UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

SAMUEL RATHMEL,
CORAMARIE RATHMEL,

Debtors.

Case No. 87-2063-C J

Chapter 11

ORDER ON CONFIRMATION OF PLAN, MOTION TO DISMISS AND MOTION FOR RELIEF FROM STAY

On July 7, 1988 the following matters came on for hearing in Des Moines, Iowa: (1) a motion to dismiss this Chapter 11 case filed by the Small Business Administration (SBA) on April 13, 1988; (2) the SBA's motion for relief filed on April 13, 1988; and (3) the United States Trustee's objections to the debtors' plan. Max Exline appeared on behalf of the debtors. Kevin R. Query, Assistant U.S. Attorney, appeared on behalf of the SBA. Terry L. Gibson appeared on behalf of the U.S. Trustee. The record before the court includes a transcript of the July 7, 1988 hearing and the exhibits submitted by the debtors. The court considers these matters fully submitted.

FACTS

The debtors operate a variety store located in Knoxville, Iowa. They sell appliances, hardware and craft supplies. In January of 1988 the debtors added a consignment shop selling used clothing, furniture and other items.

On August 14, 1987 the debtors filed for relief under Chapter 11. The SBA holds a claim against the debtors in

the principal sum of $131,645.15 which arose under a promissory note dated June 1, 1983. To secure the note, the debtors granted the SBA a mortgage interest in a two story brick building that serves as the debtors' business premises. The SBA also holds a blanket security interest in the debtors' personal property including inventory. As of the hearing on confirmation, the value of the collateral totaled $94,628.00.

The SBA's secured claim is treated in Class III of the debtors' plan. SBA is the only claim holder treated in Class III. The class is impaired. They propose to pay $94,628.00 over 25 years at 8% interest for monthly payments of $730.35 per month. The unsecured portion of SBA's claim is treated in Class IX. The debtors propose to pay unsecured claim holders a pro rata share of $529.97 over 5 years. SBA's unsecured claim totals $37,017.15. This claim comprises more than two-thirds in amount of the claims in Class IX. The SBA as a Class III claim holder and a Class IX claim holder voted to reject the plan. Wright and Wilhelmy Co., an unsecured claim holder in Class IX holds a claim of $354.37 and voted to reject the plan. Eureka Company, a Class IX claimant holding a claim in the amount of $411.82 voted to accept the plan. Counsel for the debtor is listed as a Class IX claimant holding a claim in the amount of $4,549.50. Counsel voted to accept-the plan. The other unsecured creditors did not vote.

To overcome financial difficulties, the debtors plan to rent portions of the business premises and sell ice cream and upscale bicycles. As of the confirmation hearing the debtors had not entered into any leases. Further, their plans to sell ice cream and bicycles have been postponed. The debtors also plan to manufacture and market Iowa state flags. The flag making venture has yet to progress beyond the contemplation stage. Debtor Samuel Rathmel testified that he did not know what income might be derived from the venture nor what kind of expenses might be required. Samuel works for the local sheriff's office and has committed his $500.00 per month salary to plan payments. This salary is not reflected in the debtors' cash flows.

The debtors' cash flows are summarized as follows:

	1987	1988	1989	1990	1991	1992
			INCOME			
Gross Retail Sales	$29,865	$ 84,019	$ 89,060	$ 94,860	$101,015	$101,015
Consignment Sales	480	8,280	9,936	10,152	12,486	12,486
Rental	279	360	480	480	480	480
Miscellaneous	740	150	150	150	150	150
Interest	4	10	11	12	12	12
Wages	4,019	6,480	6,480	6,480	6,480	6,480
Other Work	1,515	1,500	1,500	1,000	1,000	1,000
Rental Property	474	--	--	--	--	--
Total	$37,376	$100,799	$107,617	$113,124	$121,623	$121,623

	1987	1988	1989	1990	1991	1992
EXPENSES (including cost of goods sold)	$34,646	$90,127	$92,260	$96,073	$100,081	$100,081
PROFIT	2,730	10,672	15,357	17,051	21,542	21,542
CARRY-OVER	--	2,730	8,402	7,449	8,190	13,422
TOTAL PROFIT	2,730	13,402	23,759	24,500	29,732	34,694
DEBT SERVICE	--	5,000	16,310	16,310	16,310	15,995
CUSHION	$ 2,730	$ 8,402	$ 7,449	$ 8,190	$ 13,422	$ 18,969

The debtors' monthly reports show that for the 11-month period from September 1, 1987 through July 1, 1988 the debtors have had $45,179.97 in gross retail sales. This figure breaks down to monthly gross retail sales of $4,107,27.

DISCUSSION

I.

The U.S. Trustee in its objections to the plan and the SBA in its motion to dismiss challenge the feasibility of the debtor's plan. 11 U.S.C. section 1129(a)(11) provides that as a condition of confirmation the plan must not likely be followed by liquidation. Section 1112(b)(1) states that a case may be dismissed for cause including "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation."

With respect to feasibility determinations, the Eighth Circuit has declared that "the feasibility test is firmly rooted in predictions based on objective fact". In re

Clarkson, 767 F.2d 417, 420 (8th Cir. 1985). Sincerity and honesty are insufficient to make a plan feasible. Id. A plan based on impractical or visionary expectations can not be confirmed. In re Trail's End Lodge, 54 B.R. 898, 904 (Bankr. D. Vt. 1985). Factors to be considered include the earning power of the business, the sufficiency of the capital structure, economic conditions, managerial efficiency, and whether the same management will continue to operate the business. Clarkson, 767 F.2d at 420. In view of these standards, the court finds that the plan is not feasible.

The steps that the debtors plan to take to increase income simply are too speculative. They propose renting a portion of their building yet no tenants have been found. Plans to sell ice cream and bicycles apparently have fallen through. The flag making venture is still in the formative stages. Based upon the sales receipts from September 1, 1987 through July 31, 1988, the debtors can expect gross retail sales to total $49,287.24 in 1988, only 58% of the $84,019.00 projected for 1988. Even after applying Samuel's wages from his job at the sheriff's office, the debtors' cash flows fall far short of projections. The court commends the debtors for their desire to satisfy their creditors and their efforts in trying to rebuild their business. Certainly such attitudes are important in any reorganization attempt. However, the economic realities presented in this case prevent the debtors from successfully reorganizing.

Assuming that the-debtors had satisfied the other requirements of section 1129(a) except for subsection (a)(8), the so-called absolute priority rule would have required denial of confirmation under the facts. Class IX, the class of unsecured creditors, voted to reject the plan. The debtors do not propose to pay Class IX in full yet propose to retain property under the plan.

One of the requirements for confirming a Chapter 11 plan under section 1129(a) is that the impaired classes must accept the plan. 11 U.S.C. section 1129(a)(8)(A). A class accepts a plan if the plan has been accepted by voting creditors holding at least two-thirds in amount and more than one-half in number of the allowed claims of the class. Section 1126(c). [1] Where an impaired class votes against a plan and the plan meets the other requirements of section 1129(a), the plan still can be confirmed if it does not discriminate unfairly and satisfies the "fair and equitable" standards set out in section 1129(b). The latter provision states in relevant part:

> (b)(1) Notwithstanding section 510(a) of this title, if 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

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[1] SBA and Wright and Wilhelmy Co. hold more than two-thirds in amount of the claims in Class IX. These creditors voted to reject the plan.

> 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.
>
> (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--
>
> (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.

11 U.S.C. section 1129(b). Section 1129(b)(2)(B)(ii) embodies the absolute priority rule. It in essence means that a dissenting class of unsecured creditors must be paid in full before any junior class can retain property under the plan. Norwest Bank Worthington v. Ahlers, ___U.S.___ 108 S.Ct. 963, 966, 99 L.Ed.2d 169 (1988).

The SBA first raised an objection to the plan based on the absolute priority rule at the hearing on confirmation.

The debtors argue that the objection should not be considered because the SBA failed to raise the objection within the time period prescribed by the court's order of June 6, 1988. The court does not condone the SBA's failure to make its objection in a timely fashion. However, the SBA did timely file its ballot rejecting the plan. Moreover, the court has an independent duty to determine whether the requirements of section 1129 have been met. In re Baugh, 73 B.R. 414, 416 (Bankr. E.D. Ark. 1981/); In re Martin, 66 B.R. 921, 925 (Bankr. D. Mont. 1987); In re Hoosier Hi-Reach, Inc., 64 B.R. 34, 39 (Bankr. N.D. Ind. 1986).

The debtors apparently contend that the plan is confirmable under the "no value" exception to the absolute priority rule. The debtors argue that because they have no equity in the property they propose to retain, such property can not be considered "property" for purposes of section 1129(b)(2) (B)(ii). The Supreme Court, in its most recent pronouncement on the absolute priority rule, expressly rejected the “no value" theory. The court declared:

> We join with the overwhelming consensus of authority which has rejected this 'no value' theory. 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, 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 (CA2 1964)(Friendly, J.). And while the Code itself does not define what 'propertv' 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, 108 S.Ct. at 969. In view of this ruling, the property the debtors plan to retain is "property" under section 1129(b)(2)(B)(ii).

Next, the debtors maintain they are not a junior class to the unsecured creditors. It is a fundamental precept of bankruptcy law that an owner's interest in property is subordinate to the rights of creditors. Kansas City Terminal Ry. Co. v. Central Union Trust Co., 271 U.S. 445, 455, 46 S.Ct. 549, 551, 70 L.Ed. 1028 (1926); Louisville Trust Co. v. Louisville N.S. & C. Ry. Co., 174 U.S. 674, 684, 19 S.Ct. 827, 830, 43 L.Ed. 1130 (1899). Hence, the debtors' contention is without foundation.

Finally, the court examines the debtors' plan under the "infusion of new capital" exception to the absolute priority rule. This exception has its origins in Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939). There the Supreme Court ruled that equity holders

may retain ownership interests in a reorganized debtor, notwithstanding that senior creditors are not paid in full, if equity holders infuse new capital into the reorganized entity that at least equals the value of the interest retained. There is some question whether this exception has survived enactment of the Bankruptcy Code. See Ahlers, 108 S.Ct. at 967, n. 3 (noting division in the lower courts regarding the viability of the exception). The Ahlers court declined to rule on the issue. Id. Assuming for the purpose of analysis and disposition that the exception is viable, the debtors in the instant case fail to satisfy the exception.

A new capital contribution must represent a substantial contribution and equal or exceed the value of the retained interest. In re Potter Material Service, Inc., 781 F.2d 99, 101 (7th Cir. 1986). New value must be invested at confirmation or on the effective date of the plan. In re Pecht, 57 B.R. 137, 140 (Bankr. E.D. Va. 1986). It is the debtors' burden to show that the contribution will meet or exceed the value of the retained interest. In re Future Energy Corp., 83 B.R. 470, 502 (Bankr. S.D. Ohio 1988). In re Eisenbarth, 77 B.R. 228, 236 (Bankr. D. N.D. 1987); In re Sawmill Hydraulics, Inc., 72 B.R. 454, 458 (Bankr. C.D. Ill. 1987).

The only capital infusion the debtors propose to make as of confirmation or the effective date of the plan is $500.00 in wages from Samuel's job at the sheriff's office.

The debtors presented no evidence concerning the value of the interest they propose to retain. Consequently the court can not ascertain whether the $500.00 cash infusion is equal to or greater than the retained interest. Therefore, even if the debtors had satisfied the mandatory requirements of section 1129(a), the court could not conclude that the debtors satisfied the cram down provisions of section 1129(b).

CONCLUSION AND ORDER

WHEREFORE, based upon the foregoing discussion, the court finds that the debtors' plan is not feasible and, accordingly, can not be confirmed under 11 U.S.C. section 1129. The court further finds that there has been a continuing loss to or diminution of the estate and an absence of a reasonable likelihood of rehabilitation.

THEREFORE, IT IS HEREBY ORDERED that confirmation of the plan is denied and that the case is dismissed.

Signed and dated this 31st day of October, 1988.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE