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**UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA  
LOS ANGELES DIVISION**

In re

**DAVID L. ARNOLD and  
GRACE E. ARNOLD,**

Debtors.

Case No. 2:12-bk-15623-RK

Chapter 11

**MEMORANDUM DECISION IN  
SUPPORT OF CERTIFICATION FOR  
DIRECT APPEAL AND GRANTING  
DEBTORS' MOTION FOR  
CERTIFICATION**

DATE: July 24, 2012  
TIME: 2:30 p.m.  
PLACE: Courtroom 1675  
255 E. Temple St.  
Los Angeles, CA 90012

On May 18, 2012, the court entered an Order Denying Approval of Debtors' Disclosure Statement (the "Order") and Memorandum Decision re Denial of Approval of the Debtors' Amended Disclosure Statement (the "Memorandum Decision"). Docket Nos. 187, 188; *In re Arnold*, 471 B.R. 578 (Bankr. C.D. Cal. 2012). On May 22, 2012, David L. Arnold and Grace E. Arnold (the "Debtors") filed a Notice of Appeal and an Election to Appeal to District Court. Docket Nos. 196, 197. Also on May 22, 2012, the Debtors filed this Motion to Certify Direct Appeal to the Ninth Circuit Court of Appeals. This matter is

1 still pending before this court pursuant to Federal Rules of Bankruptcy Procedure  
2 8001(f)(2) and 8007(b).

3 The court determines that the Order is appropriate for certification to the Court of  
4 Appeals for the Ninth Circuit. Pursuant to Federal Rule of Bankruptcy Procedure  
5 8001(f)(3)(F), the court issues this memorandum decision in support of the certification of  
6 the Order under 28 U.S.C. § 158(d)(1)(A)(i) and (ii).

### 7 **BACKGROUND**

8 On August 24, 2011, the Debtors filed a Disclosure Statement and a proposed  
9 Chapter 11 Plan of Reorganization. A hearing was held on approval of the Disclosure  
10 Statement on September 28, 2011. Issues regarding the confirmability of the Plan were  
11 raised by creditor U.S. Bank, arguing that the court should not approve the Disclosure  
12 Statement because the Plan violated the absolute priority rule. The hearing was  
13 continued, and the Debtors filed an Amended Disclosure Statement and proposed  
14 Chapter 11 Plan of Reorganization dated and filed on October 14, 2011. On November  
15 16, 2011, the court held a hearing on the Amended Disclosure Statement, where U.S.  
16 Bank objected on the same grounds. That hearing was continued to January 18, 2012.  
17 Supplemental briefing was filed, and before that hearing, the court vacated the January  
18 18 hearing and took the matter under submission.

19 While the matter was under submission, the Bankruptcy Appellate Panel (“BAP”)  
20 of the Ninth Circuit, in a divided 2-1 decision, issued an opinion on March 19, 2012 in  
21 *Friedman v. P+P, LLC (In re Friedman)*, 466 B.R. 471 (9th Cir. BAP 2012), which held  
22 that the absolute priority rule does not apply in Chapter 11 bankruptcy cases of individual  
23 debtors after the enactment of the Bankruptcy Abuse Prevention and Consumer  
24 Protection Act of 2005 (“BAPCPA”), Pub. L. No. 109-8, 119 Stat. 23 (2005). On March  
25 20, 2012, the court issued an order inviting further briefing from the parties in light of the  
26 recent BAP decision. A final hearing on the Debtors’ Disclosure Statement was held on  
27 April 25, 2012.

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1 Because U.S. Bank holds more than one-third of the allowed claims in Class 5,  
2 and because U.S. Bank has voiced its intention to vote against the proposed Plan in the  
3 opposing papers, the Debtors' Plan would not satisfy the requirement of 11 U.S.C.  
4 § 1129(a)(8) and would therefore need to satisfy the cramdown provisions of § 1129(b).  
5 See 11 U.S.C. § 1126. Section 1129(b) states that a plan may be confirmed if it "does  
6 not discriminate unfairly, and is fair and equitable, with respect to each class of claims or  
7 interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1).  
8 As to an impaired dissenting class of unsecured creditors, such as Class 5, the  
9 Bankruptcy Code defines "fair and equitable" as follows:

10 (i) the plan provides that each holder of a claim of such class receive or  
11 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

12 (ii) the holder of any claim or interest that is junior to the claims of such  
13 class will not receive or retain under the plan on account of such junior  
14 claim or interest any property, except that in a case in which the debtor is  
15 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.

16 11 U.S.C. § 1129(b)(2)(B).

17 The Debtors' Plan would provide for less than 15% of General Unsecured Claims;  
18 thus, the Plan must satisfy § 1129(b)(2)(B)(ii) to be confirmed.

19 Section 1129(b)(2)(B)(ii) codifies the "absolute priority rule" and prohibits "the  
20 bankruptcy court from approving a plan that gives the holder of a claim anything at all  
21 unless all objecting classes senior to him have been paid in full." *Everett v. Perez (In re*  
22 *Perez)*, 30 F.3d 1209, 1214 (9th Cir.1994); *see also Norwest Bank Worthington v. Ahlers*,  
23 485 U.S. 197, 202, (1988) (the absolute priority rule "provides that a dissenting class of  
24 unsecured creditors must be provided for in full before any junior class can receive or  
25 retain any property [under a reorganization] plan").

26 BAPCPA added § 1115 and amended §1129(b)(2)(B)(ii). Following BAPCPA,  
27 there has been a split among courts as to whether the absolute priority applies in  
28 individual Chapter 11 cases.

1 In denying approval of the Debtors' Disclosure Statement, the court concluded that  
2 the absolute priority rule does apply in individual cases, that the Debtors' Plan violated  
3 the absolute priority rule, and the Debtors' Plan was therefore patently unconfirmable. *In*  
4 *re Arnold*, 471 B.R. at 614.

## 5 DISCUSSION

6 A court of appeals has jurisdiction of appeals from a bankruptcy court if (1) the  
7 bankruptcy court<sup>1</sup> certifies the order from which the appeal is taken and (2) the court of  
8 appeals authorizes the direct appeal of the order. 28 U.S.C. § 158(d). The bankruptcy  
9 court must certify that,

10 (i) the judgment, order, or decree involves a question of law as to which  
11 there is no controlling decision of the court of appeals for the circuit or of  
12 the Supreme Court of the United States, or involves a matter of public  
13 importance;

14 (ii) the judgment, order, or decree involves a question of law requiring  
15 resolution of conflicting decisions; or

16 (iii) an immediate appeal from the judgment, order, or decree may  
17 materially advance the progress of the case or proceeding in which the  
18 appeal is taken

19 28 U.S.C. § 158(d)(2)(A).

20 This case involves the question of whether the absolute priority rule applies in  
21 individual Chapter 11 cases. The court certifies the Order under § 158(d)(2)(A)(i) and (ii).

### 22 I. No Controlling Decision

23 The Order should be certified because it involves the question of whether the  
24 absolute priority rule applies in individual Chapter 11 cases. There is no controlling  
25 decision by the Ninth Circuit Court of Appeals or by the Supreme Court. Although a  
26 recent majority decision from the BAP concluded that the absolute priority rule does not  
27 apply in individual Chapter 11 cases, this court held, along with other courts, that BAP  
28 decisions are not controlling on other bankruptcy courts. *In re Arnold*, 471 B.R. 587-590;

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<sup>1</sup> If the matter is no longer pending before the bankruptcy court within the meaning of Federal  
Rules of Bankruptcy Procedure 8001(f)(2) and 8007, then the district court or bankruptcy  
appellate panel must certify the order. 28 U.S.C. § 158(d)(2)(A); Fed. R. Bank. P. 8001(f)(2)(A).

1 see also *Bank of Maui v. Estate Analysis, Inc.*, 904 F.2d 470, 471 (9th Cir. 1990); *In re*  
2 *Grant*, 423 B.R. 320 (Bankr. S.D. Cal. 2010); *In re Zimmer*, 313 F.3d 1220, 1225–1226  
3 (9th Cir. 2002); *Rinard v. Positive Investments, Inc. (In re Rinard)*, 451 B.R. 12 (Bankr.  
4 C.D. Cal. 2011).

## 5 **II. Conflicting Decisions**

6 Courts have reached conflicting decisions regarding the applicability of the  
7 absolute priority rule in individual Chapter 11 cases.

8 A majority of the courts ruling on the issue has ruled that the absolute priority rule  
9 applies in Chapter 11 bankruptcy cases of individual debtors. See *In re Lively*, 467 B.R.  
10 884 (Bankr. S.D. Tex. 2012); *In re Tucker*, 2011 WL 5926757 (Bankr. D. Or. 2011); *In re*  
11 *Borton*, 2011 WL 5439285 (Bankr. D. Idaho 2011); *In re Lindsey*, 453 B.R. 886 (Bankr.  
12 E.D. Tenn. 2011); *In re Kamell*, 451 B.R. 505 (Bankr. C.D. Cal. 2011); *In re Draiman*, 450  
13 B.R. 777 (Bankr. N.D. Ill. 2011); *In re Maharaj*, 449 B.R. 484 (Bankr. E.D. Va. 2011); *In re*  
14 *Walsh*, 447 B.R. 45 (Bankr. D. Mass. 2011); *In re Stephens*, 445 B.R. 816 (Bankr. S.D.  
15 Tex. 2011); *In re Karlovich*, 456 B.R. 677 (Bankr. S.D. Cal. 2010); *In re Steedley*, 2010  
16 WL 3528599 (Bankr. S.D. Ga. 2010); *In re Gelin*, 437 B.R. 435 (Bankr. M.D. Fla. 2010);  
17 *In re Mullins*, 435 B.R. 352 (Bankr. W.D. Va. 2010); *In re Gbadebo*, 431 B.R. 222 (Bankr.  
18 N.D. Cal. 2010). In addition to the cases cited, the Court of Appeals for the Fourth Circuit  
19 recently held that the absolute priority rule applies in individual Chapter 11 cases. See *In*  
20 *re Maharaj*, 681 F.3d 558 (4th Cir. 2012). The Fourth Circuit is the first and only circuit  
21 court of appeals to have ruled on this issue so far.

22 A minority of courts has ruled to the contrary that the absolute priority rule does  
23 not apply in individual Chapter 11 bankruptcy cases. See *Friedman v. P+P, LLC (In re*  
24 *Friedman)*, 466 B.R. 471 (9th Cir. BAP 2012); *SPCP Group, LLC v. Biggins*, 465 B.R.  
25 316 (M.D. Fla. 2011); *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010); *In re Roedemeier*,  
26 374 B.R. 264 (Bankr. D. Kan. 2007); *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007);  
27 *In re Bullard*, 358 B.R. 541, 545 (Bankr. D. Conn. 2007); see also *In re Johnson*, 402  
28 B.R. 851, 852-853 (Bankr. N.D. Ind. 2009) (dicta that individual Chapter 11 debtor's plan

1 need not satisfy the absolute priority rule of 11 U.S.C. § 1129(b)(2)(B)(ii); *In re*  
2 *Hockenberry*, 457 B.R. 646, 660-661 & n.14 (Bankr. S.D. Ohio 2011) (collecting cases on  
3 issue, but not reaching the issue because case decided on other grounds).

4 Because the issue of whether the absolute priority rule applies in a Chapter 11  
5 bankruptcy case of an individual debtor will determine the outcome of the bankruptcy  
6 case, i.e., whether the debtors may confirm a reorganization plan over the objection of  
7 the unsecured creditor class, and the law is uncertain due to the sharp split in opinion  
8 among the courts which have decided the issue, including various courts within this  
9 circuit, the court concludes that the instant motion should be granted.

10 **CONCLUSION**

11 The court certifies the Order Denying Approval of Debtors' Disclosure Statement  
12 (Docket No. 187) to the Court of Appeals for the Ninth Circuit under 28 U.S.C.  
13 § 158(d)(1)(A)(i) and (ii).

14 Counsel for the Debtor shall submit a proposed order consistent with this  
15 memorandum decision.

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United States Bankruptcy Judge

26 DATED: July 25, 2012

