UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
Lexington Division

IN RE	:	
	:	**Chapter 11**
GARY D. ROLAND and	:	**Case No. 14-52221**
RENEE' A. ROLAND,	:	**Judge Tracey N. Wise**
	:	
Debtors	:	
	:	

ORDER DENYING APPROVAL OF DISCLOSURE STATEMENT AND SETTING VALUATION HEARING

This matter came before the Court for hearing on August 31, 2016, on the approval of Debtors' disclosure statement [ECF No. 500] ("Disclosure Statement") with respect to their second amended plan [ECF No. 499] ("Plan") and an objection thereto [ECF No. 513] filed by JPMorgan Chase Bank, N.A. ("Chase"), NRZ-Pass Through Trust V, U.S. Bank National Association, Trustee through its servicing agent, Fay Servicing, LLC ("Fay"), and MTGLQ Investors, LP through its servicing agent Rushmore Loan Management Services, LLP ("Rushmore" and together with Chase and Fay, "Chase Creditors").

The primary issue before the Court is whether approval of the Disclosure Statement is appropriate where it is uncontested that the Debtors' Plan violates the absolute priority rule set forth in § 1129(b)(2)(B)(ii). Debtors contend a $10,000 contribution ("Contribution") provided by Mr. Roland's sister satisfies the new value exception to the absolute priority rule. The Chase Creditors contend the Contribution is per se inadequate; and thus, the Plan cannot be confirmed as a matter of law and the Disclosure Statement should not be approved. Debtors assert the adequacy of the proposed new value contribution is a factual determination. They further contend that because they have no equity in their non-exempt prepetition property, the Contribution is not

per se inadequate; and, therefore, their Disclosure Statement should be approved leaving the Contribution's adequacy at issue for the confirmation hearing.

The Court ordered the parties to file supplemental briefs addressing the requisite elements of new value in the individual chapter 11 context, the standard of proof, and whether the Court may deny approval of a Disclosure Statement on the grounds that the proposed new value is per se inadequate or must the Court defer the adequacy determination to the hearing on confirmation of the Plan. In addition, the Debtors were specifically ordered to address the factual basis for their contention that the Contribution is sufficient and to propose an amended disclosure on this issue to be included in a revised disclosure statement. The parties timely filed their briefs and these matters were taken under submission.

LAW AND ANALYSIS

This Court has jurisdiction of this matter pursuant to 28 U.S.C. § 1334(b) and this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(L).

The Debtors, as the Plan proponents, bear the burden of proof to show, by a preponderance of the evidence, that their Plan meets statutory requirements for confirmation, including the sufficiency of the Contribution. *In re Crosscreek Apts., Ltd.* 213 B.R. 521, 546 (Bankr. E.D. Tenn. 1997) ("Like other confirmation requirements, the burden of proving these new value elements lies with the plan proponent.").

Section 1125 of the Bankruptcy Code provides that a Court may approve a disclosure statement only if it provides "adequate information" so that "a hypothetical investor typical of the holders of claims or interests" in the case can make an informed decision on whether they should support a proposed chapter 11 plan. 11 U.S.C. § 1125(a), (b). "It is within the Court's discretion to determine whether a disclosure statement contains adequate information" *In re Ferguson*, 474 B.R. 466, 471 (Bankr. D.S.C. 2012).

> Where unsecured creditors are not being paid in full and a debtor plans to retain non-exempt property, the disclosure statement should provide adequate disclosures as to the reasons why the debtor should be allowed to retain such property. Without such information, creditors, particularly unsecured creditors, cannot make an informed decision.

Id. at 472. Here, the Debtors intend to retain non-exempt, prepetition property. The Plan does not provide for full payment of unsecured creditors. The Chase Creditors hold several claims against the Debtors, including partially secured claims and unsecured deficiency claims. The Chase Creditors will not vote in favor of the Plan and the Debtors may only seek confirmation under the cram down provisions of the Code. 11 U.S.C. § 1129(b).

Section 1129(b)(2), known as the "absolute priority rule," provides in relevant part:

> (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
>
> . . . .
>
> (B) 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 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.

§ 1129(b)(2)(B)(ii). In brief, the absolute priority rule "provides that every unsecured creditor must be paid in full before the debtor can retain 'any property' under a plan." *Ice House Am., LLC v. Cardin*, 751 F.3d 734, 737 (6th Cir. 2014). In the Sixth Circuit, there is no question the absolute priority rule applies to an individual chapter 11 debtor. *Id.* at 740 ("We therefore hold that the absolute-priority rule continues to apply to pre-petition property of individual debtors in Chapter 11 cases.").

The exception (or corollary) to the absolute priority rule, is a new value contribution whereby an individual chapter 11 debtor may retain non-exempt prepetition property over the

objection of a class of creditors whose claims are not paid in full, in exchange for a fresh contribution of new value. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) (applying new value concept to individual debtors); *In re Andrews*, No. 3:14-bk-10730, 2015 WL 4608091 (Bankr. M.D. Tenn. July 31, 2015) (same). While courts have not consistently identified the elements a debtor must prove to meet the new value contribution exception, all courts require that the contribution must be "reasonably equivalent" to the value of the assets retained by the debtor.[1]

Courts also consistently hold that the new value contribution must come from a source other than the debtor. *In re Rogers*, No. 14-40219-EJC, 2016 WL 3583299, at *10 (Bankr. S.D. Ga. June 24, 2016) ("[I]t is not an easy task for an individual debtor to satisfy the [new value] exception because the new value must typically come from a source other than the debtor."); *see also Andrews*, 2015 WL 460091, at *2 (the debtor's future income cannot be considered a new value contribution because 11 U.S.C. § 1129(a)(15) already requires an individual debtor to distribute all of his projected disposable income under the plan). Here, the proposed Contribution is a cash gift from Mr. Roland's sister.

In analyzing the Contribution's sufficiency, the Debtors state "[g]iven the lack of equity in their non-exempt assets, Debtors submit that a $10,000 contribution by Debtor, Gary Roland's sister, is reasonably equivalent to the Debtors' interest in the prepetition property . . . retained under the Plan." [ECF No. 535 at 11.] The Debtors are simply wrong. As the Supreme Court stated in *Ahlers*:

> Even where debts far exceed the current value of assets, a debtor who retains his equity interest in the enterprise retains "property." Whether the value is "present or prospective, for dividends or only for purposes of control" a retained equity interest is a property interest to "which the creditors [are] entitled ... before the stockholders [can] retain it for any purpose whatever." *Northern Pacific R. Co. v. Boyd,* 228 U.S., at 508, 33 S. Ct., at 561. *Indeed, even in a sole proprietorship,*

[1] *See e.g., In re Trevarrow Lanes, Inc.*, 183 B.R. 475, 493 (Bankr. E.D. Mich. 1995) (discussing and analyzing elements of new value exception, including thorough analysis of elements required by Sixth Circuit in *Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co., Inc. (In re U.S. Truck Co., Inc.),* 800 F.2d 581 (6th Cir. 1986)).

> *where "going concern" value may be minimal, there may still be some value in the control of the enterprise; obviously, also at issue is the interest in potential future profits of a now-insolvent business. See SEC v. Canandaigua Enterprises Corp.*, 339 F.2d 14, 21 (2d Cir. 1964) (Friendly, J.). And while the Code itself does not define what "property" means as the term is used in § 1129(b), the relevant legislative history suggests that Congress' meaning was quite broad. "'[P]roperty' includes both tangible and intangible property." See H.R. Rep. No. 95-595, at 413, U.S. Code Cong. & Admin. News 1978, at 6369.

Ahlers, 485 U.S. at 207–08 (emphasis added).

Debtors are retaining their rental properties which have "going concern" value, even if minimal, and the rental properties provide a stream of income. In addition, the Debtors held ownership interests in eleven entities at the beginning of this case. [*See* Debtors' Periodic Report Regarding Value, ECF No. 89]. The disposition and/or going concern value of those interests is not discussed in the Disclosure Statement.[2] Further, at least one of such entities, Roland Commercial Properties, LLC, provides Debtors with annual income of $18,000. *See Rogers*, 2016 WL 3583299 (setting a valuation hearing to determine the value of debtor's non-exempt property, including debtor's ownership interest in a limited liability company from which debtor received a stream of income).

Debtors' lack of equity in the rental properties does not control the determination of whether the Contribution is "reasonably equivalent" to the property retained for purposes of analyzing the absolute priority rule. "It is the retained value of the asset, not its liquidation value, which is used to determine if it is reasonably equivalent to the new value contribution." *Andrews*, 2015 WL 4608091, at *2. "And there is great common sense in [creditors'] contention that 'obviously, there is some going concern value here, or the parties would not have been litigating over it for the last three years.'" *Ahlers*, 485 U.S. at 209.

[2] In their Chapter 7 Liquidation Analysis, Debtors briefly discuss their equity in three of the entities, concluding that if the entities were liquidated under chapter 7, the costs of liquidation and administrative expenses would preclude any distribution to unsecured creditors from such liquidation. [Disclosure Statement ¶ 5.10.] As discussed herein, mere lack of equity in the property retained is not determinative of the sufficiency of a new value contribution.

Thus, to some extent, both sides have it wrong. The Chase Creditors' argument that the Contribution is inadequate based on the total amount of the Debtors' unsecured claims is without merit. The adequacy of the new value is not dependent on the size of the unpaid claims; but rather, on the value of the retained assets. *See generally*, 7 COLLIER ON BANKRUPTCY ¶ 1129.03[4][c][iv][B] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) (*Case* requires that any value contributed must be "reasonably equivalent to the interest being received."). On the other hand, Debtors' argument conflates the best interest analysis required by § 1129(a)(7) with the new value exception to the absolute priority rule of § 1129(b). For this reason alone the Debtors' disclosures are inadequate. Debtors also fail to adequately identify the non-exempt assets they propose to retain, which, in addition to real estate, may include interests in limited liability companies.

While the Code provides that the "court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets," 11 U.S.C. § 1125(b), in this case judicial economy and the interests of the bankruptcy estate, its creditors and the Debtors are best served by conducting an evidentiary valuation hearing sooner rather than later. This is a small case, it is Debtors' second attempt at reorganizing under chapter 11, the case has been pending for two years, and mediation between these parties was unsuccessful. It is undisputed a hearing will be required. Thus, a hearing on the "reasonably equivalent" value of the Debtors' proposed retained non-exempt assets will be set prior to embarking on the confirmation process. The Court can discern no prejudice to any party to have this factual issue determined at this stage.

Based on the forgoing, **IT IS HEREBY ORDERED**:

1. Approval of the Disclosure Statement is DENIED.

2. On or before **October 11, 2016**, Debtors shall file a supplement to the Disclosure Statement which identifies the prepetition non-exempt property they propose to retain and the

factual basis for their contention that $10,000 is the reasonably equivalent value of the retained property (the "Supplement").

3. If the Supplement is not timely filed, this case will be dismissed without further notice or hearing.

4. If the Supplement is timely filed, an evidentiary hearing to determine whether the Contribution is reasonably equivalent to such retained property will be conducted at **9:30 a.m. on December 8, 2016, in the United States Bankruptcy Court, 100 E. Vine Street, 3rd Floor Courtroom, Lexington, Kentucky**.

5. Joint Stipulations. The parties shall file Joint Stipulations of Fact in accordance with the Court's normal stipulation process.[3]

6. Testimony by Affidavit. Except as otherwise provided herein, each party shall present the direct testimony of its witnesses, including any expert witnesses, by affidavit(s) sworn to under penalty of perjury and otherwise admissible under Federal Rules of Evidence. The oral testimony offered at the hearing by a party will be strictly limited to rebuttal testimony. If a portion of an affidavit of a witness concerns an exhibit to be admitted into evidence at the hearing, the exhibit must be attached to the affidavit.

7. Affidavits Unavailable. If a party is unable to obtain an affidavit of a witness, counsel for that party shall file an affidavit stating the name of the witness and a detailed summary of the expected testimony and why counsel was unable to obtain the witness affidavit. Failure to make every reasonable effort to obtain the affidavit of any such witness will result in exclusion of any oral testimony of such witness. If a party intends to present testimony of the witness by a

[3] Instructions available at http://www.kyeb.uscourts.gov, Judges' Info—Special Instructions—Joint Stipulation Preparation.

transcript of a deposition of the witness, only those portions of the transcript intended to be offered should be attached to counsel's affidavit.

8. Cross-Examination of Affiant(s). The affidavit of a witness will be admissible at the hearing, subject to timely objections, *only if* the affiant is present at the hearing to submit to cross examination.

9. Qualification of Expert Witnesses. On the date set forth below, the parties shall serve and file a statement as to the qualifications of any expert witness. The testimony of the expert witness will be allowed unless written objections to the qualifications of the witness are timely filed.

10. Exhibits. The parties shall produce for inspection by the opposing party(ies) and file an Exhibit List and copies of all exhibits that are to be placed in evidence in accordance with the Court's Administrative Procedures Manual. The exhibits shall be marked with exhibit numbers and the pages of each shall be numbered. Unless written objections to the authenticity and/or admissibility of each such exhibit are timely filed, the exhibit shall be deemed authentic and may be admitted upon request of the party to admit the exhibit into evidence at the hearing. In the absence of good cause, no exhibit may be offered in evidence except upon compliance with the conditions contained in this order. Each party shall have a sufficient number of copies of pre-numbered exhibits at the evidentiary hearing for the Court, opposing counsel, and the witness.

11. Time for Filing Joint Stipulations, Affidavits, Exhibits, Expert Witness Qualifications and Objections. All Joint Stipulations, Briefs, Affidavits, Exhibits and Expert Witness Qualifications shall be filed on or before **November 23, 2016**. Any objections to the Affidavits, Exhibits or Expert Witness Qualifications shall be filed on or before **December 1, 2016**.

12. Debtors are directed to serve this order in conformity with the notice procedures previously approved herein.

The affixing of this Court's electronic seal below is proof this document has been signed by the Judge and electronically entered by the Clerk in the official record of this case.

Signed By:
Tracey N. Wise
Bankruptcy Judge
Dated: Monday, October 03, 2016
(tnw)