

JUL 31 2018

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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:) BAP No. SC-17-1273-LSKu
)
CHRISTOPHER JOHN HAMILTON and) Bk. No. 3:14-bk-3142-C-11
ELIZABETH LEIGH TESOLIN,)
)
Debtors.)
)
_____)
)
ELITE OF LOS ANGELES, INC.;)
SAN DIEGO TESTING SERVICES,)
INC.,)
)
Appellants,)
)
v.) **M E M O R A N D U M**
)
CHRISTOPHER JOHN HAMILTON;)
ELIZABETH LEIGH TESOLIN,)
)
Appellees.)
_____)

Argued and Submitted on May 24, 2018
at Pasadena, California

Filed - July 31, 2018

Appeal from the United States Bankruptcy Court
for the Southern District of California

Honorable Christopher B. Latham, Bankruptcy Judge, Presiding

Appearances: Gerald N. Sims of Pyle Sims Duncan & Stevenson
argued for Appellants; Paul John Leeds of Higgs
Fletcher & Mack LLP argued for Appellees.

*This disposition is not appropriate for publication.
Although it may be cited for whatever persuasive value it may
have (see Fed. R. App. P. 32.1), it has no precedential value.
See 9th Cir. BAP Rule 8024-1.

1 Before: LAFFERTY, SPRAKER, and KURTZ, Bankruptcy Judges.

2 Appellants Elite of Los Angeles, Inc. ("Elite") and San
3 Diego Testing Services, Inc. ("SDTS") (collectively,
4 "Appellants") appeal the bankruptcy court's order confirming
5 Debtors' Sixth Amended Combined Plan of Reorganization and
6 Disclosure Statement dated March 21, 2017 (the "Plan").
7 Appellants argue that the bankruptcy court erred in finding that
8 all confirmation requirements were met and in approving a Plan
9 provision that enjoined them from enforcing their
10 nondischargeable claims against Debtors for the term of the Plan.

11 We REVERSE.

12 **FACTS**

13 **A. Events Giving Rise to the Debt to Appellants**

14 Elite provided academic counseling, tutoring, and college
15 preparatory and standardized test prep services to high school
16 students. In 1999, Mr. Hamilton joined Elite as a faculty
17 member. In 2006, Elite formed a sister company, SDTS, and
18 Mr. Hamilton became a shareholder, officer, and director of SDTS.

19 After a few years, Mr. Hamilton grew discontent with Elite.
20 In 2011, he retained a law firm to advise him on separating from
21 Elite and forming his own company. Thereafter, while still an
22 officer and director of SDTS, Mr. Hamilton formed Summa
23 Consulting, LLC ("Summa"), an academic counseling and tutoring
24 company. He also began gathering Elite's proprietary information
25 with the assistance of other SDTS employees and his wife,
26 Ms. Tesolin. He took employee personnel files, student records,
27 teaching materials and lesson plans, curriculum development
28 tools, and a copy of the data on SDTS's server. He also began

1 undermining SDTS's prospective business by discouraging potential
2 students from enrolling at SDTS and diverting them to Summa's
3 programs.

4 On October 6, 2011, without any prior notice, Mr. Hamilton
5 resigned from SDTS. That same day, he used Elite's confidential
6 contact list to send emails notifying SDTS's clients of his
7 departure and soliciting business for Summa. Over the next two
8 weeks, several other employees left SDTS to join Mr. Hamilton at
9 Summa, leaving only one employee remaining at SDTS.

10 Shortly thereafter, Appellants filed suit in state court
11 against the Debtors, Summa, and other former SDTS employees,
12 asserting causes of action for breach of fiduciary duty, breach
13 of the duty of loyalty, intentional interference with prospective
14 economic advantage, trade secret misappropriation, unfair
15 competition, aiding and abetting, violation of California Penal
16 Code § 502, and unjust enrichment. Following a trial, the jury
17 returned two special verdicts in Appellants' favor. In relevant
18 part, it found Mr. Hamilton liable for \$2,070,000 for breach of
19 fiduciary duty, breach of the duty of loyalty, intentional
20 interference with prospective economic advantage, trade secret
21 misappropriation, and punitive damages. It also found
22 Ms. Tesolin jointly and severally liable for \$1,855,000 under an
23 aiding and abetting theory ("Elite Judgment").

24 The state court also entered judgment against Summa for
25 \$1,000,000. Thereafter, Summa was recapitalized by new investors
26 in exchange for a majority stake of the company; Mr. Hamilton's
27 ownership interest was reduced to thirteen percent. The new
28 majority owners required Mr. Hamilton to sign an employment

1 agreement with Summa that included covenants against competing
2 with Summa. A few weeks later, in February 2014, the new owners
3 terminated Mr. Hamilton's employment with Summa. Mr. Hamilton
4 sued Summa and its owners in state court for damages and
5 declaratory relief related to Summa's termination of
6 Mr. Hamilton's employment.¹

7 On April 24, 2014, the day of a scheduled sheriff's sale of
8 Mr. Hamilton's stock in SDTS, Debtors filed a chapter 11²
9 petition. Appellants filed proofs of claim based on the debt
10 arising from the Elite Judgment. Appellants also filed an
11 adversary proceeding seeking to except the Elite Judgment from
12 discharge under § 523(a)(6). After a trial in the adversary
13 proceeding, the bankruptcy court entered a judgment finding the
14 \$2,070,000 Elite Judgment nondischargeable in its entirety as to
15 Mr. Hamilton and \$160,000 of the Elite Judgment nondischargeable
16 as to Ms. Tesolin. The bankruptcy court also awarded Appellants
17 postjudgment interest at varying rates for different time
18 periods.³

19
20 ¹That action was removed to the bankruptcy court, and the
21 parties settled the litigation in the spring of 2017.

22 ²Unless specified otherwise, all chapter and section
23 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, all
24 "Rule" references are to the Federal Rules of Bankruptcy
Procedure, and all "Civil Rule" references are to the Federal
Rules of Civil Procedure.

25 ³This Panel affirmed the nondischargeability determination
26 by memorandum decision issued April 17, 2018 (BAP Nos. SC-17-
1126-FBL and SC-17-1223-FBL). In the same decision, the Panel
27 reversed and remanded on the issue of the appropriate rate for
28 postjudgment interest, holding that Appellants were entitled to

(continued...)

1 **B. Mr. Hamilton's Employment With HCC**

2 Shortly after the bankruptcy petition was filed,
3 Mr. Hamilton became employed by Crystal Vision Enterprises, LLC,
4 dba Hamilton College Consulting ("HCC"), an entity formed in
5 April 2014. HCC's sole member is Mr. Hamilton's mother, Diana
6 Hamilton. HCC offers college test preparation, admissions
7 counseling, and private tutoring. Mr. Hamilton has no ownership
8 interest in HCC but is its president as well as its Head of
9 Faculty and Curriculum. He is paid an annual salary of \$199,000.
10 Mr. Hamilton's employment agreement with HCC provides that HCC
11 will indemnify Mr. Hamilton for expenses, including attorneys'
12 fees and costs, incurred by Mr. Hamilton in the bankruptcy case
13 and related adversary proceedings ("Indemnity Agreement"). HCC's
14 Operating Agreement also contains a provision indemnifying
15 Mr. Hamilton for the Elite Judgment itself.

16 **C. Debtors' Plan of Reorganization**

17 Over the course of the bankruptcy, Debtors filed several
18 plans, drawing objections from Appellants and Summa.⁴ In March
19 2017 Debtors filed the Plan. The Plan contains the following
20 relevant provisions:

- 21 • The Plan is to be funded from (i) a portion of
22 Mr. Hamilton's salary at HCC (totaling \$90,000 over the
23

24 ³(...continued)
25 postjudgment interest at the state rate (ten percent) for the
26 entire postjudgment period. Both dispositions were appealed to
the Ninth Circuit Court of Appeals (18-60026 and 18-60027), where
they currently remain pending.

27 ⁴Pursuant to the settlement of the Summa litigation in May
28 2017, Summa withdrew its objections to confirmation.

1 Plan term); (ii) \$60,000 in settlement proceeds from
2 the Summa litigation; and (iii) approximately \$57,000
3 generated from Mr. Hamilton's SDTS stock (dividends or
4 proceeds) over the 60-month Plan term.

- 5 • Appellants' claims are partially secured by Debtors'
6 equity in their rental property in Pasadena, California
7 (Class 1E). Specifically, the Plan treats \$298,881.06
8 of those claims as secured, to be paid over 360 months
9 with interest at 6 percent, for a total payout of
10 \$644,943.47. The Plan treats the balance of
11 Appellants' claims, approximately \$1.9 million, as
12 unsecured.

- 13 • Total general unsecured claims are estimated at \$2.3
14 million, including Appellants' claims. General
15 unsecured creditors, including Appellants, will receive
16 between 6.5 and 9 percent of their allowed claims over
17 the Plan term, depending on the amount of funds
18 generated from the STDS stock.

- 19 • For administrative claims, the estate will contribute
20 \$30,000 and HCC will contribute, on the effective date,
21 \$200,000 toward Debtors' attorneys' fees totaling
22 \$580,000, with the balance to be paid by a secured
23 promissory note from HCC to be delivered on the
24 effective date. The remaining administrative claims
25 will be paid on the effective date.

- 26 • Enforcement of nondischargeable claims against property
27 committed to the Plan is enjoined during the Plan
28 period so long as Debtors are not in material default

1 under the Plan.⁵

- 2 • Debtors will retain their equity interest in the
3 Pasadena property. According to the Plan, this
4 provision does not violate the absolute priority rule
5 because HCC is providing new value by contributing
6 \$200,000 on the effective date.
- 7 • The payments of professional fees by HCC may be
8 deductible by HCC as a business expense, but if not,
9 they are deductible by Debtors. In any event, HCC is
10 required under the employment contract to increase
11 Mr. Hamilton's compensation to cover any income tax
12 liability arising from disallowance of such a
13 deduction.
- 14 • According to the liquidation analysis, general
15 unsecured creditors would receive nothing in a
16 chapter 7 liquidation;⁶

17 In its Order Denying Confirmation of the Fifth Amended
18 Combined Plan and Disclosure Statement, the bankruptcy court had
19 found that the proposed collection injunction would be

20
21 ⁵After confirmation and within the appeal period, Debtors
22 filed a motion to correct the confirmation order, arguing that
23 the provision permitting collection against income or property
24 not committed to fund the Plan was "hopelessly ambiguous." The
25 bankruptcy court construed the motion as one under Civil Rule
26 59(e), applicable via Rule 9023, and denied the motion as
27 unjustified. Debtors did not cross-appeal this ruling.

28 ⁶According to the liquidation analysis, estimated net
proceeds from real and personal property and avoidance of
preferential or fraudulent transfers would be approximately
\$130,000; after deducting estimated chapter 7 administrative
expenses (\$40,000) and chapter 11 professional fees (\$580,000),
there would be nothing left over for any other creditors.

1 permissible so long as (i) its duration was limited to the plan
2 period; (ii) the injunction would not apply to any income or
3 property not being used to fund the plan; (iii) it would end upon
4 a material default under the plan; and (iv) any creditor could
5 move to modify or dissolve the injunction for cause. The Plan so
6 provided.

7 Appellants filed an objection to confirmation of the Plan,
8 arguing that (i) the Plan was not proposed in good faith;
9 (ii) the Plan was illusory as it did not provide for payment of
10 nondischargeable claims at the end of the enforcement stay;
11 (iii) the Plan was not feasible; (iv) the Plan was not fair and
12 equitable; (v) the cramdown requirements were not satisfied;
13 (vi) the Plan violated the absolute priority rule, and HCC's
14 contributions did not constitute new value. Appellants also
15 argued that Debtors' disclosures were inadequate. Appellants
16 voted against confirmation; all other creditors voted in favor of
17 confirmation.

18 After the initial confirmation hearing held May 17, 2017,
19 the bankruptcy court issued an interim order finding in relevant
20 part that (i) additional discovery as to whether HCC was
21 Mr. Hamilton's alter ego was unnecessary as that relationship was
22 not an impediment to plan confirmation; and (ii) HCC's effective
23 date contribution satisfied the new value corollary to the
24 absolute priority rule. The court, however, requested additional
25 briefing on whether HCC's payment of Debtors' personal legal
26 bills and other expenses would be a taxable event for the estate.

27 The parties submitted additional briefing on the tax issue,
28 and the court held a second confirmation hearing on July 21,

1 2017. At that hearing, the bankruptcy court found that the
2 indemnification payments from HCC would not result in additional
3 tax liability for Debtors, and that even if HCC could not deduct
4 those payments, it had sufficient revenues to satisfy the
5 resulting tax liability. Accordingly, the court overruled all of
6 Appellants' objections and confirmed the Plan.

7 Appellants timely appealed.

8 JURISDICTION

9 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
10 §§ 1334 and 157(b) (2) (L). We have jurisdiction under 28 U.S.C.
11 § 158.

12 ISSUE

13 Whether the bankruptcy court abused its discretion in
14 confirming Debtors' Plan.

15 STANDARDS OF REVIEW

16 We review the bankruptcy court's decision to confirm a plan
17 of reorganization for abuse of discretion. Computer Task Group,
18 Inc., v. Brotby (In re Brotby), 303 B.R. 177, 184 (9th Cir. BAP
19 2003). To determine whether the bankruptcy court has abused its
20 discretion, we conduct a two-step inquiry: (1) we review de novo
21 whether the bankruptcy court identified the correct legal rule to
22 apply to the relief requested and (2) if it did, whether the
23 bankruptcy court's application of the legal standard was
24 illogical, implausible, or without support in inferences that may
25 be drawn from the facts in the record. United States v. Hinkson,
26 585 F.3d 1247, 1262-63 & n.21 (9th Cir. 2009) (en banc).

27 A determination that a plan meets confirmation standards
28 requires the bankruptcy court to make factual findings and

1 interpret the law. In re Brotby, 303 B.R. at 184. Factual
2 determinations regarding good faith and feasibility are reviewed
3 for clear error, id., as is a determination that a plan is in the
4 best interest of creditors, United States v. Arnold & Baker Farms
5 (In re Arnold & Baker Farms), 177 B.R. 648, 653 (9th Cir. BAP
6 1994), aff'd, 85 F.3d 1415 (9th Cir. 1996), and is fair and
7 equitable. See Acequia, Inc. v. Clinton (In re Acequia, Inc.),
8 787 F.2d 1352, 1358 (9th Cir. 1986).

9 We review de novo the bankruptcy court's interpretation of
10 the Bankruptcy Code, including its construction of § 1129(b)
11 allowing individual debtors to utilize the new value exception to
12 the absolute priority rule. In re Brotby, 303 B.R. at 184.

13 **DISCUSSION**

14 To this Panel, the most challenging aspect of the Plan is
15 the collection injunction, which the bankruptcy court approved
16 despite the fact that the Plan makes no provision for any
17 meaningful payment of Appellants' claims. As will be discussed,
18 we hold that the bankruptcy court erred in approving that
19 injunction. With or without the collection injunction, the Plan
20 is not feasible. And given that the Plan delays payment of
21 Appellants' claims without any definite proposal to pay them, it
22 essentially neuters Appellants' rights to be paid, and thus does
23 not meet the good faith requirement. Finally, the bankruptcy
24 court did not make sufficient findings to support its conclusion
25 that the \$200,000 contribution by HCC met the new value exception
26 to the absolute priority rule.

1 **A. The bankruptcy court erred in approving the collection**
2 **injunction where the Plan did not make a feasible proposal**
3 **to pay Appellants' nondischargeable claims in full.**

4 Paragraph 7 of the Plan provides that any creditors holding
5 nondischargeable claims are

6 specifically enjoined from enforcing such claims during
7 the Plan period, so long as Debtors are not in material
8 default under the Plan. The injunction described in
9 this section is limited to the Plan period. It does
10 not apply to any income or property not being used to
11 fund the Plan. If there is a material default under
12 the Plan, the injunction described in this section will
13 terminate. At any time, any creditor may move to
14 modify and/or dissolve the injunction for cause.

15 The bankruptcy court approved this provision over
16 Appellants' objections. In doing so, the court extensively
17 analyzed the relevant authorities, concluding - correctly - that
18 a collection injunction is not per se prohibited under the Code
19 (see discussion, below). The bankruptcy court then applied the
20 standard for injunctive relief set forth in this Panel's decision
21 in Brotby (discussed below), and concluded that the proposed
22 injunction was permissible. Specifically, the court found that
23 Debtors had shown that the injunction was necessary for a
24 successful reorganization because, without it, Appellants could
25 collect against income and property being used to fund the Plan,
26 and the Plan would fail. The bankruptcy court also found that
27 the circumstances weighed in favor of the injunction, so long as
28 Appellants were not prohibited from pursuing income or property
not being used to fund the Plan. We conclude, however, that the
bankruptcy court erred in approving the collection injunction
because the Plan provided for no meaningful distribution to
Appellants' nondischargeable claims. In fact, due to the accrual
of interest, the net effect of the Plan is to increase the amount

1 of those claims during the Plan term.⁷ In the cases relied upon
2 by the bankruptcy court, the plans at issue provided for full
3 payment of such claims. Lacking either such a provision, or an
4 analysis that would have provided doctrinal support for the
5 proposition that a plan might not merely delay payment, but might
6 make payment materially less certain, the Plan here cannot
7 satisfy the test for injunctive relief set forth in those cases.

8 Section 1141(d)(2) provides that “[a] discharge under this
9 chapter does not discharge a debtor who is an individual from any
10 debt excepted from discharge under section 523 of this title.”
11 Thus, a chapter 11 plan may not discharge a nondischargeable
12 claim. The Code, however, does not prohibit payment of such a
13 claim through a plan. See In re Mercado, 124 B.R. 799, 801-02
14 (Bankr. C.D. Cal. 1991) (noting that § 1141(d)(2) preserves the
15 right of a creditor holding a nondischargeable claim to full
16 payment but does not provide that the provisions of a confirmed
17 plan cannot affect the rights of that creditor).⁸ Moreover,
18 § 1141(d)(2) does not prohibit a plan from placing conditions on
19 the creditor’s right to collect such a claim. In re Brothby,
20 303 B.R. at 189-90. “There is no indication that the statute was
21 intended to prohibit a temporary restriction on the collection
22 activities of creditors holding nondischargeable claims.” Id. at

24 ⁷At oral argument, Appellants’ counsel estimated, and
25 Debtors’ counsel did not dispute, that the claims will have grown
to over \$3 million by the end of the Plan term.

26 ⁸Of course, nothing in the Code **requires** that a plan provide
27 for payment of a non-dischargeable claim – but the failure to
28 account for such a claim would almost certainly lead to a failure
to demonstrate feasibility.

1 188. And § 105 provides the necessary authority to impose such
2 an injunction in a chapter 11 plan in appropriate circumstances.
3 Id. at 190-91.

4 As the Brotby Panel observed, interpreting § 1141(d)(2) to
5 permit temporary restrictions on collection of nondischargeable
6 claims in a chapter 11 plan is

7 consistent with the bankruptcy policy favoring a fresh
8 start for the debtor, while giving appropriate
9 protection to the rights of creditors. This
10 interpretation encourages flexibility for debtors
11 attempting to reorganize, and may serve as an incentive
12 to pursue confirmation of a plan instead of
13 liquidation. At the same time, creditors, including
14 those holding nondischargeable claims, are protected by
15 the confirmation standards. In practice, as here,
16 nondischargeable claims are paid in full, while other
17 creditors also receive a benefit. An interpretation of
18 § 1141(d)(2) that an individual debtor's plan can in no
19 fashion modify the rights of a creditor holding a claim
20 excepted from discharge would effectively grant that
21 creditor a veto over the reorganization process. If a
22 creditor holding a nondischargeable claim could not be
23 temporarily prevented by a plan from pursuing
24 collection, even where the creditor will be paid in
25 full over time, that creditor is "in a position to
26 undercut a debtor's attempt to reorganize, possibly
27 harming other creditors who might benefit from the
28 proposed plan."

Id. at 189-90 (quoting In re Mercado, 124 B.R. at 803).

The plan at issue in Brotby provided for full payment of a
nondischargeable claim, assuming the debtor did not prevail in a
pending appeal of the original judgment.⁹ In the meantime, the

⁹Debtor was to deposit monthly payments into a reserve
account. If the creditor prevailed on appeal, it would be
entitled to the money paid into the account and any remaining
payments over six years, and the debtor would continue to make
monthly payments to the creditor for two more years to satisfy
the entire amount of the nondischargeable debt. If debtor
prevailed in the appeal, the funds in the reserve account would
be applied to the unpaid balances owed to general unsecured

(continued...)

1 creditor was to be enjoined from any attempts to collect the
2 nondischargeable portion of its claim other than through its
3 receipt of plan payments. The bankruptcy court overruled the
4 creditor's objections and confirmed the plan, including the
5 collection injunction, and the creditor appealed. The Brotby
6 Panel held that although the collection injunction was not per se
7 prohibited by the Code, approval of such a provision must be
8 supported by findings that: (i) the injunction "is necessary to
9 allow the debtor to successfully reorganize and perform the terms
10 of the Chapter 11 plan," 303 B.R. at 190; (ii) the injunction is
11 "tailored in duration and scope to afford the necessary relief to
12 the debtor while not placing unnecessary restrictions on the
13 target creditor's rights," id.; (iii) the injunction is
14 "effective only as long as the debtor is properly performing and
15 complying with the terms of the plan," id.; and (iv) the
16 bankruptcy court has balanced the relative hardships on the
17 debtor and creditor and concluded that the equities favor
18 imposition of the injunction and confirmation of the plan." Id.
19 at 190-91.¹⁰ Because the bankruptcy court had not made the

21 ⁹(...continued)
22 creditors. 303 B.R. at 182.

23 ¹⁰These standards are akin to those applicable when
24 determining whether to grant a preliminary injunction. To obtain
a preliminary injunction, the plaintiff must show:

25 (1) a strong likelihood of success on the merits, (2)
26 the possibility of irreparable injury to plaintiff if
27 preliminary relief is not granted, (3) a balance of
28 hardships favoring the plaintiff, and (4) advancement
of the public interest (in certain cases).

(continued...)

1 necessary findings to support imposition of the collection
2 injunction, the Panel remanded. Id. at 191. Significantly, the
3 required findings on remand did not include a finding that the
4 nondischargeable claim would be paid in full because that
5 requirement was neither factually nor legally in dispute.

6 Similarly, the plan at issue in Mercado provided that
7 creditors with nondischargeable claims would be paid in full,
8 while simultaneously enjoining those creditors from executing on
9 any nondischargeable judgment in the absence of a plan default.
10 The Mercado court found that the injunction was not per se
11 inconsistent with § 1141(d)(2) but did not approve the injunction
12 because it found that the debtor had failed to prove that the
13 injunction was necessary for the success of his reorganization.
14 Id. at 805.

15 In both of these cases, the question was not **whether** the
16 creditor would be paid in full through the plan, but **when**. Full
17 payment was assumed. See In re Brotby, 303 B.R. at 190 ("the
18 debtor must demonstrate that the injunction does not prevent, but
19 merely postpones, the creditor's collection of the
20 nondischargeable claim in full pending debtor's performance of
21 the plan"); In re Mercado, 124 B.R. at 803 ("[c]learly, the
22

23 ¹⁰(...continued)

24 Alternatively, a court may grant the injunction if the
25 plaintiff demonstrates either a combination of probable
26 success on the merits and the possibility of
27 irreparable injury or that serious questions are raised
28 and the balance of hardships tips sharply in his favor.

Solidus Networks, Inc. v. Excel Innovations, Inc. (In re Excel
Innovations, Inc.), 502 F.3d 1086, 1093 (9th Cir. 2007).

1 creditor has a right to be paid the full amount of its claim.
2 The plan cannot substitute some other treatment."). In both
3 cases, the bankruptcy courts also found that the injunction could
4 be approved so long as the debtors made the requisite showing
5 that they would pay the nondischargeable claims in full, over
6 time, and that the purpose of the plan injunction was to allow
7 other creditors also to receive material, non-trivial
8 distributions. And in Brotby, we agreed with this reasoning. So
9 the effect of the injunctions in both of those cases was merely
10 to delay, but not to deny or avoid full payment of the
11 nondischargeable claim.

12 As such, Mercado and Brotby cannot be cited to support the
13 injunction proposed here. The Plan does not merely delay payment
14 on the nondischargeable claims over the entirety of the plan term
15 - it fails to make any provision for the forestalled creditor
16 ever to be paid in full. While the injunction does not prohibit
17 Appellants from executing against assets or income not committed
18 to the Plan, there is no evidence in the record of the value of
19 any such assets or income. And the Plan provides no basis
20 whatsoever for payment of the nondischargeable claims after the
21 completion of the Plan. Rather, at the end of the Plan term,
22 Appellants will be left with the same ability to collect, but
23 from an individual who is five years older and will apparently
24 have no increased ability or additional resources to pay the
25 nondischargeable claims.¹¹ And it goes without saying that the

27 ¹¹Appellants' counsel represented at oral argument that
28 Debtors intend to pay the nondischargeable claim at the end of
(continued...)

1 debtor's earnings would remain nominally controlled by his
2 mother.

3 Under these facts, one cannot apply the test for injunctive
4 relief applied in Brotby and Mercado. Because those cases
5 assumed as a factual and legal certainty that the
6 nondischargeable claim was required to be and would be paid, the
7 injunctive relief test did not require an affirmative showing
8 regarding certainty of payment (i.e., "likelihood of success") or
9 a balancing of the respective harms to the debtor and holder of
10 the nondischargeable claim other than impact of the delay of
11 payment to one creditor - the nondischargeable claim holder -
12 against the likelihood that, without the injunction, there would
13 be no distribution to holders of general unsecured claims.

14 Where a plan merely delays, but does not imperil, the
15 payment of a nondischargeable claim, such a plan may be
16 consistent with the overall bankruptcy purpose of maximizing
17 payments to all creditors. An injunction under such a plan may
18 be analyzed via a simple application of the injunctive relief
19 standards. A court can determine the likelihood of ultimate
20 payment (feasibility), as well as balance relative hardships
21 (balancing mere delay in payment, which can be compensated via
22 interest, versus the opportunity for the debtor to pay other
23 creditors and get a fresh start with respect to dischargeable
24 claims).

25
26 ¹¹(...continued)
27 the Plan term, but the Plan makes no such commitment, nor is
28 there evidence in the record that Debtors will have the means to
pay the claim in full at that time.

1 But here, it is impossible to justify the Plan's collection
2 injunction on those principles, or even to decide how a judge
3 would fairly and competently perform the requisite analysis. The
4 proposed plan imposes a five-year hiatus on collection (without
5 any increased consideration for any uncertainty imposed merely by
6 delay). Moreover, there is no proposal how, let alone assurance
7 that, the debtor - then five years older - is going to pay such a
8 claim. The proposed collection injunction is not merely delaying
9 payment; it is, in a real sense, either avoiding or denying
10 payment to the creditor. Such a plan turns putatively low risk
11 nondischargeable claims into what are the equivalent of
12 discharged claims via delay and enforced forbearance.

13 Similarly, there is simply no way to "balance the hardships"
14 in such a scenario. Neither Mercado nor Brotby, which each
15 purport to use an injunctive relief standard, even address how
16 such a balancing test might work on these facts. Nor does either
17 case suggest how to reduce to numerical terms the risk of
18 significant delay, which might result in nonpayment, versus the
19 benefit of some payment to other creditors - and indeed, this
20 Panel is at a loss to know how to articulate or apply such a
21 balancing test - doing so would require formulating a legal test
22 not expressed in the applicable case law and, more importantly,
23 factfinding that it would be inappropriate for this Panel to
24 undertake.

25 The bankruptcy court here misapplied the test for injunctive
26 relief when it essentially ignored the long-term effect of the
27 plan and the vastly increased risk to Appellants: an increase in
28 the amount of the nondischargeable claim with absolutely no

1 mechanism to pay it in or out of the Plan. Under these
2 circumstances, the purported delay, which is effectively denial
3 of payment, is not outweighed by any benefit to Appellants. In
4 other words, there is no "balancing" of anything - the injunction
5 essentially obliterates the rights of the holders of the
6 nondischargeable claims.

7 We wish to stress here that we are not today declaring a
8 "per se" rule that any plan that purports to deal with a
9 nondischargeable claim must in every instance provide for the
10 full and certain payment of such a claim. This case simply does
11 not provide us the opportunity nor the analytical framework to
12 make such a declaration, and it is unnecessary to our conclusion
13 that the plan provision at issue was impermissible.

14 Moreover, there are practical reasons to avoid such a bright
15 line rule. A plan proponent who chooses to deal with a
16 nondischargeable claim in a plan but who proposes less than full
17 payment, with or without a collection injunction, might include
18 favorable provisions to induce the holder of a nondischargeable
19 claim's acquiescence. For example, a plan might provide a higher
20 interest rate for such a claim, or a substantial "up front"
21 payment, or it might offer security for payment not previously
22 available to the holder of a nondischargeable claim. Any of
23 these potential favorable treatments might convince the holder of
24 a nondischargeable claim that it is better off taking the
25 proposed treatment than spending its postconfirmation time and
26 money levying or executing against the reorganized debtor's
27 assets. A bright line rule requiring full payment would remove
28 the incentive for negotiating such plan provisions.

1 Under these circumstances, it would be inappropriate to
2 announce a bright line rule requiring full payment for
3 nondischargeable claims through any plan of reorganization. What
4 we can say is that a plan that purports to enjoin holders of
5 nondischargeable claims while not paying them, and leaving them
6 worse off economically at the end of the plan, without even an
7 articulated basis for payment, is essentially a plan that ensures
8 non-payment. As such, it runs afoul of Mercado and Brotby, and
9 there is no basis on which to craft a standard for the
10 confirmation of such a plan.

11 For these reasons, the bankruptcy court erred as a matter of
12 law in approving the collection injunction provision of the Plan.

13 **B. The bankruptcy court erred in finding that the Plan was**
14 **feasible.**

15 Under § 1129(a)(11), to be confirmed, the court must find
16 that confirmation "is not likely to be followed by the
17 liquidation, or the need for further financial reorganization, of
18 the debtor or any successor to the debtor under the plan"
19 Feasibility may be established by the showing of a reasonable
20 probability of success. "The Code does not require the debtor to
21 prove that success is inevitable, and a relatively low threshold
22 of proof will satisfy § 1129(a)(11), so long as adequate evidence
23 supports a finding of feasibility." In re Brotby, 303 B.R. at
24 191-92 (citations omitted). Some courts have concluded that the
25 feasibility requirement includes an analysis of whether the plan
26 will enable the debtor to emerge from bankruptcy as a "viable
27 entity." In re Union Financial Services Group, Inc., 303 B.R.
28 390 (Bankr. E.D. Mo. 2003). See also In re Valley View Shopping

1 Ctr., L.P., 260 B.R. 10, 33 (Bankr. D. Kan. 2001) ("Will the
2 reorganized debtor emerge from bankruptcy solvent and with a
3 reasonable prospect of success?").

4 In its tentative ruling for the July 21, 2017 hearing, the
5 bankruptcy court found the Plan to be feasible based on Debtors'
6 and HCC's financial projections attached to the Plan. The court
7 also found that any tax liabilities of Debtors or HCC arising
8 from HCC's indemnification obligations to Mr. Hamilton for the
9 Elite Judgment and attendant professional fees and costs would
10 not impact feasibility.

11 Given our conclusion that it was error to approve the
12 collection injunction provision when the Plan did not provide for
13 any meaningful payment of Appellants' nondischargeable claims, it
14 follows that the Plan as proposed is not feasible. There is
15 simply not enough money or property committed to the Plan to
16 satisfy the nondischargeable claims. But even if the collection
17 injunction were permissible, the bankruptcy court erred in
18 finding the Plan feasible given that the amount owed on the
19 nondischargeable claims would have grown, not diminished, during
20 the Plan term. The bankruptcy court did not give sufficient
21 consideration to whether the Debtors would be economically viable
22 at the end of the Plan. Cf. Sherman v. Harbin (In re Harbin),
23 486 F.3d 510, 517-18 (9th Cir. 2010) (a bankruptcy court cannot
24 adequately determine a plan's feasibility without evaluating
25 whether a potential future judgment may affect the debtor's
26 ability to implement its plan). In the absence of any evidence
27 of how Debtors intend to deal with the Elite Judgment, it is
28 highly questionable that confirmation would not be followed by

1 the need for liquidation or further reorganization. Accordingly,
2 the record does not support the bankruptcy court's finding of
3 feasibility, and we must reverse.

4 **C. The bankruptcy court clearly erred in finding that the plan**
5 **was proposed in good faith as required by § 1129(a)(3).**

6 To be confirmed, a plan must be "proposed in good faith and
7 not by any means forbidden by law." § 1129(a)(3). "A plan is
8 proposed in good faith where it achieves a result consistent with
9 the objectives and purposes of the Code." Platinum Capital,
10 Inc., v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.), 314 F.3d
11 1070, 1074 (9th Cir. 2002) (citation omitted). In determining
12 good faith, the bankruptcy court is to consider the totality of
13 the circumstances. Id. "The test is whether a debtor is
14 attempting to unreasonably deter and harass creditors or
15 attempting to effect a speedy, efficient reorganization on a
16 feasible basis." Marsch v. Marsch (In re Marsch), 36 F.3d 825,
17 828 (9th Cir. 1994).

18 As discussed above, the Plan essentially neuters the rights
19 of Appellants, in light of the collection injunction and the fact
20 that the Plan provides no meaningful distribution to Appellants
21 on their nondischargeable claims. In our view, a plan that
22 enjoins collection of a non-dischargeable debt for five years and
23 results in the debtor owing more at the completion of the plan
24 than was owed on the effective date does not constitute an
25 attempt to effect a speedy, efficient reorganization. Under
26 these circumstances, the bankruptcy court's good faith finding
27 was implausible, illogical, and unsupported by the record.

28 In addition, for reasons that are not clear from the record,

1 the relationship between Mr. Hamilton and HCC was never fully
2 explored.¹² At the May 17, 2017 hearing, the bankruptcy court
3 expressed concern about Mr. Hamilton's relationship with HCC:

4 [F]acially, it's a curious arrangement. We have
5 Mr. Hamilton's mother saying in deposition she doesn't
6 know how it works and doesn't run it and Mr. Hamilton
7 runs it. . . . A separate question though is whether
8 HCC is Mr. Hamilton's alter ego. . . . And here I think
9 we need to get to the bottom of that because it goes
10 directly to good faith. . . . [i]t may mean that
there's other money being earned by HCC that could be
available to Mr. Hamilton; it could mean that
Mr. Hamilton is keeping property for himself if it's an
alter ego; and it goes directly to good faith. So I
think Elite's request that there be discovery on that
makes sense.

11 The court was concerned that HCC might have the ability to
12 generate additional value that could be used to pay a higher
13 dividend to creditors: "[W]hat if there's a lot more value in
14 there to be squeezed out of HCC for the benefit of creditors in
15 the next five years? That's what I'm having a problem with."
16 The court took the good faith issue under submission to consider
17 whether to grant Appellants' request for further discovery.¹³
18 But the court eventually concluded that further discovery was
19 unnecessary because

20 Elite's allegations ultimately are not an obstacle to
21 plan confirmation. At the time [HCC was formed],
22 Mr. Hamilton was embroiled in litigation with two
23 business partners and so sought another who presumably
would be less antagonistic toward him (his mother).
Elite provides no evidence that Mr. Hamilton can grow
HCC any larger or more quickly at this point. Nor,

24
25 ¹²This relationship is pivotal to confirmation because it
26 impacts not only good faith, but also feasibility and the best
interests of creditors as well.

27 ¹³Appellants had conducted a Rule 2004 examination of
28 Mr. Hamilton's mother, Diana Hamilton, in March 2016 but sought
to depose HCC's bookkeeper.

1 given the Thirteenth Amendment, can he be compelled to
2 work any harder than he is willing. HCC projects
3 approximately \$2 million in annual revenues to start.
4 If Mr. Hamilton does not want to apply himself to
5 increase that total, he will share in creditors' pain.
6 That is, there will be less money for both himself and
7 his creditors. But he cannot be obliged to work
8 against his will.

9 The bankruptcy court's allusion to the Thirteenth Amendment
10 misses the point. Appellants were not suggesting that
11 Mr. Hamilton should be compelled to work harder to generate more
12 revenue to devote to the Plan. Rather, the purpose of granting
13 Appellants discovery regarding HCC's finances was to determine
14 whether there was more value that could be contributed to the
15 Plan. The circumstances suggest that Mr. Hamilton may be in
16 total control of HCC. The bankruptcy court had earlier
17 acknowledged that this issue went directly to good faith and
18 should have been resolved. To the extent that Mr. Hamilton
19 placed HCC under his mother's control to use it as his
20 instrumentality to frustrate his creditors, this would not merely
21 impact good faith, but would essentially prevent a true
22 evaluation of feasibility and the best interests of creditors
23 test, as it would suggest that the Debtor would be able to
24 manipulate the income available to him to fund his plan. But
25 because these circumstances were never fully explored, the
26 bankruptcy court's good faith finding was not supported by the
27 record.

28 For these reasons, we must reverse the bankruptcy court's
good faith finding.

1 **D. The bankruptcy court erred in finding that the new value**
2 **corollary to the absolute priority rule was satisfied.**

3 Where, as here, a class of impaired creditors has not
4 accepted the plan, if all other § 1129(a) requirements are met
5 and one class of impaired creditors has accepted the plan, the
6 court, on request of the plan proponent, "shall confirm the plan
7 . . . if the plan does not discriminate unfairly, and is fair and
8 equitable, with respect to each class of claims or interests that
9 is impaired under, and has not accepted, the plan."

10 § 1129(b) (1). For a plan to be fair and equitable, it must, at a
11 minimum, comply with the absolute priority rule, which requires
12 that a dissenting class of unsecured creditors is provided for in
13 full before any junior class can receive or retain any property
14 under the plan. Norwest Bank Worthington v. Ahlers, 485 U.S.
15 197, 202 (1988). The absolute priority rule applies in
16 individual chapter 11 cases. Zachary v. Cal. Bank & Tr.,
17 811 F.3d 1191, 1192 (9th Cir. 2016).

18 Where a plan violates the absolute priority rule, it may
19 still be confirmable if it satisfies the new value corollary to
20 that rule. Under the new value corollary, allowing old equity to
21 retain an interest does not violate the absolute priority rule if
22 the former equity holders provide new value to the reorganized
23 debtor. Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. P'ship
24 (In re Ambanc La Mesa Ltd. P'ship), 115 F.3d 650, 654 (9th Cir.
25 1997). To satisfy the new value corollary, former equity holders
26 must offer value under the plan that is: (1) new;
27 (2) substantial; (3) in money or money's worth; (4) necessary for
28 successful reorganization; and (5) reasonably equivalent to the

1 value or interest received. Id.; In re Brotby, 303 B.R. at 195.

2 Recognizing that the new value corollary was initially
3 developed with the corporate debtor in mind, bankruptcy courts
4 have observed that its application in individual chapter 11 cases
5 is difficult and have concluded that the exception should be
6 narrowly construed. In re Davis, 262 B.R. 791, 798-99 (Bankr. D.
7 Ariz. 2001); In re Cipparone, 175 B.R. 643, 644 (Bankr. E.D.
8 Mich. 1994). See also In re Rocha, 179 B.R. 305, 307-08 (Bankr.
9 M.D. Fla. 1995) (noting that it is more difficult for an
10 individual debtor to meet the new value exception because the new
11 value must come from a source other than the debtor); and
12 In re Harman, 141 B.R. 878, 887 (Bankr. E.D. Pa. 1992) (purpose
13 of the new value exception is to encourage equity holders to make
14 capital contributions necessary to allow the debtor's business to
15 survive, a purpose that is generally not applicable to consumer
16 debtors).

17 Here, the Plan provides that Debtors will retain their
18 equity interest in their Pasadena rental property.¹⁴ Debtors
19 acknowledge that this facially violates the absolute priority
20 rule. But the bankruptcy court found that HCC's \$200,000
21 effective date contribution satisfied the new value corollary.
22 Specifically, the bankruptcy court found that HCC's contribution
23 (i) was "new" because it came from an outside source and not the
24 Debtors; (ii) was "substantial" because it represented more than

25
26 ¹⁴During the bankruptcy, for purposes of valuing secured
27 claims, the parties stipulated that the Pasadena property was
28 worth \$700,000 and was fully encumbered by a consensual lien to
Wells Fargo Bank and Appellants' judgment lien. Debtors proposed
to retain any future increase in equity.

1 ten percent of the unsecured claims; (iii) was in money or
2 money's worth; (iv) was necessary for a successful reorganization
3 because, without it, Debtors would have insufficient funds to pay
4 administrative claims on the effective date; and (v) was
5 reasonably equivalent to - in fact, "greatly exceeds" - Debtors'
6 equity in the Pasadena property.

7 The bankruptcy court erred in concluding that HCC's
8 contribution was new. The bankruptcy court summarily rejected
9 Appellants' argument that HCC's contribution could not be
10 considered new because HCC was already obligated to pay
11 Mr. Hamilton's legal fees. A contribution is "new" if it becomes
12 an asset in the new entity's balance sheet. Sun Valley
13 Newspapers, Inc. v. Sun World Corp. (In re Sun Valley Newspapers,
14 Inc.), 171 B.R. 71, 78 (9th Cir. BAP 1994). Here, because HCC
15 was previously obligated to pay Debtors' legal expenses, that
16 obligation was already an asset on the Debtors' balance sheet.
17 Thus HCC's commitment to contribute \$200,000 on the effective
18 date did not constitute new value.

19 In addition, as discussed above, Appellants raised a
20 legitimate factual question regarding Mr. Hamilton's relationship
21 with HCC, which the bankruptcy court initially acknowledged but
22 later dismissed as irrelevant. This left unexplored the question
23 of whether the \$200,000 was truly being contributed from an
24 outside source. But our critique goes beyond the mere
25 uncertainty left by a failure to resolve this issue. If, as may
26 well be the case, HCC is in actuality completely under the
27 control of the Debtor, and not his mother, then it would follow
28 that HCC is in reality the Debtor's asset and subject to the

1 claims of creditors. And if that is the case, then there can be
2 no "new value" contribution that would overcome the absolute
3 priority rule and support confirmation of this plan.

4 For these reasons, the bankruptcy court erred in concluding
5 that HCC's effective date contribution satisfied the new value
6 corollary.¹⁵

7 **E. We will not consider Appellants' argument that the**
8 **bankruptcy court erred in finding that the Plan satisfied**
9 **the best interests of creditors test.**

10 Section 1129(a)(7) requires, with respect to an impaired
11 class of creditors that has not accepted the plan, that the class
12 "will receive or retain under the plan on account of such claim
13 or interest property of a value, as of the effective date of the
14 plan, that is not less than the amount that such holder would so
15 receive or retain if the debtor were liquidated under chapter 7
16 of this title on such date[.]"

17 According to Debtors' liquidation analysis, general
18 unsecured creditors would receive nothing in a chapter 7
19 liquidation, while those creditors are to receive approximately
20 6.5 percent of their claims under the Plan. Appellants contend
21 that the liquidation analysis is flawed because it does not
22 include indemnity payments from HCC. Appellants did not raise
23 this argument in the bankruptcy court but contend that the Panel
24 should nevertheless consider it, relying on Everett v. Perez (In
25 re Perez), 30 F.3d 1209, 1213-14 (9th Cir. 1994). Although we do
26 have discretion to consider arguments not raised in the

27 ¹⁵We need not address Appellants' arguments that the
28 contribution was not substantial or that it was not necessary for
the Debtors' reorganization.

1 bankruptcy court, we will not do so where the record requires
2 further development. Id. at 1214. Because this issue was not
3 raised in the bankruptcy court, there was no opportunity for the
4 parties to brief it or for the bankruptcy court to decide it.
5 Accordingly, we will not consider the issue in this appeal.

6 **CONCLUSION**

7 For the reasons explained above, we REVERSE the bankruptcy
8 court's order confirming Debtors' Plan.