UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

IN RE:	CASE NO.	13-30350 (JAM)
	CASE NO.	13-30443 (JAM)
RICHARD AND STEPHANIE LUCARELLI		(Jointly Administered)
LUCARELLI'S EXECUTIVE ANSWERING SERVICE, LLC	CHAPTER	11
DEBTORS.	ECF NOS.	145, 168

APPEARANCES

Kenneth Lenz, Esq.
Lenz Law Firm, LLC
236 Boston Post Road
Orange, CT 06477

Attorney for Richard and Stephanie Lucarelli

Carl T. Gulliver, Esq.
Coan, Lewendon, Gulliver & Miltenberger, LLC
495 Orange Street
New Haven, CT 06511

Attorney for Lucarelli's Executive Answering Service, LLC

Michael A. Carbone, Esq.
Zeldes, Needle & Cooper, P.C.
1000 Lafayette Boulevard
Bridgeport, CT 06604

Attorney for unsecured creditor Sweet Delights, LLC

RULING ON CONFIRMATION OF SECOND AMENDED JOINT PLAN OF REORGANIZATION

Before the court is the Second Amended Joint Plan of Reorganization (the "Joint Plan"), of Richard and Stephanie Lucarelli (the "Lucarellis"), and Lucarelli's Executive Answering Service, LLC ("LEAS"). On September 4, 2014, in connection with the objection to confirmation of the Joint Plan filed by the unsecured creditor, Sweet Delights, LLC ("Sweet Delights"), a Memorandum of Decision was issued regarding the applicability of the absolute

priority rule in individual Chapter 11 cases. *In re Lucarelli,* 517 B.R. 42 (Bankr. D. Conn. 2014). The facts and circumstances surrounding confirmation of the Joint Plan are set forth in the reported decision and are incorporated herein by reference.

On September 24, 2014, a status conference was held to identify the remaining issues to be decided in connection with confirmation of the Joint Plan. The Lucarellis, LEAS, and Sweet Delights agreed that the final confirmation issues to be addressed were: (i) whether the Lucarellis acted in good faith by reducing the amount of their salaries earned from LEAS; (ii) whether the Lucarellis acted in good faith by proposing to liquidate an exempt asset in their Chapter 11 case and using the proceeds to fund payments under the Joint Plan; (iii) whether the new value exception to the absolute priority rule exists; and (iv) whether the proposed new value is adequate to allow confirmation of the Joint Plan. After review of the supplemental briefs and consideration of the arguments at the continued confirmation hearing held on December 15, 2014, the court ruled that: (i) the Joint Plan was filed in good faith; (ii) the Lucarellis acted in good faith by proposing to liquidate an exempt asset and use the proceeds to fund the Joint Plan; and (iii) the new value exception to the absolute priority rule exists. The only remaining issue is whether the proposed new value to be contributed is adequate to overcome the absolute priority rule and allow for confirmation of the Joint Plan.

The Joint Plan provides that the Class 8 impaired unsecured creditors of the Lucarellis, including Sweet Delights, will receive a distribution of approximately 3% on their unsecured claims. The Joint Plan further provides that upon confirmation, the Lucarellis will retain their 100% ownership in LEAS. Furthermore, the Joint Plan provides that the new value the Lucarellis propose to contribute —the proceeds from the liquidation of their 401(k) accounts— will only be contributed if the Joint Plan is confirmed.

Under applicable law, the Lucarellis' 401(k) accounts are exempt assets and therefore beyond the reach of their creditors, including Sweet Delights. However, if the Joint Plan is confirmed, the Lucarellis will liquidate their 401(k) accounts and use the proceeds to pay at least some of the administrative expenses of both the LEAS and Lucarelli estates, pay the priority claims of the Lucarelli estate, and fund a small distribution to the Class 8 unsecured creditors of the Lucarellis, including Sweet Delights. Sweet Delights argues that the proceeds to be contributed are not reasonably equivalent to the value of LEAS, which the Lucarellis will retain if the Joint Plan is confirmed, and therefore confirmation should be denied. The Lucarellis argue that despite Sweet Delights' objections, the Joint Plan can be confirmed under the cram down provisions of 11 U.S.C. § 1129 (b).

At the continued confirmation hearing, the Lucarellis presented evidence that liquidating their 401(k) accounts will produce proceeds of approximately $128,000.00.[1] The Lucarellis also introduced evidence of the value of LEAS. The valuation report, prepared by an expert witness, found the going concern value of LEAS to be $153,700.00. The Lucarellis, LEAS, and Sweet Delights all stipulated to the expert's valuation of LEAS for purposes of confirmation of the Joint Plan. Although Sweet Delights stipulated to the value of LEAS, it argues that because the proceeds from the liquidation of the 401(k) accounts do not equal the value of the LEAS, the new value is not reasonably equivalent value and therefore the Joint Plan should not be confirmed.

It appears that there are no reported decisions in this district or the Second Circuit addressing the adequacy of a new value contribution in an individual Chapter 11 case. However,

[1] The Lucarellis assert that the liquidation of their 401(k) accounts will produce proceeds in an amount not less than $128,000.00. However, under applicable law, the liquidation of a 401(k) account will likely result in an early distribution penalty. Additionally, the liquidation of the 401(k) accounts will cause the Lucarellis to incur personal tax liabilities.

the Second Circuit discussed the new value exception in the corporate case of *Coltex Loop Cent. Three Partners, L.P. v. BT/SAP Pool C Assoc, L.P.*, 138 F.3d 39, 41 (2d Cir. 1998). In *Coltex*, the Court noted that if it were to rely on the traditional framework for evaluating new value exceptions to the absolute priority rule, a five-part test must be met—the new value contribution must be: (1) new, (2) substantial, (3) money or money's worth, (4) necessary for a successful reorganization and (5) reasonably equivalent to the value of the property to be retained by old equity. *Id* at 45.

In *Coltex,* the Second Circuit explained the fourth prong of the new value exception—necessity—as follows:

> under the [new value exception's] necessary requirement old equity must be willing to contribute more money than any other source for the interest it would receive or it must be the lender of 'last resort'. Old equity must do more than demonstrate that new capital is necessary for a successful reorganization. The old owners must also show that the reorganized entity needs funds from the prior owner-managers because no other source of capital is available.

Id. at 45 (original italics, brackets, internal quotes and ellipsis omitted). One year after *Coltex*, the United States Supreme Court, in *Bank of Am. Nat'l Tr. and Savings Ass'n v. 203 N. LaSalle St. P'ship,* 526 U.S. 434, 458, 119 S.Ct. 1411 (1999), held that "assuming a new value corollary . . . plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of §1129(b)(2)(B)(ii)."

Bankruptcy courts in this circuit have read *LaSalle* and *Coltex* to require that "the debtor . . . show[] that funds are necessary for the reorganization, that it was necessary for the old equity to be the one who contributes those funds and that equity in the reorganized debtor must be determined in accordance with the market[,]" in order to satisfy the fourth prong of the new value exception test. *In re RAMZ Real Estate Co., LLC*, 510 B.R. 712, 719 (Bankr. S.D.N.Y. 2013) (noting that "[b]ased on the Supreme Court's mandate in *LaSalle*, there is no possibility

but to deny confirmation . . . [where] Debtor has not provided for a competing plan nor is there evidence that any other party was given an opportunity to bid on the interest sought by new equity"); *see also In re RYYZ, LLC*, 490 B.R. 29, 45 (Bankr. E.D.N.Y. 2013).

In this case, the Lucarellis have not demonstrated that they are the lenders of last resort, or that their ownership interest in LEAS was otherwise "market tested" to ensure no other source was willing to contribute more than the $128,000.00 to the Joint Plan. As such, the fourth prong of the new value exception has not been satisfied.

As to the fifth prong of the new value analysis, as noted above, the parties have stipulated that LEAS, and by extension the Lucarelli's 100% ownership interest in LEAS, has a value of $153,700.00. The proposed new value offered by the Lucarellis, which they represent will amount to no less than $128,000.00, is not equal to the stipulated value LEAS. Although the proposed new value does not necessarily have to equal the value of LEAS, the proposed new value is less than reasonably equivalent to the value of LEAS.

Additionally, courts have been reluctant to confirm plans when it is doubtful that the debtor will actually be able to furnish the full amount of the proposed new value.[2] In this case, it is unlikely that the liquidation of the 401(k) accounts will produce proceeds of $128,000.00 given the resulting penalties and personal tax liabilities. It is reasonable to conclude that the liquidation of the 401(k) accounts will produce proceeds in an amount less than $128,000.00, thus widening the gap between the proposed new value and the stipulated value of LEAS. Therefore, the Lucarellis have failed to demonstrate reasonably equivalent value and the fifth prong of the new value exception has not been met.

---

[2] *See, e.g., In re RYYZ, LLC*, 490 B.R. at 38, 45 ("The plan will be funded by the Debtors' continued operations, and a $250,000 infusion of working capital by the Debtors' equity holders [i.e., the proposed "new value"] to address any cash flow deficiencies. . . . **In any event, several factors make satisfaction of the new value exception highly improbable**. . . . Third, **the Debtors have not established that the equity holders are able to contribute $250,000 to the plan**.") (emphasis added).

In light of the above, the Joint Plan cannot be confirmed. Despite a thorough review of case law in the Second Circuit that would permit confirmation of the Joint Plan, no cases were uncovered in which the new value proposed by an individual Chapter 11 debtor resulted in confirmation of the debtor's plan. While it is clear that the Lucarellis, LEAS, and Sweet Delights could benefit from confirmation of the Joint Plan, the requirements of 11 U.S.C. § 1129(b)(2)(B)(ii) have not been met. As the United States Supreme Court stated in *Norwest Bank Worthington v. Ahlers*, the bankruptcy court should not substitute its own judgment for that of the creditors, who Congress believed were "better judges of the debtor's economic viability and their own economic self-interest than the courts" in Chapter 11 cases. 485 U.S. 197, 207, 108 S.Ct. 963 (1988). Accordingly, confirmation of the Joint Plan is denied without prejudice to LEAS and/or the Lucarellis filing a plan of reorganization within sixty (60) days of this ruling.

IT IS HEREBY SO ORDERED.

Dated at New Haven, Connecticut this 5th day of February, 2015.

Julie A. Manning
Chief United States Bankruptcy Judge