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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

COUNCIL FOR REFRACTIVE
SURGERY QUALITY
ASSURANCE D/B/A
USAEYES.ORG,

Debtor.

Case No.: 10-39240

DC No. CAH-9

Date: October 4, 2011
Time: 1:32 p.m.
Dept: B

**POST-HEARING BRIEF IN SUPPORT OF BURCH'S OBJECTION TO DEBTOR'S
PLAN OF REORGANIZATION**

COMES NOW Lauranell Burch ("Burch"), through counsel, an unsecured creditor in the above captioned case, submits this Post-Hearing Brief in Support of Her Opposition to Debtor's Plan of Reorganization to address issues raised at the first hearing on plan confirmation.

**I.
INTRODUCTION**

Burch believes the absolute priority rules applies to Council for Refractive Surgery

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1 Quality Assurance (the “Debtor”). As a result, the Debtor’s plan violates the absolute priority
2 rule and is not confirmable. Additionally, the Debtor’s Plan does not have a proper consenting
3 class and cannot be confirmed on that basis alone.

4 The Debtor is not exempt from the absolute priority rule merely because it is a non-profit
5 organization. The Debtor’s lone “volunteer” and “Executive Director” is Glenn Hagele
6 (“Hagele”); he dominates the Debtor for his own benefit. Most of the Debtor’s assets are
7 distributed to or for the benefit of Hagele—primarily for the payment of Hagele’s health care
8 premiums and deductibles. Hagele controls these payments and very little of the Debtor’s assets
9 are used for any public purpose. In short, Hagele has control over the Debtor and he has a
10 significant economic interest in the Debtor’s profits. Hagele has all of the characteristics of an
11 equity holder in a “for-profit” corporation.

12 The absolute priority rule was instituted to ensure that equity holders do not obtain too
13 good of a deal at the expense of the unsecured creditors. Similarly, Hagele should not be able to
14 obtain too good of a deal at Burch’s expense. As the plan allows Hagele to keep his equity like
15 interests in the Debtor and remain in control of the Debtor while Burch remains unpaid, the Plan
16 violates the absolute priority rule and confirmation should be denied.

17 **II.** 18 **FACTS**

19 It cannot reasonably be contested that Hagele controls the Debtor. He is the only person
20 who conducts any business on the Debtor’s behalf, and the Debtor’s minimal business is run out
21 of a spare room in Hagele’s residence. For all practical purposes, the Debtor acts at Hagele’s
22 whim, if there is any separation between the Debtor and Hagele at all.

23 Moreover, according to the latest Monthly Operating Report (PACER No.128), the Debtor
24 received revenues of \$3,625.00. The Debtor recorded expenses of \$4,627.43. Of those expenses
25

1 \$994.56 was paid to cover Hagele's personal insurance premiums and copayments; \$67.72 was
 2 paid to iTunes, the Apple Store, and Best Buy; \$855.00 was paid to Hagele for "rent;" \$973.23
 3 was paid for utilities, many of which are "shared" with Hagele; \$36.00 was paid, upon
 4 information and belief, so that Hagele could purchase a subscription to Russian Life. In all, over
 5 80% of the Debtor's income was spent for purposes which directly benefit Hagele. Less than
 6 \$250.00 was paid for business expenses that did not directly benefit Hagele. These expenses are
 7 typical.
 8

9 Hagele has a plain interest and control over the Debtor's profits. Even assuming arguendo
 10 that there is some corporate separateness between the Debtor and Hagele, the Debtor is the
 11 equivalent of a for-profit corporation controlled by a single shareholder, Hagele. Hagele should
 12 not be permitted to retain these benefits without paying Burch's claim in full. Under these facts,
 13 the absolute priority rule should be applied to bar Hagele's post-confirmation continued control
 14 over the Debtor.
 15

16 **III.** 17 **ARGUMENT**

18 **A. The Absolute Priority Rule Applies and the Plan is Not Confirmable.**

19 Under 11 U.S.C. § 1129, a plan may not be confirmed by cram down if "the holder of any
 20 claim or interest that is junior to the claims of [the impaired] class [receives] or retain[s] under the
 21 plan on account on such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii).
 22 This provision is commonly referred to as the "absolute priority rule."
 23

24 The reason for such a limitation [is] the danger inherent in any
 25 reorganization plan proposed by a debtor . . . that the plan will
 26 simply turn out to be too good a deal for the debtor's owners.
 Hence . . . fairness and equity required that the creditors be paid
 before the stockholders [can] retain [equity interests] for any
 purpose whatever.

27 *Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434,
 28

1 444 (1999).

2 A non-profit corporation's unique structure creates a complication with respect to the
3 application of the absolute priority rule. The fact that non-profit entities do not have equity
4 members "raises the question of how to apply the absolute priority rule to plans in which the pre-
5 petition interests of holders of a nonprofit (usually its directors or members) retain control of, and
6 thus an interest in, the reorganized, post-petition debtor." *Amelia Rawls, Applying the Absolute*
7 *Priority Rule to Nonprofit Enterprises in Bankruptcy*, 118 YALE L.J. 1231, 1232 (2009)
8 [hereinafter, "*Applying the Absolute Priority Rule*"]. The Ninth Circuit has resolved this tension
9 by comparing the controlling interests of the non-profit debtor to the characteristics of traditional
10 equity. *In re General Teamsters, Warehousemen and Helpers Union, Local 890*, 265 F.3d 869,
11 876 (9th Cir. 2001), citing *In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1318-19 (7th Cir.
12 1995) (wherein the court identified three components of equity interest: control, profit share and
13 ownership of corporate assets. "Where control does not convey the ability to make commercial
14 decision that generate profits or corporate ownership, there is no property retained on account of
15 an equity interest and therefore no absolute priority problem"); *see also Applying the Absolute*
16 *Priority Rule* at 1234 fn. 17 (collecting cases holding that the absolute priority rule applied to bar
17 confirmation of a non-profit's plan of reorganization on the specific facts of the case).

18 Here, Hagele does have control to make commercial decisions which could result in
19 generating profits which evidences an "equity" like interest. Moreover, lesser benefits than the
20 tax-free distributions the Debtor makes for Hagele's benefit have been held to invoke the absolute
21 priority rule. "Although these benefits are not packaged as conventional equity instruments like
22 stock dividends or capital gains, they include such opportunities as guaranteed discounts on
23 purchased goods and services, shares of appreciated patronage capital, and interests in
24 appreciated real estate." *Applying the Absolute Priority Rule* at 1238 (citing *S. Pac. Transp. Co. v.*
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1 *Voluntary Purchasing Groups, Inc.*, 252 B.R. 373, 377 (E.D. Tex. 2000); *In re E. Me. Elec.*
 2 *Coop., Inc.*, 125 B.R. 329, 339 (Bankr. D. Me. 1991); *In re S.A.B.T.C. Townhouse Ass'n*, 152
 3 B.R. 1005 (Bankr. M.D. Fla. 1993)).

4
 5 Moreover, no policy is furthered by allowing the Debtor to skirt the provisions of the
 6 absolute priority rule. *Applying the Absolute Priority Rule* at 1242. The Debtor plays an
 7 insignificant role in its target community. It spends almost no money on charitable services, either
 8 “in absolute terms or as a percentage of its total operating costs.” *Id.* The general community does
 9 not benefit from the Debtor’s existence, the only person that the Debtor benefits is Hagele.

10 In this case, Hagele’s interest in the Debtor is almost identical to that of traditional equity.
 11 He controls the Debtor and almost all of the Debtor’s profits are distributed in ways that directly
 12 benefit Hagele.¹ Under these circumstances, Hagele should not be able to retain control over the
 13 Debtor for his own benefit at the expense of unsecured creditors, such as Burch.

14
 15 **B. Debtor’s Plan Fails as it Does Not Have A Proper Consenting Class.**

16 Burch previously objected to the Debtor’s Plan for improper classification of her claim.
 17 Burch and Brent Hanson were improperly separately classified as Class 2 when their treatment is
 18 identical to Class 3, general unsecured creditors. Thus, these two classes should be combined and
 19 if that occurs, the new combined Class would reject the plan. The Debtor, in its response to
 20 Burch’s objection, concedes to combine Class 2 with Class 3 because it relies on Class 1. The
 21 holder of Class 1 is the Internal Revenue Service (“IRS”) based on priority tax debt. (See
 22 Amended Tabulation of Ballots, PACER No.129). However, the IRS as a holder of a priority tax
 23 debt cannot be the consenting class that carries the plan.

24 The bankruptcy code dictates specific treatment for priority tax claims. (See generally,

25 ¹ In *In re General Teamsters, Warehousemen and Helpers Union*, the Ninth Circuit also highlighted the
 26 fact that the members had no interest in the Debtor’s assets in determining that the member’s interests
 27 were not akin to equity. *In re General Teamsters, Warehousemen and Helpers Union, Local 890*, 265 F.3d
 28 at 876. Hagele’s interest in the Debtor’s assets cannot be known for certain without the corporate
 documents governing the Debtor’s management—e.g. the Articles of Organization. That said, even if
 Hagele has no present interest in the Debtor’s assets, he shares in the profits and there is little, if any,
 corporate separateness. This interest is sufficient to invoke the absolute priority rule.

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1 Section 1129(a)(9)). As a result, priority tax claims do not need to be classified in Chapter 11
 2 plans. Section 1123(a)(1) provides that “a plan shall designate, subject to section 1122 of this
 3 title, classes of claims, *other than claims of a kind specified in section 507(a)(2), 507(a)(3), or*
 4 *507(a)(8)* of this title, and classes of interests”. (emphasis added). Accordingly, the IRS priority
 5 tax claim, a 507(a)(8) claim, is not even supposed to be classified in the plan. As such, the IRS’
 6 vote should not be counted to carry the plan. Accordingly, the Debtor’s plan fails to satisfy
 7 Section 1129(a)(10) and is not confirmable.

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 10 **IV.**
CONCLUSION

11 The Plan is too good of a deal for Hagele. The absolute priority rule should be applied to
 12 bar confirmation of the Plan of Reorganization. Additionally, the plan does not have a proper
 13 consenting class.

14 WHEREFORE, based on the foregoing, Creditor Lauranell Burch respectfully requests
 15 the Court deny confirmation of the Debtor’s Plan.

16 DATED: September 6, 2011

WILKE, FLEURY, HOFFELT, GOULD &
 BIRNEY LLP

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 18 By: Megan A. Lewis
 19 MEGAN A. LEWIS
 20 Attorneys for Creditor
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