, 22B, and 22C, *reprinted in* Norton Bankruptcy Law and Practice 2d, Bankruptcy Rules, at 1146 (Thomson/West 2006-2007 ed.).

A leading bankruptcy treatise describes the reading of § 1129(a)(15)(B) that Bankers proposes as "flawed."[FN12] Based on these authorities, the Court concludes that in calculating an individual Chapter 11 debtor's projected disposable income, § 1129(a)(15)(B) must be read to allow a judicial determination of the expenses that are reasonably necessary for the support ***273** of the debtor and his or her dependents. Bankers has not questioned the reasonableness of any of the Debtor's claimed expenses, and the Court declines to raise that question itself.

FN12. 7 *Collier on Bankruptcy*, ¶ 1129.03[15][a] at p. 1129-74.9.

The Debtor's "current monthly income," as reported on his Form 22B, is substantially less than the monthly personal expenses he projects having to pay to support himself during his plan. Consequently, the projected disposable income the Debtor would be expected to receive during the five-year period beginning on the date his first payment would be due following confirmation of his plan, calculated as required by § 1129(a)(15)(B), is $0. Since the Debtor's plan proposes to distribute property worth more than that, the plan satisfies this new confirmation requirement.

b. Does the Debtor's plan satisfy the requirements for cramdown under § 1129(b)(2)(B)?

[5] Although his plan has been rejected by the class of general unsecured creditors, the Debtor has asked the Court to consider confirming the plan through cramdown under § 1129(b). As relevant here, paragraph (1) of that subsection provides:

> [I]f all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if 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.

Under this paragraph, the Court must determine whether the plan "does not discriminate unfairly" against the general unsecured creditors, and "is fair and equitable" with respect to them. The prohibition against unfair discrimination is concerned only with differing treatment among classes of the same priority.[FN13] The only unsecured creditors the Debtor has are priority tax creditors and general unsecured creditors. The tax creditors are, of course, entitled to the priority Congress has given them in the Bankruptcy Code, and the Debtor's plan treats their claims accordingly. The plan places all the general unsecured creditors in a single class, so it contains no discrimination, fair or unfair. This leaves the question whether the plan is fair and equitable.

FN13. *See* 7 *Collier on Bankruptcy*, ¶ 1129.04[3].

[6] Before the BAPCPA was enacted in 2005, the fair and equitable requirement of cramdown had two key components that unquestionably applied to all Chapter 11 debtors: (1) the absolute priority rule, and (2) the rule against paying any creditor more than it is owed.[FN14] The Court sees nothing indicating the Debtor's plan would pay any creditor more than it is owed, but the fact the Debtor is proposing to remain the owner of Deer Creek raises the question whether the absolute priority rule might bar confirmation.

FN14. 7 *Collier on Bankruptcy*, ¶ 1129.04[4][a]. For an extensive discussion of all aspects of cramdown, *see* 7 *Collier on Bankruptcy*, ¶ 1129.04[4][a], [b], & [c], and ¶ 1129.05[1] through [4].

As relevant in this case, § 1129(b)(2)(B) indicates the "fair and equitable" requirement includes at least the following part of the judicially-developed absolute priority rule:

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> With respect to a class of unsecured claims-
>
> (i) the plan provides that each holder of a claim of such class receive or retain ***274** on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

The Debtor's plan proposes to pay $30,000 on general unsecured claims totaling about $875,000, a dividend of less than 3%, so subparagraph (i) does not apply here. Before the BAPCPA, subparagraph (ii) did not include the "except" clause that applies only to individual debtors, so it largely precluded individual debtors from retaining ownership of their businesses through a Chapter 11 plan since few of them could satisfy subparagraph (i) by paying their unsecured creditors in full. The BAPCPA added the clause at the end of subparagraph (ii), obviously creating some sort of exception for individual Chapter 11 debtors to the part of the absolute priority rule stated in that subparagraph. The question in this case becomes what that new exception means.

In addition to the exception that was appended to § 1129(b)(2)(B)(ii), the BAPCPA added to the Bankruptcy Code § 1115, one of the provisions referred to in the exception. Subsection (a) of § 1115 reads:

> In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541-
>
> (1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and
>
> (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.

This new provision both refers to the property already brought into the bankruptcy estate by § 541 and brings more property into the estate. Unfortunately, the exception and § 1115(a) are worded in such a way that the exception could be construed narrowly to cover only the additional, postpetition property brought into the Chapter 11 bankruptcy estate by § 1115(a), or broadly to cover not only that property but also all the property brought into the estate by § 541, most of which is property the debtor had before filing for bankruptcy. The first construction would greatly limit the impact of the new exception under § 1129(b)(2)(B)(ii), but the second would exempt an individual Chapter 11 debtor from the main facet of the absolute priority rule, allowing him or her to retain both pre-and postpetition property under a plan even though a class of unsecured creditors would not be paid in full. The Court must determine which interpretation matches Congress's intent in making these changes.

Before the BAPCPA, some debtors tried to avoid the absolute priority rule by arguing that under a plan like the Debtor's, he would retain his ownership of Deer Creek "on account of" his contribution of new value to the bankruptcy estate (the $30,000 from his postpetition earnings and other business income to be distributed to his general unsecured creditors), not "on account of" his prepetition ownership. This possibility is typically referred to as the new value exception or new value corollary ***275** to the absolute priority rule. In *Norwest Bank Worthington v. Ahlers*, however, the Supreme Court ruled that any new value proposed to be contributed in order to avoid the absolute priority rule must be in money or money's worth, and that a contribution of labor or services in the future cannot fulfill that requirement.[FN15] As of the time the Debtor's plan might be confirmed, his proposed contribution of $30,000 from his postpetition earnings and other business income would be, to the extent it came from his earnings (sure to be the bulk of the income of the dental practice), nothing more than his promise to contribute the product of his future labor or services, a promise essentially the same as the contribution rejected in *Ahlers*. Consequently, the Debtor's proposed contribution would not satisfy the

money-or-money's-worth requirement of any new value corollary that might exist.

FN15. 485 U.S. 197, 202-06, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988).

As a matter of fact, for most individual debtors, their future labor or services are the only significant source of new value they will have available to them, and *Ahlers* means they cannot propose a confirmable Chapter 11 plan. [FN16] If the new exception in § 1129(b)(2)(B)(ii) is read narrowly, although it would mean the Debtor could keep his postpetition earnings and other property he acquired postpetition without violating the absolute priority rule, the exception would not help him avoid the *Ahlers* ruling because the new value he would be contributing to the plan would still be at least mostly his postpetition earnings,[FN17] and he would be retaining his prepetition ownership of Deer Creek. These considerations indicate the narrow reading of the new exception in § 1129(b)(2)(B)(ii) would have little impact on this Debtor's (and probably most other individual debtors') ability to reorganize in Chapter 11.

FN16. See 4 William L. Norton, Jr., & William L. Norton, III, *Norton Bankruptcy Law & Practice 2d,* § 84A:5 (2007) (discussing difficulty of separating sole proprietor's income generated by personal services from other business income), and § 84A:8 (discussing difficulty individual debtors had in providing new value that could let them keep their businesses without paying creditors in full).

FN17. The Debtor's offer of new value in the form of whatever other business income he would be contributing to the plan could not currently be accepted as sufficient new value to justify his retention of Deer Creek because its adequacy has not been tested by any form of market valuation, as required by the Supreme Court's decision in *Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership,* 526 U.S. 434, 437, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999).

The broader view of the exception, on the other hand, helps to explain why a number of changes, including the exception, were made to Chapter 11, namely, so that it could function for individual debtors much like Chapter 13 does. Many of the BAPCPA's changes to Chapter 11 apply only to individual debtors and are clearly drawn from the Chapter 13 model:

1. § 1115 brings property the debtor acquires postpetition into the estate;

2. § 1123(a)(8) calls for the debtor's plan to provide for payment to creditors from the debtor's postpetition earnings from services or other future income;

3. the exception in § 1129(b)(2)(B)(ii) allows the debtor to keep property included in the estate under § 1115, without paying in full a class of unsecured creditors that rejected his or her plan;

4. § 1129(a)(15) authorizes the debtor to overcome an objection to the plan made by a single unsecured creditor by proposing to distribute under the plan property worth at least as much as the ***276** debtor's projected disposable income for a five-year period;

5. § 1141(d)(5) ordinarily delays the entry of the debtor's discharge until completion of all payments under the plan; and

6. § 1127(e) permits modification of a confirmed plan even after substantial consummation for certain purposes.[FN18]

FN18. See 5 Keith M. Lundin, *Chapter 13 Bankruptcy, 3d Ed.,* § 368.1 at pp. 368-1 to 368-5 (2000 & Supp.2006) (correlating all these new Chapter 11 provisions with similar Chapter 13 provisions).

Significantly, Chapter 13 does not impose the absolute priority rule on debtors.[FN19] Taken together, these changes indicate Congress intended to extend the exemption from the absolute priority rule to individual Chapter 11 debtors as well. If a class of unsecured creditors who are not to be paid in full under an individual Chapter 11 debtor's plan can bar the debtor from keeping any prepetition property (which will nearly always include the debtor's interest in whatever business the debtor engages in) by rejecting the plan and invoking the absolute priority rule-that is, if

the new exception in § 1129(b)(2)(B)(ii) is read narrowly-then it is difficult to see what purpose these other, related amendments can serve. At least one court has adopted the broader construction of the new exception added to § 1129(b)(2)(B)(ii), indicating it could find no other court opinions considering the question, but did find three commentators who took that view.[FN20] This Court similarly concludes that Congress intended for the new exception to the absolute priority rule for individual Chapter 11 debtors to be read broadly.

> FN19. Ralph A. Peeples, *Staying in: Chapter 11, Close Corporations and the Absolute Priority Rule*, 63 Amer. Bankr.L.J. 65, 103-04 (Winter 1989) (noting both Chapter 12 and Chapter 13 lack the absolute priority rule, and suggesting best-efforts, disposable-income standard would be better than absolute priority rule in Chapter 11 for debtors who are close corporations, partnerships, and sole proprietors).
>
> FN20. *In re Tegeder*, 369 B.R. 477 (Bankr.D.Neb.2007).

Under the Debtor's plan, he would remain the owner of his limited liability company, Deer Creek Family Dental. Except for his exempt property, the Debtor's interest in his property is junior to his general unsecured creditors' interest in it. Deer Creek is an entity separate from the Debtor and it is property that he owned before filing for bankruptcy. If the absolute priority rule applied to the Debtor, his retention of Deer Creek would preclude confirmation of his plan. The Court is convinced, however, that it should adopt the broader construction of the new exception in § 1129(b)(2)(B)(ii), making the Debtor's plan exempt from the absolute priority rule. This conclusion means the Debtor's plan satisfies all the applicable requirements of § 1129, and it will be confirmed.

CONCLUSION

The Court concludes the Debtor's disclosure statement contains adequate information about his proposed plan of reorganization, so it is approved. The plan satisfies all the requirements of § 1129(a) except subparagraph (8), the requirement that the plan be accepted by all impaired classes. This makes cramdown under § 1129(b) available and, at the Debtor's request, the Court has considered that possibility. The Court concludes the Debtor's plan satisfies the applicable requirements for cramdown under § 1129(b), and the plan will therefore be confirmed.

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(Cite as: 2009 WL 2475017 (Bkrtcy.N.D.W.Va.))

United States Bankruptcy Court,
N.D. West Virginia.
In re Cynthia GRAY, Debtor.
No. 06-927.

Aug. 11, 2009.

Martin P. Sheehan, Sheehan & Nugent, P.L.L.C., Wheeling, WV, for Debtor.

MEMORANDUM OPINION

PATRICK M. FLATLEY, United States Bankruptcy Judge.

*1 Down East Community Hospital ("Down East") objects to confirmation of Dr. Gray's proposed Chapter 11 Plan of Reorganization on the grounds that Dr. Gray is not committing all of her projected disposable income to her Plan. Down East also seeks dismissal of Dr. Gray's bankruptcy case due to it allegedly being filed in bad faith.

For the reasons stated herein, the court will sustain Down East's objection to confirmation of the Debtor's proposed plan, but will not dismiss the Debtor's case.

I.BACKGROUND

Dr. Gray, the Debtor, is a physician practicing in the area of obstetrics and gynecology. During the late 1990's, the Debtor maintained an independent medical practice in Pittsburgh, Pennsylvania. When she decided to close her independent practice and seek employment at a medical facility, the Debtor liquidated approximately $500,000 in retirement accounts to pay her business creditors. By doing so, the Debtor incurred about $200,000 in individual income tax liability, which is a precipitating cause of the Debtor's bankruptcy.

The Debtor obtained employment with Down East in Machias, Maine, and it loaned her over $100,000 to finance her move. Meanwhile, the Debtor put her Pittsburgh home on the market, but was unsuccessful in selling it. After moving to Maine and purchasing a home there, she had an employment dispute with Down East and she left her job.

The Debtor relocated to Weirton, West Virginia, and obtained employment at Weirton Hospital. Meanwhile, the Debtor was unable to sell her home in Maine, and the Debtor was also obligated to repay Down East the loan it gave her to finance her move to Maine.

The Debtor lives with a companion, Trudy Strupe, who accompanied her on her move from Pittsburgh, to Machias, and then to Weirton. The two have lived together for over twenty years, and the Debtor's Pittsburgh home was built to provide room enough for Ms. Strupe's parents to live with them. The Debtor testified that they lived as "one large family" during that time, with both the Debtor and Ms. Strupe contributing to the household expenses. For the past twelve months, however, Ms. Strupe has not contributed to the household expenses because she has had two major surgeries, and she suffers from severe arthritis. These ailments prevent her from working. Consequently, the Debtor pays for many of Ms. Strupe's household expenses, and medical bills.

II.DISCUSSION

In her proposed Chapter 11 Plan, the Debtor states that she will make monthly plan payments of $4,500. Down East contends that the $4,500 monthly payment does not represent the Debtor's best efforts to repay her creditors on the grounds that the Debtor has budgeted for unreasonable and/or unnecessary expenses. Also, Down East contends that the Debtor's actions throughout her case demonstrate her bad faith, and Down East seeks dismissal of her case on that basis.

A. Calculation of Disposable Income

As proposed, the Debtor's plan calls for monthly payments of $4,500 to be paid to a "representative" who will then distribute the funds in accordance with the Plan. Down East does not believe $4,500 repre-

sents the Debtor's best effort to repay her creditors.

*2 Section 1129(a)(15) requires that "the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor...." 11 U.S.C. § 1129(a)(15). Section 1129(a)(15)(B) references § 1325(b)(2) as providing the definition of "disposable income."

Under § 1325(b)(2), "disposable income" is defined as "current monthly income received by the debtor ... less amounts reasonably necessary to be expended-(A)(i) for maintenance or support of the debtor or a dependant of the debtor...." 11 U.S.C. § 1325(b)(2). A Debtor's "current monthly income" (CMI), is calculated pursuant to § 101(10A) of the Bankruptcy Code. In that section, Congress prescribed a six-month look back period to determine the CMI of a debtor before filing bankruptcy; the look back period ends on "the last day of the calendar month immediately preceding the date of the commencement of the case...." 11 U.S.C. § 101(10A)(A)(i).

Using Official Form 22B, the Debtor calculated her CMI as $18,830 .35. Having determined the Debtor's CMI, the next step in determining the Debtor's "disposable income" is to look to her reasonably necessary expenses. §§ 1129(a)(15)(B); 1325(b)(2)(A). The Debtor estimates her monthly payroll deductions on Schedule I at $8,962.55 and monthly expenses on Schedule J at $6,743.31. Down East contends that the following expenses should be eliminated from the Debtor's budget as being unreasonable and/or unnecessary: (1) expenses to support Ms. Strupe; (2) expenses related to the care of 15 dogs; and (3) television and telecommunication expenses.

1. Ms. Strupe

The Debtor and Down East disagree on whether Ms. Strupe is a "dependent" of the Debtor, and whether expenses for her support are excludable from the Debtor's disposable income.

The term "dependent" is not defined in the Bankruptcy Code. Although definitions exist in other federal statutes,[FN1] these definitions are not duplicated in § 1325, and, therefore, are not controlling. *E.g., In re Bauer,* 309. B.R. 47, 51 (Bankr.D.Idaho.2004) ("Congress did not in § 1325 establish the sort of express and detailed conditions for finding dependency as it did in [other statutes; therefore, the definition of dependent in § 1325 is] to be evaluated based on that term's commonly understood meaning.").

> FN1. 26 U.S.C. § 152(d)(2)(H) (an individual with the same principal place of abode as the taxpayer qualifies an a "dependent" for purposes of the federal income tax code; 10 U.S.C. § 1072 ("dependent" as defined with respect to members of the U.S. Armed Forces)

In determining who is a "dependent" under § 1325, some courts allow a debtor to budget expenses for the support of a debtor's adult children, parents and grandparents, and grandchildren. *E.g., In re Smith,* 269 B.R. 686, 689-90 (Bankr.W.D.Mo.2001) (allowing expenses of 20-year-old daughter living at home and attending college); *In re Wegner,* 91 B.R. 854, 859 (Bankr.D.Minn.1988) (allowing expenses for adult children and grandchildren). Other courts have declined to adopt such individuals as "dependents" under the Bankruptcy Code. *E.g., In re Beharry,* 264 B.R. 398, 404 (Bankr.W.D.Pa.2001) (disallowing expenses for second wife's minor child); *In re Cox,* 249 B.R. 29, 32 (Bankr.N.D.Fla.2000) (disallowing expenses for support of mother, fiancé, and fiancé's children).

*3 In determining whether Ms. Strupe is a "dependent" of the Debtor, the court is guided by the purpose of the term "dependent" in § 1325, which is to recognize and protect a genuine family unit, which may be broader than the traditional nuclear family. *E.g., In re Gonzales,* 297 B.R. 143, 150-152 (Bankr.D.N.M.2003) (noting that standards set by administrative agencies or industries should not influence courts to ignore "cultural and societal norms").

Here, the Debtor and Ms. Strupe have lived together for over twenty years. At one point, they lived as "one large family" with Ms. Strupe's parents and the respective children of the Debtor and Ms. Strupe. Until becoming ill and unable to work, Ms. Strupe contributed to the Debtor's household expenses. For example, the Debtor testified that during the period when her wages were subject to garnishment by the Internal Revenue Service, Ms. Strupe paid the household bills until the Debtor's garnishment was stopped. Currently, however, Ms. Strupe is unable to work due

to extensive surgeries and severe arthritis, and the Debtor supports Ms. Strupe through the payment of Ms. Strupe's medical bills ($375.00 monthly), household expenses ($900.00 monthly for the Debtor and Ms. Strupe), and occasionally fuel ($350.00 monthly, part of which is for Ms. Strupe's automobile). Based on their extensive history together, including the continued support they provide for one another, the court concludes that the Debtor and Ms. Strupe form a "family unit," such that Ms. Strupe is a "dependent" of the Debtor.

Having established the dependency of Ms. Strupe, the court must determine whether the Debtor's expenses listed on Schedule J are reasonably necessary for the support of the Debtor and Ms. Strupe. This determination is left entirely to the court's discretion. *E .g., In re Roedemeier,* 374 B.R. 264, 272-273 (Bankr.D.Kan.2007) ("[section] 1129(a)(15) must be read to allow a judicial determination of the expenses that are reasonably necessary for the support of the debtor and his or her dependents.").

The expenses that the Debtor incurs to support Ms. Strupe in the form of medical bills ($375.00 monthly), household expenses (jointly totaling $900.00 monthly), and fuel (jointly totaling $350.00 monthly) for Ms. Strupe's car are reasonable and necessary. Ms. Strupe is currently unable to support herself due to her medical conditions. Therefore, it is necessary that the Debtor pay Ms. Strupe's expenses until such time when Ms. Strupe can begin working again. The amounts of the expenses are reasonable, do not appear to be extravagant, and are consistent with the long term living arrangement between Ms. Strupe and the Debtor.

2. Dogs

The Debtor currently cares for 15 dogs. She spends approximately $750.00 per month for the care and maintenance of the animals. Spending $750.00 per month on animals that provide no necessary service to the Debtor is unreasonable and unnecessary-the Debtor cares for these dogs only out of a feeling of moral responsibility. The court will therefore disallow this expense from the Debtor's budget.

3. TV & Telecommunications

*4 The Debtor subscribes to two television services: Comcast and Direct TV. The Debtor's Comcast package consists of telephone, television, and internet service; Direct TV is also a television service provider. It is unreasonable and unnecessary for the Debtor to maintain two television services. The Court will disallow the $149.00 per month spent on Direct TV service. *See, e.g., In re Gavita,* 177 B.R. 43 (Bankr.W.D.Pa.1994) (disallowing $100.00 expense for movie rentals when debtors subscribed to cable television plus "The Movie Channel").

Likewise, considering that the Debtor has internet service through her Comcast subscription, it is unnecessary for her to spend $25.90 per month to subscribe to AOL. *See, e.g., id.*

Regarding her $250.00 monthly cellular phone service, the court finds that this expense is too high.[FN2] A more reasonable amount is $100 per month. *See, e.g., In re Veenhuis,* 143 B.R. 887 (Bankr.D.Minn.1992) (reducing cell phone service of $40 per month).

> FN2. The Debtor testified that a $10.00 charge on her cell phone bill is attributed to her adult daughter being on the plan. The Debtor's adult daughter is gainfully employed and self-reliant. In determining that $100.00 monthly is a reasonable and necessary cell phone expense, the court has also deducted the monthly $10.00 charge attributed to the cell phone given to the Debtor's daughter.

In sum, having determined which expenses are not reasonably necessary for the support of the Debtor and Ms. Strupe, an additional $1,074.90 per month is available as disposable income for the benefit of the Debtor's unsecured creditors. Also, the Debtor budgeted $667.95 in monthly vehicle installment payments on Schedule J, which are also listed by the Debtor as being paid in her proposed plan. Because the Debtor already provides for payment of this claim in her Plan, the court will disallow it as a scheduled expense. Therefore, the Debtor's disposable income will be increased by $1,741.90 per month. Using the formula prescribed in § 1325(b)(2),[FN3] the Debtor's monthly disposable income is $4,867.30. Therefore, the total value of property to be distributed pursuant to § 1129(a)(15), including installment payments on the Debtor's vehicle, is $292,038.00 [FN4] or payment

of 100 percent to the unsecured creditors, whichever is less.

FN3. CMI (Form 22B)-Payroll Deductions (Schedule I)-reasonably necessary expenses (Schedule J) = monthly disposable income; $18,830 .35-$8,962.55-$5,000.51 = $4,867.30.

FN4. $4,867.30(60 months) = $292,038.00

Because the Debtor's current proposal to contribute $4,500 per month is less than the Debtor's disposable income as calculated above,[FN5] the Debtor has not met her disposable income requirement as prescribed by statute. Thus, the court will sustain Down East's objection.

FN5. $4,867.30 > $4,500.00

A. Dismissal

Down East also seeks to have the Debtor's Chapter 11 case dismissed on the basis that its filing and/or prosecution is in bad faith.

Under § 1112(b), a court may dismiss a case under Chapter 11 if the moving party establishes cause. 11 U.S.C. § 1112(b)(1). In deciding whether a case is filed in bad faith, the court may consider any factor that evidences an intent to abuse the protections afforded in bankruptcy. *In re Marshall*, 403 B.R. 668, 689-90 (C.D.Cal.2009) ("A filing lacks good faith if it is filed in an attempt ... to achieve objectives outside the legitimate scope of the bankruptcy laws."). In determining whether to dismiss a case for bad faith, the court must consider the totality of the circumstances...." *In the Matter of Madison Hotel Associates*, 749 F.2d 410, 425 (4th Cir.1984).

***5** Here, considering the totality of the circumstances, there does not appear to be any illegitimate end sought by the Debtor in filing her bankruptcy petition. The court is satisfied that the Debtor did not file her case in an attempt to delay or frustrate creditors. Rather, it appears as though the Debtor filed in good faith to handle substantial tax liabilities which she encountered while paying past creditors, and to shed her liability from two unsold homes that she purchased in her efforts to find better employment opportunities.

I.CONCLUSION

The court will enter a separate order that sustains Down East's objection to confirmation, and that denies Down East's request to dismiss the case.

Order Entered.

Bkrtcy.N.D.W.Va.,2009.
In re Gray
Slip Copy, 2009 WL 2475017 (Bkrtcy.N.D.W.Va.)

END OF DOCUMENT

Chapter 11 and the High Net Worth Individual-

In re John Doe, Case No. 10-12345

John Doe is an entrepreneur with ownership interests in several business enterprises. John's business interests include a 100% interest in Handyman Hardware Corp., which owns a chain of hardware stores in Brooklyn, NY; a 100% interest in Hardware Realty Corp., which owns the real property out of which Handyman operates its main store; a 100% interest in Doe Laundromat Corp., which operates a Laundromat in a residential neighborhood in Brooklyn; a 100% interest in Laundromat Realty Corp., which owns the building out of which the Laundromat operates; and 50% interests in Waterfront Condo Corp. and Tower Condo Corp., each of which owns a 100 unit building in an up-and-coming neighborhood which is in the process of being renovated and redeveloped as a condominium project. The other 50% interest in these corporations is owned by John's son, John Jr.

John lives with his wife Joanne and their three other children, ages 16, 19 and 22, in a house in a luxury neighborhood conservatively valued at $1,000,000, encumbered by a $500,000 mortgage. John and his wife own the house as tenants by the entirety. Joanne has no independent source of income.

The buildings owned by Hardware Realty and Laundromat Realty have been encumbered to finance John's investment with John Jr. in the two condo projects. Unfortunately, the collapse of the real estate market has hit the condo projects hard. Both are in default on their building loans; the redevelopment work (though nearly complete) has ground to a halt; and both are underwater. The holders of the building loans on both of these projects have begun foreclosure proceedings.

John is barely keeping up with the mortgage payments on the Hardware Realty and Laundromat Realty buildings, but believes there is substantial equity in those properties. Handyman Hardware and Doe Laundromat have historically been very profitable, and though their businesses too have felt the effects of the recession, they still generate a positive cash flow.

Other than approximately $100,000 in credit card debt, John's obligations consist primarily of his guarantees of the mortgages on the properties owned by Hardware Realty and Laundromat Realty. He depends on the cash flow from Handyman Hardware and Doe Laundromat to finance his living expenses and to pay the mortgages on the Hardware Realty and Laundromat Realty properties. John has pledged his equity interests in the two condo corporations to a mezzanine lender which provided additional funding for these two projects, and these loans are also in default.

John files a Chapter 11 petition in bankruptcy court in Brooklyn. His schedules and statement of financial affairs disclose his interests in the corporations, and his credit card and guarantee obligations, but make no disclosure whatsoever concerning the assets or liabilities of the corporations. John claims an exemption in the residence he owns jointly with Joanne.

Citing *Queenie v. Nygard*, 321 F. 3d 282 (2d Cir. 2003), John's lawyer sends letters to the lenders to Waterfront Condo and Tower Condo informing them that their foreclosure actions are automatically stayed by John's bankruptcy filing. Except for these creditors, and the lenders to Hardware Realty and Laundromat Realty who hold John's guarantee, none of the creditors of the corporate entities in which John has an interest receive notice of his bankruptcy filing.

John continues to use the cash flow from Handyman Hardware and Doe Laundromat to pay the mortgage on his residence and to fund his family's expenses, including college tuition and living expenses (and car lease payments on BMWs) for the two adult children who still live with him and Joanne. Handyman and Doe also continue to fund private school tuition for John Jr.'s children, as they had done prior to the bankruptcy filing.

John's exit strategy is to complete the condo projects and to market the condo units in the improving real estate market; to persuade the lenders on those projects to accept a short payout and to take the payment over time as the units are sold; and to restructure his obligations to the mezzanine lender, possibly giving them a mortgage on assets of some of the other corporations. Ultimately, John settles with the lenders on the condo projects and with the mezzanine lender, and files a plan which contemplates the payout of these obligations from the sale of the condo units, and provides that the unit sales will be exempt from transfer or mortgage recording tax under Section 1146 of the Bankruptcy Code. The plan pays provides for a payment of 25% to John's unsecured creditors.

1. Is John's lawyer correct that foreclosure actions on the condominium properties are stayed by John's individual bankruptcy filing?

2. Is John required to make any disclosure concerning the assets and liabilities of the corporations in which he has an interest? Can the corporations in which John has an interest be required to file operating reports?

3. Is there any restriction on the payment of expenses of John and his family members by Handyman Hardware and Doe Laundromat, given that those two entities are not in bankruptcy? Do those payments even have to be disclosed on John's Schedule I and J or on his operating reports? Is there any restriction on the transfer of funds or assets between the various corporate entities in which John has an interest? Is it necessary to seek bankruptcy court approval in order for those entities to sell assets outside the ordinary course of business or to borrow funds?

4. What are reasonable and necessary expenses which could be paid by John for his family members? For example, is it a reasonable and necessary expense for John to pay (i) the BMW lease payment for John Jr.?, (ii) the son's college tuition? -- does it make a difference if the costs are a lot or a little?, (iii) the driver for John Jr. where John Jr. is severely handicapped?, and (iv) the costs of monthly landscaping? -- does it make a difference if the costs are extraordinary (e.g., over $5,000/month)? Should a Court consider the prior "standard of living" or "lifestyle" of an individual debtor vs. those of an average family of the same size?

5. Can the sale of the condo units contemplated by John's reorganization plan, which are not property of the estate, be exempted from transfer or mortgage recording tax under Section 1146? What about the mortgages which are being given to the mezzanine lender on the real property owned by Hardware Realty and Laundromat Realty (also not property of the estate)—can those mortgages be exempted from recording tax? See *In re T.H. Orlando*, 391 F. 3d 1287 (11th Cir 2004); *In re Amsterdam Avenue Development Associates*, 103 B.R. 454 (Bankr. S.D.N.Y. 1989); *In re Kerner Printing Co.*, 188 B.R. 121 (Bankr. S.D.N.Y. 1995). What is the impact of the Supreme Court's decision in *Picadilly Cafeterias*, 2008 US Lexis 5025, on this question?

6. Does John's plan proposal to pay 25% to unsecured creditors, while retaining the exempt equity in his residence, violate the absolute priority rule?

Chapter 11 & High Net Worth Individuals

Honorable Thomas J. Catliota (U.S. Bankr. D. Md)
Honorable Carla E. Craig (U.S. Bankr. E.D.N.Y.)
Honorable Stephen S. Mitchell (U.S. Bankr. E.D. Va.)

Deborah H. Devan (Moderator)
Neuberger, Quinn, Gielen, Rubin & Gibber, P.A. (Baltimore)

Melanie L. Cyganowski (Facilitator)
Otterbourg, Steindler, Houston & Rosen, P.C. (NYC)
Former U.S. Bankruptcy Judge, E.D.N.Y.

The Story of John Doe

- John Doe is an entrepreneur with ownership interests in several business enterprises, including
  - 100% interest -- Handyman Hardware Corp., which owns a chain of hardware stores
  - 100% interest -- Hardware Realty Corp., which owns the real property out of which Handyman operates its main store
  - 100% interest in Doe Laundromat Corp., which operates a Laundromat in a residential neighborhood
  - 100% interest in Laundromat Realty Corp., which owns the building out of which the Laundromat operates
  - 50% interests in Waterfront Condo Corp. and Tower Condo Corp., each of which owns a 100 unit building in an up-and-coming neighborhood which is in the process of being renovated and redeveloped as a condominium project.
- The other 50% interest in these corporations is owned by John's son, John Jr.

The Story of John Doe Continues

- John lives with his wife Joanne and their three other children (ages 16, 19 and 22).
- Owns a house in a luxury neighborhood -- valued at $1,000,000, encumbered by a $500,000 mortgage.
- John and his wife own the house as tenants by the entirety.
- Joanne has no independent source of income.

The Story of John Doe Continues

- The buildings owned by Hardware Realty and Laundromat Realty have been encumbered to finance John's investment with John Jr. in the two condo projects.

- Unfortunately, the collapse of the real estate market has hit the condo projects hard.

- Both are in default on their building loans; the redevelopment work (though nearly complete) has ground to a halt; and both are underwater.

- The holders of the building loans on both of these projects have begun foreclosure proceedings.

The Story of John Doe Continues

- John is barely keeping up with the mortgage payments on the Hardware Realty and Laundromat Realty buildings, but believes there is substantial equity in those properties.

- Handyman Hardware and Doe Laundromat have historically been very profitable, and though their businesses too have felt the effects of the recession, they still generate a positive cash flow.

The Story of John Doe Continues

- Other than approximately $100,000 in credit card debt, John's obligations consist primarily of his guarantees of the mortgages on the properties owned by Hardware Realty and Laundromat Realty.

- He depends on the cash flow from Handyman Hardware and Doe Laundromat to finance his living expenses and to pay the mortgages on the Hardware Realty and Laundromat Realty properties.

- John has pledged his equity interests in the two condo corporations to a mezzanine lender which provided additional funding for these two projects, and these loans are also in default.

The Story of John Doe Continues

- John files a Chapter 11 petition in bankruptcy court in Brooklyn.

- His schedules and statement of financial affairs disclose his interests in the corporations, and his credit card and guarantee obligations, but make no disclosure whatsoever concerning the assets or liabilities of the corporations.

- John claims an exemption in the residence he owns jointly with Joanne.

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- Citing *Queenie v. Nygard*, 321 F. 3d 282 (2d Cir. 2003), John's lawyer sends letters to the lenders to Waterfront Condo and Tower Condo informing them that their foreclosure actions are automatically stayed by John's bankruptcy filing.

- Except for these creditors, and the lenders to Hardware Realty and Laundromat Realty who hold John's guarantee, none of the creditors of the corporate entities in which John has an interest receive notice of his bankruptcy filing.

The Story of John Doe Continues

- John continues to use the cash flow from Handyman Hardware ("Handyman") and Doe Laundromat ("Doe") to pay the mortgage on his residence and to fund his family's expenses, including college tuition and living expenses (and car lease payments on BMWs) for the two adult children who still live with him and Joanne.

- Handyman and Doe also continue to fund private school tuition for John Jr.'s children, as they had done prior to the bankruptcy filing.

The Story of John Doe Continues

- John's exit strategy is
  - to complete the condo projects and to market the condo units in the improving real estate market
  - to persuade the lenders on those projects to accept a short payout and to take the payment over time as the units are sold, and
  - to restructure his obligations to the mezzanine lender, possibly giving them a mortgage on assets of some of the other corporations.
- Ultimately, John settles with the lenders on the condo projects and with the mezzanine lender.
- John then files a plan which contemplates the payout of these obligations from the sale of the condo units, and provides that the unit sales will be exempt from transfer or mortgage recording tax under Section 1146 of the Bankruptcy Code.
- The plan pays provides for a payment of 25% to John's unsecured creditors.

Question # 1

Is John's lawyer correct that foreclosure actions on the condominium properties are stayed by John's individual bankruptcy filing?

Question # 2

Is John required to make any disclosure concerning the assets and liabilities of the corporations in which he has an interest?

Can the corporations in which John has an interest be required to file operating reports?

Question # 3

- Is there any restriction on the payment of expenses of John and his family members by Handyman Hardware and Doe Laundromat, given that those two entities are not in bankruptcy?

- Do those payments even have to be disclosed on John's Schedule I and J or on his operating reports?

- Is there any restriction on the transfer of funds or assets between the various corporate entities in which John has an interest?

- Is it necessary to seek bankruptcy court approval in order for those entities to sell assets outside the ordinary course of business or to borrow funds?

Question # 4

- What are reasonable and necessary expenses which could be paid by John for his family members?

- For example, is it a reasonable and necessary expense for John to pay
  - (i) the BMW lease payment for John Jr.?,
  - (ii) the son's college tuition? -- does it make a difference if the costs are a lot or a little?,
  - (iii) the driver for John Jr. where John Jr. is severely handicapped?, and
  - (iv) the costs of monthly landscaping? -- does it make a difference if the costs are extraordinary (e.g., over $5,000/ month)?

- Should a Court consider the prior "standard of living" or "lifestyle" of an individual debtor vs. those of an average family of the same size?

Question # 5

- Can the sale of the condo units contemplated by John's reorganization plan, which are not property of the estate, be exempted from transfer or mortgage recording tax under Section 1146?

- What about the mortgages which are being given to the mezzanine lender on the real property owned by Hardware Realty and Laundromat Realty (also not property of the estate)—can those mortgages be exempted from recording tax?

  - See *In re T.H. Orlando*, 391 F. 3d 1287 (11th Cir 2004); *In re Amsterdam Avenue Development Associates*, 103 B.R. 454 (Bankr. S.D.N.Y. 1989); *In re Kerner Printing Co.*, 188 B.R. 121 (Bankr. S.D.N.Y. 1995).

- What is the impact of the Supreme Court's decision in *Picadilly Cafeterias*, 2008 US Lexis 5025, on this question?

Question # 6

Does John's plan proposal to pay 25% to unsecured creditors, while retaining the exempt equity in his residence, violate the absolute priority rule?