

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION**

In re:

US Route 23 Supply, LLC,

Debtor.

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Case No. 10-62903

Chapter 11

Judge Caldwell

**MEMORANDUM OPINION AND ORDER DENYING CONFIRMATION OF
SECOND AMENDED PLAN (DOC. NO. 75), CONVERTING CASE TO CHAPTER 7
AND ORDERING IMMEDIATE CESSATION OF OPERATIONS
AND APPOINTMENT OF INTERIM TRUSTEE**

US Route 23 Supply, LLC (“Debtor”) appeared before the Court on September 19, 2011, to obtain confirmation of its Second Amended Plan of Reorganization (“Plan”) (Doc. No. 75), with creditors Roberta and William Hendershot (“Hendershots”), and Famous Enterprises, Inc. (“Famous Enterprises”) filing objections to confirmation. After hearing the parties’ arguments, reviewing the motions and briefs filed, and in accordance with this Court’s order approving the disclosure statement and giving notice of conversion or dismissal (Doc. No. 60), the Court denies confirmation of Debtor’s Plan, orders conversion of Debtor’s bankruptcy proceeding to Chapter 7, with an immediate cessation of operations and appointment of an interim trustee. A brief history of this case illustrates the bases for the Court’s decision.

The Debtor is a retail and wholesale plumbing, heating, and cooling parts supply company headquartered in Circleville, Ohio, with miscellaneous businesses in pool and barbecue sauce sales. Mr. Michael Grashel is the sole member and owner of Debtor, which filed for Chapter 11 relief on October 29, 2010 to stop the Hendershots from executing on a state court pre-judgment attachment.

At the time of filing, Debtor listed approximately \$598,000.00 in total debts, and currently Debtor has claims against it totaling \$1,325,515.46. The First Amended Disclosure Statement (Doc. No. 58) was approved over the objections of the Hendershots and Famous Enterprises. The Court noted in its order (Doc. No. 60) that confirmation of the plan in its current form was unlikely, and if the plan could not be confirmed, the Court would dismiss or convert this case to Chapter 7. The Court was giving the Debtor one last opportunity to file an amended plan that addressed the two creditor objections.

Debtor's Plan creates seven classes: (1) administrative expenses; (2) governmental priority claims; (3) the impaired Kingston secured claim; (4) the impaired Toyota secured claim for a Toyota Tundra; (5) an impaired secured Toyota Motor Corporation Claim on a Toyota forklift; (6) impaired unsecured non-priority creditors; and (7) the interest of the equity security holder. Under the proposed Plan, administrative and secured creditors are paid in full and unsecured creditors would receive a 15% dividend on their claims through monthly payments of \$673.57 over 60 months.

To secure payment for the unsecured creditors, the Plan proposes that Debtor execute a first mortgage on unencumbered property in favor of a nominated member of the class, holding that mortgage in trust until the entire class is paid in full. Debtor owns a pole-barn and the surrounding acreage in Circleville, Ohio, which is unencumbered and serves as Debtor's

headquarters. This property was purchased for \$285,000.00 in 2008, was valued in the schedules at \$200,200.00; and Debtor testified that he received purchase offers at \$135,000.00.

The Plan also provides that if Debtor must contribute new value to retain his ownership interest, Mr. Grashel is prepared to contribute \$23,500.00 in commitments from friends and relatives. The amended disclosure statement provides the names of the seven individuals who are evidently willing to provide between \$1,000.00 and \$5,000.00 each to help Mr. Grashel retain his ownership interests. The Plan, however, provides no guarantee that the funds will be paid.

Although the impaired Toyota Motor Credit Corporation B-3 class voted to accept the Plan, the unsecured creditor C-1 class voted against it. Famous Enterprises and the Hendershots also filed objections to confirmation of the Plan on four bases. First, it fails the absolute priority rule under 1129(b) because Mr. Grashel retains his equity interest in Debtor's unencumbered property while unsecured creditors receive less than full repayment. Second, the Plan is not feasible, violating 1129(a)(11). Third, the Plan does not satisfy the best interest of creditors as required by 1129(a)(7). Fourth, the objecting parties claim that the Plan was not proposed in good faith, breaching 1129(a)(3). When asked what remedy they would prefer in the event the Court denied confirmation, Counsel for Famous Enterprises and the Hendershots both preferred Chapter 7 liquidation.

Turning to the applicable standards, section 1129 of the United States Bankruptcy Code ("Code") requires that a debtor demonstrate by a preponderance of the evidence that the plan satisfies statutory standards. *Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. P'ship (In re Ambanc La Mesa Ltd. P'Ship)*, 115 F.3d 650, 653 (9th Cir. 1997). Additionally, the Court has an independent duty to determine whether the plan complies with the Code. *In re Hockenberry*, No.

09-59064, 2011 Bankr. LEXIS 3568, at *12–*43 (Bankr. S.D. Ohio Sept. 16, 2011). The Code requirements are less strict when there are no objecting creditors and impaired voting classes accept the plan. In such instances, the debtor only has to show compliance with section 1129(a) which ensures that the plan is feasible, is proposed in good faith, and is in the best interest of all creditors. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

When impaired classes reject the plan, however, debtors must additionally satisfy the absolute priority rule in section 1129(b), which requires that if a junior class retains property under the plan, senior classes must be provided for in full. *Travelers Insurance Co. v. Bryson Props., XVIII (In re Bryson Props., XVIII)*, 961 F.2d 496, 500 (4th Cir. 1992).

The orderly process of distributing a debtor’s assets requires creditors to stand in line, and unsecured creditors are paid before equity. *In re Montgomery Court Apartments of Ingham Cnty., Ltd.*, 141 B.R. 324, 343 (Bankr. S.D. Ohio 1992). The absolute priority rule mandates that equity holders cannot retain property if senior claims are not paid in full. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

However, the “new value” exception allows an equity holder to retain their interest by presenting new value in the form of liquid capital. *See In re Crosscreek Apartments.*, 213 B.R. 521 (Bankr. E.D. Tenn. 1997). This new value must be both (1) reasonably equivalent to the value that the equity class retains, and (2) necessary to the debtor’s reorganization and ongoing business needs. *See Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939); *Montgomery Court*, 141 B.R. at 343–44.

Although Debtor recognized the necessity of dealing with the absolute priority rule, it failed to satisfy its requirements. Under the Plan, Mr. Grashel, the Debtor’s sole equity holder, will retain his interest post-confirmation. In comparison, unsecured creditors will receive

approximately \$40,414.20 in cash distributions, a dividend far less than 100%. As unsecured creditors would receive less than the full amount of their claims, Mr. Grashel must provide new value to retain his interest.

In response, the Debtor proposes to (1) grant a security interest in its unencumbered property to a member of the unsecured creditor class; and (2) provide up to \$23,500.00 of capital contributed by friends and family. The Court finds and concludes that the proposed capital contributions and mortgage are not reasonably equivalent to the value retained by Mr. Grashel.

After substantial consummation of the Plan, unsecured creditors would receive up to \$63,914.00, while Mr. Grashel retains the unencumbered property worth, at a minimum, \$135,000.00. The mortgage only ensures payment; it does not provide unsecured creditors with any increased percentage distribution on their claims. In addition, there is no guarantee that the proposed capital contributions would be made. In sum, the Debtor has failed to provide new value that is reasonably equivalent to the interest retained by equity. As a result, the Plan violates the absolute priority rule, and cannot be confirmed. This finding and conclusion makes it unnecessary to discuss the remaining objections.

Regarding the disposition of this case, Debtor's records show that there are significant assets that may yield a meaningful recovery for creditors. Conversion to Chapter 7 provides an orderly liquidation and distribution of assets. On the other hand, dismissal results in a scramble to collect, which is an anathema to the purpose of bankruptcy—ensuring a fair and orderly distribution of a debtor's assets. *See In re Iowa R.R. Co.*, 840 F.2d 535, 536–37 (7th Cir. 1988). As a result, the Court finds and concludes that the conversion of this case to Chapter 7 is in the best interest of creditors.

For all these reasons, the Court **DENIES** confirmation of the Debtor's Plan, and **ORDERS** that this case is **CONVERTED** to Chapter 7 of the United States Bankruptcy Code, and that all business operations **CEASE**, immediately.

IT IS FURTHER ORDERED that the United States Trustee shall **FORTHWITH** appoint an interim trustee, and shall **FORTHWITH** notify the Court of the selection.

IT IS SO ORDERED.

Copies to:

All Creditors and Parties in Interest