

Absolute Priority Rule  
New Value Exception  
Individual Chapter 11  
11 USC § 1129(b) (2) (B)

Clinton and Delynn Tucker, Case No. 10-67281-fra11

11/28/2011 FRA

Unpublished

Debtors filed an individual chapter 11 case. Their plan of reorganization provided for payment of creditors from future income and cash flow from the operation of their business. Unsecured creditors would receive approximately 16% of their claims over a period of five years and the Debtors would retain their interest in all assets of the estate, which would re-vest in them upon confirmation. Unsecured creditors as a class rejected the plan. The court denied confirmation from the bench and stated it would issue a written opinion expanding on its ruling.

The primary issue is whether the Absolute Priority Rule applies to individual chapter 11 debtors, the provisions for which were added by the 2005 Reform Act. The Absolute Priority Rule at § 1129(b) (2) (B) (ii) provides that with respect to a class of unsecured claims where such a class has not accepted a plan, no junior claim or interest will receive or retain any property on account of such junior claim or interest. The Reform Act added additional language to that provision regarding individual chapter 11 debtors which referred to a newly added section defining property of the estate where the debtor is an individual. Courts have interpreted the language of these two provisions and come to differing opinions as to whether the Absolute Priority Rule applies to individual chapter 11 debtors. The bankruptcy court in this case ruled that it does.

Given that the Absolute Priority Rule is applicable here, the court stated that the New Value Exception to the Rule is also applicable. The New Value Exception provides that a junior class may still retain property where a senior class is receiving less than its allowed claims to the extent that the junior class provides "new value." Debtors argued that Debtor Clinton Tucker would pay additional future salary into the Plan to satisfy the new value requirement. The court, however, ruled that an unsecured promise of payments out of anticipated future salary does not constitute new value as defined by the court in *Northwest Bank Worthington v. Alhers*, 485 U.S. 197, 204 (1988). Debtors were given additional time to file an amended plan.

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

In re:	}	
	}	Bankruptcy Case No. 10-67281-fra11
CLINTON SCOTT TUCKER and	}	
DELYNN G. TUCKER,	}	
Debtors.	}	MEMORANDUM OPINION

This Memorandum Opinion documents the bankruptcy court’s ruling at a hearing held on November 3, 2011, at which confirmation of Debtors’ individual chapter 11 Plan of Reorganization was denied based on the Plan’s failure to meet the requirements of the Absolute Priority Rule. The Court’s analysis of the issues and the reasons for its ruling follow.

DISCUSSION

Debtors’ First Amended Plan of Reorganization (Plan) provided for the payment of their creditors from future income and cash flow from the operations of their tanning salon business. The Plan provided for five classes of secured claims, one class of unsecured claims, and one class of equity security holders. Unsecured creditors would receive approximately 16.19% of the allowed amount of their unsecured claims through quarterly payments of varying amounts over a period of 61 months. Class 7 equity security holders (the Debtors herein) would not receive any distribution under the Plan, but would retain their interest in all assets of the estate, which would re-vest in the Reorganized Debtors upon confirmation.

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1 Prior to the November 3 confirmation hearing, Debtors submitted a summary of the creditors  
 2 accepting and rejecting the Plan. Class 6 unsecured creditors rejected the Plan, with slightly less than the  
 3 required 2/3 of the dollar amount of allowable claims of voting creditors having voted to accept.

4 Absolute Priority Rule

5 11 U.S.C. § 1129(b)(2)(B)<sup>1</sup> provides that each member of a dissenting class of unsecured claims  
 6 must either be paid an amount equal to the amount of its allowed unsecured claim as of the effective date of  
 7 the plan, or

8 (ii) the holder of any claim or interest that is junior to the claims of such class will not  
 9 receive or retain under the plan on account of such junior claim or interest any  
 10 property, except that in the case in which the debtor is an individual, the debtor may  
 11 retain property included in the estate under section 1115, subject to the requirements of  
 12 subsection (a)(14) of this section [emphasis added].

13 The part of the provision cited above that is underlined was added as part of the 2005 revision of  
 14 the bankruptcy code (BAPCPA) and confirmation of Debtors' Plan is dependent on how it is interpreted  
 15 because junior Class 7 interest holders will remain in possession of property of the estate while senior Class 6  
 16 claimants, which rejected the Plan, will receive less than their allowable claims. Section 1115 was also added  
 17 by BAPCPA to define property of the estate in an individual chapter 11 case:

18 (a) In a case in which the debtor is an individual, property of the estate includes, in  
 19 addition to the property specified in section 541 --  
 20 (1) all property of the kind specified in section 541 that the debtor acquires after the  
 21 commencement of the case but before the case is closed, dismissed, or converted to a  
 22 case under chapter 7, 12, or 13, whichever occurs first . . . .

23 Debtors urge the court to adopt the interpretation of the added language to the Absolute Priority  
 24 Rule commonly referred to as the "broad construction," which holds that the Absolute Priority Rule was  
 25 abolished for individual chapter 11 cases. The reasoning of these courts is generally that § 1115 captures both  
 26 pre- and post-petition property as property of the estate, which 1129(b)(2)(B)(ii) allows individual chapter 11  
 27 debtors to retain over a dissenting class of unsecured creditors. Examples of the "broad construction"

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28 <sup>1</sup> Unless otherwise indicated, all statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101 to  
 29 1532.

1 interpretation include In re Tegeder, 369 B.R. 477 (Bankr. D. Neb. 2007), In re Roedemeier, 374 B.R. 264  
2 (Bankr. D. Kan. 2007), In re Shat, 424 B.R. 854 (Bankr. D. Nev. 2010).

3 In contrast, other courts have adopted the so-called “narrow view” in concluding that the  
4 Absolute Priority Rule survived the changes made by BAPCPA for individual chapter 11 debtors. They come  
5 to this conclusion by finding that the phrase “included in the estate under section 1115” can only be  
6 interpreted as meaning “added to the bankruptcy estate by § 1115.” In re Gbadebo, 431 B.R. 222, 229  
7 (Bankr. N.D. Cal. 2010). See also In re Kamell, 451 B.R. 505 (Bankr. C.D. Cal. 2011)(adopts narrow view).  
8 The bankruptcy court in In re Karlovich, 456 B.R. 677 (Bankr. S.D. Cal. 2010) also adopted the narrow view  
9 in holding that a “plain, unambiguous reading” of the statutes at issue leads to the conclusion that §  
10 1129(b)(2)(B)(ii) excludes from the Absolute Priority Rule only property “the debtor acquires after the  
11 commencement of the case . . . .” Id. at 681. The court noted that “[t]he effect of the new provision in §  
12 1129(b)(2)(B)(ii) is not to abrogate the absolute priority rule, but to make it the same for individual and non-  
13 individual Chapter 11 debtors, as it was prior to BAPCPA.” Id. at 681.

14 The Court agrees with the “narrow view” interpretation of § 1129(b)(2)(B)(ii) and adopts the  
15 reasoning and holding of Chief Judge Bowie in his Karlovich opinion. The Absolute Priority Rule as applied  
16 to individual chapter 11 debtors survived the changes made by BAPCPA to § 1129(b)(2)(B)(ii) and the  
17 addition of § 1115, and puts individual chapter 11 debtors in the same position as other chapter 11 debtors  
18 with respect to the Absolute Priority Rule.

#### 19 New Value Exception

20 Given the Court’s holding regarding the Absolute Priority Rule, it follows that caselaw providing  
21 an exception to the Absolute Priority Rule to “old equity” where “new value” is contributed to the  
22 reorganized debtor is also pertinent in the case of individual chapter 11 debtors. If the new value exception is  
23 met, it would allow such a debtor to “cram down” a dissenting class of unsecured creditors while still  
24 retaining an interest in the reorganized debtor. For a debtor’s plan to be confirmed as “fair and equitable”  
25 over the objection of a dissenting class, the “new value” exception requires the individual chapter 11 debtor to  
26 offer value that is “(1) new, (2) substantial, (3) money or money’s worth, (4) necessary for a successful

1 reorganization, and (5) reasonably equivalent to the value or interest received.” In re Bonner Mall  
2 Partnership, 2 F.3d 899, 908-09 (9th Cir. 1993). The value must be “tangible, alienable, enforceable, and  
3 something of value to the creditors at the time the plan is confirmed.” Northwest Bank Worthington v.  
4 Ahlers, 485 U.S. 197, 204 (1988).

5 Debtors state that Mr. Tucker will be contributing money to the Reorganized Debtor in the form  
6 of future salary earned by him over the term of the Plan. This, they argue, should constitute the new value  
7 necessary to allow Debtors to retain their interest in the business while the senior class of dissenting unsecured  
8 creditors is being paid less than the amount of their allowed claims. While it is laudable that the Debtors are  
9 willing to put additional personal money into the business to keep it going, the contribution of future salary  
10 does not, as the Court held at the November 3 hearing, constitute “new value” as it is defined in Ahlers. The  
11 Debtor’s unsecured promise of payments out of anticipated future salary does not meet the requirement that  
12 the value given be in “money or moneys worth,” because it cannot be exchanged in any market for something  
13 of value to the creditors at the time the plan is confirmed.

#### 14 CONCLUSION

15 Debtors’ Chapter 11 Plan of Reorganization proposed to pay unsecured creditors less than their  
16 allowed claims while the individual Debtors, junior to the class of unsecured creditors, would continue to  
17 retain pre-petition property of the estate on account of their junior claim. Because the class of unsecured  
18 creditors voted to reject the Plan, the Plan cannot be confirmed because it violates the Absolute Priority Rule  
19 of § 1129(b)(2)(B)(ii), and the unsecured promise of payments out of expected future salary does not  
20 constitute “new value” to meet the “new value exception.”

21 As the Court’s minute order of the November 3 hearing indicates, Debtors will be given additional  
22 time to file an amended plan.



25 FRANK R. ALLEY, III  
26 Chief Bankruptcy Judge