

Concurrent Session

Chapter 13: The Better Bankruptcy Option for Insolvent Professionals?

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**Chapter 13: The Better Bankruptcy Option for Insolvent
Professionals? (A Comparison with Chapter 11)**

Eligibility

The Plan

Confirmation Requirements

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I. Introduction

This paper briefly addresses some chapter choice considerations for insolvent professionals, specifically comparing Chapter 13 and Chapter 11. There is no right choice for every insolvent professional. Ultimately the decision should depend on a number of factors, only a few of which are discussed in this paper.

II. Is the Insolvent Professional Eligible?

Chapter 11 is available to nearly all entities, except stockbrokers, commodity brokers and certain banks.¹ Chapter 13, on the other hand, is not available to everyone. Only an *individual* may file a petition under Chapter 13, and the individual must not be a stockbroker² or commodity broker,³ and must have non-contingent, un-liquidated secured debts *less than* \$1,081,400 and unsecured debts *less than* \$360,475, as of April 1, 2010.⁴ These debts limits change every three years and the next change will be April 2013.

Sometimes practitioners confuse the concept of a “contingent” debt with a debt that is “disputed;” however, courts have little difficulty recognizing the distinction. A contingent debt is one in which “the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor.”⁵ On the other hand, a disputed debt is *not* contingent (for purposes of eligibility) but rather one in which the liability is questioned –

¹ 11 U.S.C. § 109(d).

² 11 U.S.C. § 101(53A) defines stockbroker for purposes of this section. For interpretations of the definition of stockbroker, see *In re Baker & Getty Financial Services, Inc.*, 106 F.3d 1255 (6th Cir. 1997); *In re Schave*, 91 B.R. 110 (Bankr. D. Colo. 1988); *In re Berry*, 22 B.R. 950 (Bankr. N.D. Ohio 1982).

³ 11 U.S.C. § 101(6) defines commodity broker for purposes of this section.

⁴ 11 U.S.C. §§ 104, 109(e).

⁵ *In re Nicholes*, 184 B.R. 82, 88 (9th Cir BAP 1995).

a legitimate dispute exists as to the debtor's liability, and the debtor is clear and unequivocal in his denial of the validity of the debt and the liability on the claim.⁶

Debts that are contractual generally are not contingent, even if liability is subject to avoidance by some later occurrence.⁷ Likewise, a claim that has not been reduced to judgment is not contingent.⁸

A debt is liquidated when the amount is capable of ascertainment, even by computation.⁹ Some practitioners assume a debt that has not been reduced to judgment must be un-liquidated. This assumption is flawed: if the amounts can be easily ascertainable at a simple hearing, the debt may be liquidated even if not reduced to judgment.¹⁰ It is only when the debt is one that is *not* capable of determination absent an extensive, contested evidentiary hearing in which substantial evidence may be necessary to establish amounts or liability, that the debt may be characterized as un-liquidated.¹¹ Typically, contract claims that are not reduced to judgment will be liquidated but tort claims may or may not be liquidated. This is because the potential liability arising out of contract disputes can be easily ascertained, but the potential liability arising out a tort claim may not.¹² For example, if the tort claim is in the nature of fraud, quantum meruit, or arises from a piercing of the corporate veil, then in order to determine the amount of the claim, a court must first determine liability. Thus, these types of tort actions have been classified as un-

⁶ See e.g., *In re Kirby*, No. 07-71495 (Bankr. W.D. Va. January 13, 2009) for discussion of a valid dispute over liability (in the context of an objection to claim).

⁷ *Id.*, citing *In re Albano*, 55 B.R. 363, 366-67 (N.D. Ill. 1985).

⁸ *Nicholes* at 88, citing *In re Dill*, 30 B.R. 546, 549 (9th Cir. BAP 1983), *aff'd* 731 F.2d 629 (9th Cir. 1984).

⁹ See *In re Williams*, 51 B.R. 249 (Bankr.S.D. Ind. 1984).

¹⁰ See *Slack*, *supra* at 1074-75; *In re Loya*, 123 B.R. 338 (9th Cir. BAP 1991); *In re McGarry*, 230 B.R. 272 (Bankr. W.D. Pa. 1999); *In re Wenberg*, 94 B.R. 631, 634 (9th Cir. BAP 1988).

¹¹ *Slack* at 1073-74, citing *Wenberg*, *supra*, 94 B.R. 631 (9th Cir BAP 1988), *aff'd* 902 F.2d 768 (9th Cir. 1990).

¹² *In re Sylvester*, 19 B.R. 671 (9th Cir BAP 1982).

liquidated.¹³ The Ninth Circuit reconciled this apparent inconsistency with a simple guideline: for purposes of section 109(e), debts that are capable of ‘ready determination,’ are counted in the debt limit calculation, even if a dispute over the debt exists; and a debt that is not capable of ready determination, whether as a result of a dispute or not, is not counted in the debt limit calculation.¹⁴

A. How do I count the malpractice claims that have not been reduced to judgment?

Consider the insolvent professional who has potential malpractice claims that could exceed the dollar limits for Chapter 13 eligibility. If, for example, the professional had received a demand in excess of \$1,000,000, but the cause of action had not been filed, the claim (demand) could be counted in the total unsecured debts for Chapter 13 eligibility. Similarly, if the professional had participated in an arbitration proceeding to resolve pending grievance complaints, yet no cause of action had been filed in a court of law, the grievances that were the subject of the arbitration proceedings may be counted in the debt limits for Chapter 13 eligibility.¹⁵ Contrast this with the professional who has received an inquiry and is on notice that a complaint could arise but has not been told of a particular amount for damages, or has been accused of a tort, such as, fraud. Now this individual may be eligible for Chapter 13.

B. How do I count the split claims?

Almost as troubling as determining how to count a debt that the debtor honestly believes he does not owe is how to count the debt that falls into both the secured and unsecured category. Generally, a “split claim,” that is, one that is partially secured, is counted partially in the secured

¹³ *In re Clark*, 91 B.R. 570, 574 (Bankr. D. Colo. 1988).

¹⁴ *In re Nicholes*, 184 B.R. 82, 91 (9th Cir. 1995). *See, for example, In re Loya*, 123 B.R. 338 (9th Cir. BAP 1991)(if a court can readily determine the liability to be zero based on expiration of Statute of Limitations, then the claim can be counted as zero for purposes of debt limits).

¹⁵ *In re Teague*, 101 B.R. 57 (Bankr. W.D. Ark. 1989).

pool.¹⁶ Even though courts will rely upon a debtor's schedules as the basis for the computation, the schedules will not be solely controlling or determinative. For example, if it can be shown that the schedules were not drafted or proposed in good faith,¹⁷ the courts may consider other factors.¹⁸ In addition, the courts will count a secured debt that is subject to avoidance,¹⁹ whether consensual or not, in the unsecured pool.²⁰ Leases, which are subject to unique treatment, different from secured and unsecured claims, are nonetheless counted in unsecured pool.²¹ Finally, when section 506 will render a debt wholly unsecured (because the superior liens exist to secure debts of a value more than the total value of the collateral), courts generally count the debt in the unsecured pool, not the secured pool.²²

III. How does the individual with a large potential civil claim or claims reorganize?

A. Drafting the Plan

One of the first steps in the reorganization will be drafting a plan. What the plan may provide and what the plan must provide under Chapter 11 and Chapter 13 are found in Bankruptcy Code sections 1123 and 1322 respectively.

¹⁶ *Miller v. United States (In re Miller)*, 907 F.2d 80 (8th Cir. 1990); *Scovis v. Henrichsen*, 249 F.3d 975 (9th Cir. 2001); *In re Lower*, 311 B.R. 888 (Bankr. D. Colo. 2004)(split claim counted part secured and part unsecured and even claim secured by property owned by non-debtor corporation not counted as secured for purposes of debt limits for individual's chapter 13).

¹⁷ *Scovis* 249 F.3d at 981; *Matter of Pearson*, 773 F.2d 751 (6th Cir. 1985).

¹⁸ *See also In re Salazar*, 348 B.R. 559 (Bankr. D. Colo. 2006)(finding court should look beyond the schedules even if schedules found to be filed in good faith and consider both schedules and filed proofs of claim).

¹⁹ Sections 522(f) and 544 permit avoidance of certain liens.

²⁰ *In re Hanson*, 275 B.R. 593 (Bankr. D. Colo. 2002).

²¹ *In re Smith*, 325 B.R. 498 (Bankr. D. N.H. 2005).

²² *In re Smith*, No.1:08-bk-17343 (Bankr. C.D. Cal. October 9, 2009) .

B. Plan Term

In Chapter 13, a debtor may not propose a term longer than five years,²³ or less than three years, and if over the state median income, less than five years,²⁴ unless the debtor is paying his creditors in full or is in the Ninth Circuit. The Ninth Circuit has held that the commitment period (plan term) may be less than five years for an over the median income debtor, if the debtor has no disposable income pursuant to the calculation under the means test of Form 22C.²⁵ Other circuits and courts outside the Ninth Circuit, however, rule directly opposite and find that the applicable commitment period is temporal and not a multiplier.²⁶

In Chapter 11, however, the debtor may propose a plan term that is longer than five years, yet if the debtor owes creditors holding priority claims under section 507(a)(8)²⁷ the plan must propose *payment* on those claims not longer than five years. The Chapter 11 individual debtor may propose a plan period less than five years if he is paying all his unsecured claims in full, but if not, his plan will not be confirmed unless it provides for the amount to be paid to the unsecured creditors to be equal to his projected disposable income that will be received in the five year period beginning on the date that *the first payment is due* under the plan or *the plan period*, whichever is longer.²⁸ Unlike the Chapter 13 debtor who must begin payments within 30

²³ 11 U.S.C. § 1322(d).

²⁴ *Id.*

²⁵ *In re Kagenveama*, 541 F.3d 868 (9th Cir. 2008)(commitment period inapplicable if debtor has no disposable income per means test).

²⁶ *In re Fredickson*, 545 F.3d 652 (8th Cir. 2008); *In re Hylton*, 374 B.R. 579 (Bankr. W.D. Va. 2007).

²⁷ 11 U.S.C. § 507(a)(8) includes many, but not all, tax claims.

²⁸ 11 U.S.C. § 1129(a)(15)(emphasis added).

days of the petition date, the first payment due under the Chapter 11 plan may be due several months after the petition date.²⁹

C. Treatment of Secured Claims

1. Adequate Protection: Section 1326 versus Section 361

Prior to the enactment of BAPCPA,³⁰ Chapter 13 debtors were rarely bothered by the requirement to provide “adequate protection” to a secured creditor. Occasional post confirmation motions for adequate protection pursuant to section 361, or pleas for adequate protection coupled with motions for relief from stay, occurred in response to a debtor’s post petition or post confirmation default. BAPCPA introduced a new requirement in Chapter 13 for a debtor to pay adequate protection to a creditor holding an allowed claim that is secured on a purchase money security interest in personal property.³¹ The “adequate protection payments” are to begin 30 days after the petition date.³² The Code describes a method for the debtor to “pay directly to” the creditor and reduce his plan payments accordingly, or if the court “orders otherwise” pay these adequate protection payments out of plan payments to the Chapter 13 trustee. It is the later practice that has become typical in most jurisdictions. Thus, most Chapter 13 debtors simply make payments to the trustee and rely on the trustee to make the adequate protection payments as required by section 1326, without worrying about the need to account for or keep up with

²⁹ See 11 U.S.C. § 1326 (payments begin 30 days after the petition date or the filing of the plan whichever is earlier), and 11 U.S.C. §§ 1121 (debtor has exclusive right up to 180 days to file the plan) and 1129(a)(9), (15) (references amounts classes of creditors should receive *as of the effective date of the plan* which generally means as of confirmation of the plan, not as of the petition date or the plan filed date).

³⁰ References to “BAPCPA” are to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

³¹ 11 U.S.C. § 1326.

³² *Id.*

anything other than his trustee plan payments. The plan, however, must address the adequate protection payments in some manner (a simple reference may be sufficient).³³

The Chapter 11 debtor does not have an independent duty to pay adequate protection specifically to creditors holding allowed claims secured by purchase money security interests, and therefore may not voluntarily begin payments to a secured creditor 30 days after the petition date. Yet the Chapter 11 debtor may likely confront motions from secured creditors seeking some form of adequate protection during that long period of time prior to confirmation of the plan and/or the consummation of payments under the plan.³⁴ If an order is entered directing adequate protection payments, it may also provide for an appropriate credit of those payments against the payments to that creditor under the plan. Thus the plan drafting may need to take into account adequate protection orders.

The term “adequate protection” appears again in language added to Chapter 13 by BAPCPA. In section 1325(a)(5), for the plan to be confirmed, it must be accepted by the secured creditors, or provide that the secured claim will be paid in full with disbursements in equal monthly amounts, and if the creditor is secured by personal property, those amounts shall not be less than an amount to provide to the holder of the claim “adequate protection” during the term of the plan.³⁵ It appears that this requirement to disburse in equal monthly amounts applies to payments to a secured claim, not payments to cure a default (such as mortgage arrearages) on a debt that

³³ Some jurisdictions may require additional notice to be made or orders to be entered regarding these adequate protection payments. Check local practice and especially local rules prior to filing a Chapter 13 petition.

³⁴ Because the debtor is using the depreciating collateral, he may need to compensate the creditor for the decline in value until the debt is paid. *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Ltd.*, 484 U.S. 365 (1988)(such compensation may be other than contractual principal and interest payments).

³⁵ 11 U.S.C. § 1325(a)(5)(A) and (B). This may mean that the payments to be disbursed should be at least enough to compensate the creditor to the decline in value of its collateral until the claim is satisfied, or that the payments must be sufficient to retire the *claim* during the period of the plan.

extends beyond the term of the plan.³⁶ By contrast, Chapter 11 does not require “equal monthly amounts” or that amounts to be disbursed be at least enough to adequately protect the holder of the claim. Chapter 11 requires the plan to be fair and equitable with respect to each class and specifically with respect to secured claims, the plan must provide that: (1) the creditor shall retain its lien and receive on account of such claim the present value as of the effective date of the plan; (2) if the collateral is to be sold, the liens shall attach to the proceeds; or (3) the holder of the claim shall receive the indubitable equivalent of its claim.³⁷ The opportunity for the creative “indubitable equivalent” option does not exist in Chapter 13, yet the option for cure without interest³⁸ within a “reasonable” period of time³⁹ does not exist in Chapter 11.

2. *Interest to secured claims*

While each chapter requires a secured creditor to be paid the present value of its secured claim as of the effective date of the plan, and thus must be paid interest post-confirmation, in Chapter 13, the debtor need only provide interest at prime or prime plus up to three percentage points. This is thanks to the United States Supreme Court holding in *Till v. SCA Credit*,⁴⁰ which applies to Chapter 13 cases. Chapter 11 debtors may be held to different interest rates depending on the controlling precedent in their circuit.

D. Classification of Claims

Separate classification of claims is permitted under Chapter 11 and Chapter 13. How this is accomplished varies somewhat. The first principle in classification of claims is that similarly

³⁶ 11 U.S.C. § 1322(b)(5) was not amended by BAPCPA and provides that the plan may provide for a cure of these default payments “within a reasonable time.”

³⁷ 11 U.S.C. § 1129(a)(2).

³⁸ 11 U.S.C. § 1322(e) (most mortgage instruments do not provide for interest on cure of default because rarely do they permit cure by agreement).

³⁹ “Reasonable period of time” can be as long as the entire period of the plan. *United States v. Easley*, 216 B.R. 543, 546 (W.D. Va. 1997)(cure period must not exceed the period of the plan).

⁴⁰ 541 U.S. 465 (2001).

classified claims *should* be treated similarly, but *may* be treated differently. To separately classify similar claims, or to separate, and treat differently, claims that should be in the same class, is permitted when certain criteria are met. If not met, the separate classification may be deemed “unfair discrimination.”

In Chapter 11, classification of claims will be critical to plan confirmation. At the outset the debtor must identify which classes, if any, are impaired. If not impaired, the class will be deemed to accept the plan. If impaired, the class must vote. If the debtor receives a requisite number of affirmative votes (at least ½ in number of 2/3 in amount) in an impaired class, that class will be found to have accepted the plan.⁴¹ If the debtor does not have sufficient acceptances, the class will be found to have rejected the plan. The failure to vote may not constitute acceptance of a Chapter 11 plan.⁴² Classification of claims in Chapter 11, therefore, will require a consideration of the impact of the classification on voting behavior. It is for this reason that sometimes Chapter 11 debtors may attempt to provide the most favorable treatment they can afford rather than the least favorable treatment they can legally justify.

A Chapter 11 plan that provides for separate treatment of otherwise similar claims may be confirmed as long as the court finds the plan does “not discriminate unfairly.”⁴³ The test in Chapter 11 for whether the plan does “not discriminate unfairly” will require the court to consider either two or four factors. The two factor test is: 1) whether the proposed discrimination has a reasonable basis and 2) whether the discrimination is necessary for the

⁴¹ 11 U.S.C. § 1126.

⁴² See *In re Bennett*, 2008 Bankr. LEXIS 1354 (Bankr. E.D.Va. April 23, 2008); *In re Jim Beck, Inc.*, 207 B.R. 1010 (Bankr. W.D. Va. 1997), rejecting the Tenth Circuit’s holding in *In re Ruti-Sweetwater, Inc.*, 826 F.2d 1263 (10th Cir. 1988).

⁴³ 11 U.S.C. Section 1129(b)(1).

reorganization.⁴⁴ The four factor test is quite similar and considers: 1) whether there is a reasonable basis for the discrimination; 2) whether the plan can be confirmed and consummated without the discrimination; 3) whether the discrimination is proposed in good faith; and 4) the treatment of classes discriminated against.⁴⁵ The test is applied when confirmation of the plan is sought in spite of the rejection by the class subject to the discrimination.

If the insolvent professional is in Chapter 11 and wants to separately classify his malpractice claim and pay it a lower dividend than other unsecured claims, he should be able to do so as long as he can show this treatment is necessary for his reorganization.⁴⁶ On the other hand, if the professional is in Chapter 13, he may have a more difficult challenge to separately classify the malpractice claim and successfully pay it a lower dividend than other unsecured creditors.

In Chapter 13, the debtor may separately classify his unsecured claims. Typically in Chapter 13, the debtor wants to separately classify in order to pay the creditor a higher dividend, or to provide for it to be paid from a separate source (usually “outside” by co-debtor family member or a corporation). If the special treatment is to *prefer* or benefit one class of unsecured claims over another, the debtor should expect an objection from the Chapter 13 trustee. The debtor can prevail or overcome the objection if he can show that the discrimination is “not unfair” to the other unsecured creditors. The most common test requires the court to consider five factors: 1) whether there is a rational basis for the classification; 2) whether the classification is necessary to the debtor’s rehabilitation under Chapter 13; 3) whether the

⁴⁴ See generally *In re Cypresswood Land Partners, I*, 409 B.R. 396, 434-35 (Bankr. S.D. Tex. 2009).

⁴⁵ *In re Snyders Drug Stores, Inc.*, 307 B.R. 889 (Bankr. N.D. Ohio 2004); *Jim Beck, Inc.*, 207 B.R. at 1016.

⁴⁶ He may need to estimate the claim under section 502(c) or permit the claims to proceed to litigation, which could require litigation in the district court. 28 U.S.C. § 157(b)(5).

discriminatory classification is proposed in good faith; 4) whether there is a meaningful payment to the class discriminated against; and 5) the difference between what the creditors discriminated against will receive under the plan and the amount they would receive without the separate classification.⁴⁷

If the debtor is attempting to treat the separated class in a manner inferior to other unsecured creditors, the debtor should expect the objection from the class subject to the discrimination. To achieve confirmation over the objection, the debtor may not have case law support to justify the treatment.⁴⁸ Rather than prejudice the malpractice claimant, alternatively, the insolvent professional in Chapter 13 could: 1) treat the malpractice claim along with all unsecured creditors in the same class and allow the entire class to share pro rata, even if it results in a low dividend;⁴⁹ 2) propose a marshalling argument and allow insurance to satisfy the claim and discharge the difference; 3) estimate the claim or the deficiency after insurance, per section 502(c), and permit it to be paid along with all other unsecured claims; 4) propose such other treatment that the claimant accepts; 5) treat it as a long term debt and concede non-dischargeability; 6) allow the courts to first determine its dischargeability and agree that if found to be non-dischargeable, it will be treated as a long term debt or will be treated pro rata with other allowed unsecured claims but any unpaid indebtedness will survive discharge; or 7) attempt other creative methods.

A key difference in plan drafting between these two chapters is the need in Chapter 11 to employ a strategy for claims classification designed to achieve sufficient votes for confirmation.

⁴⁷ *In re Husted*, 142 B.R. 72 (Bankr. W.D. N.Y. 1992).

⁴⁸ Unlike Chapter 11, in Chapter 13, there is not a body of caselaw holding that negative discrimination is permissible as long as it is "necessary for the reorganization."

⁴⁹ Since the creditors do not vote on confirmation, the debtor may be able to successfully achieve confirmation of a low dividend plan if the Chapter 13 trustee agrees that the plan meets the liquidation test, disposable income test, does not discriminate "unfairly" and provides at least a meaningful dividend, even if low.

It is this voting process that ultimately distinguishes the Chapter 11 confirmation process from the Chapter 13 process. In Chapter 11, votes and solicitation is paramount; in Chapter 13 notice and opportunity to object is paramount. In Chapter 11, after appropriate solicitation, if the debtor has sufficient acceptances, the plan may be confirmed; in Chapter 13 if no creditor objects to confirmation after adequate notice and opportunity to object, the plan may be confirmed. Although it sounds simple, each chapter requires a variety of criteria that must be met before a plan may be confirmed; neither chapter presumes confirmation. The confirmation requirements, however, are not barriers but rather important preconditions.

IV. Confirmation requirements

Getting to confirmation in Chapter 11 requires a disclosure statement, approval of the disclosure statement, solicitation of ballots, tallying of the ballots, and a hearing on confirmation of the plan.⁵⁰ Getting to confirmation in Chapter 13, on the other hand, merely requires filing a plan and serving the creditors affected by the plan with clear and sufficient notice of its terms and its effect on the creditors' rights.⁵¹ Often the Chapter 13 plan may be confirmed without the filing of any additional pleadings, and without appearance at a hearing.⁵²

Generally, a Chapter 11 plan may be confirmed if each class has accepted the plan⁵³ or is not impaired (and therefore is deemed to have accepted).⁵⁴ If a class that is impaired has not

⁵⁰ 11 U.S.C. §§ 1125, 1126, 1128.

⁵¹ 11 U.S.C. Section 1324; Fed R. Bankr. P. 2002(b).

⁵² 11 U.S.C. Section 102.

⁵³ See 11 U.S.C. § 1126 regarding acceptance requirements.

⁵⁴ 11 U.S.C. § 1129(a).

accepted the plan,⁵⁵ the debtor may yet achieve confirmation by proving that the plan meets the requirements of section 1129(b).

A. Does the Absolute Priority Rule apply to individual Chapter 11 debtors?

Section 1129(b)(1) provides that the court shall confirm the plan if all the criteria of section 1129(a) are met (except for 1129(a)(8)), the plan does not discriminate unfairly, and is fair and equitable to each class of claims or interests that is impaired under, or has not accepted, the plan. In order to be fair and equitable, the unsecured claims must be paid in full or the absolute priority rule of section 1129(b)(2)(B)(ii) must be followed.⁵⁶

Under 1129(b)(2), amended by BAPCPA, if at least one class of impaired creditors has accepted the proposed plan, that plan can be confirmed notwithstanding the failure of other impaired classes of creditors to accept the plan as long as: (1) 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 (2) 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, *except* that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of section 1129(a)(14).⁵⁷ Prior to BAPCPA, the controlling concept under section 1129(b) was the “absolute priority rule” which provides (generally) that any holder of any claim or interest that is junior to the claims of an impaired class will not receive *or retain*

⁵⁵ See *infra*, the lack of a vote may not be deemed to be an acceptance. *In re Bennett, supra*, 2008 Bankr. LEXIS 1354 (Bankr. E.D. Va. April 23, 2009); *Jim Beck*, 207 B.R. at 1014-15.

⁵⁶ 11 U.S.C. Section 1129(b); See *In re Tregeder*, 369 B.R. 477, 479 (Bankr. D. Ne. 2007).

⁵⁷ 11 U.S.C. §§ 1129(b)(2)(B)(emphasis added). In addition, the debtor will need to show that the plan meets the liquidation test of section 1129(a)(7)(A)(ii)(provides to each class holding an unsecured claim as much as it would receive in a liquidation).

under the plan on account of such junior claim or interest, *any property*. The debtor is deemed to be holding an interest junior to the unsecured creditors. Thus, if the debtor is retaining property, the plan will likely fail the absolute priority rule, unless the unsecured creditors are being paid in full.⁵⁸

Section 1115, added to the Code by BAPCPA and referenced in section 1129(b)(2)(B)(ii), provides that if the debtor is an individual, property of the estate includes property specified in section 541 plus: (1) after acquired property (acquired after the commencement of the case but before the case is closed, dismissed or converted); and (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed or converted.⁵⁹ Because section 1115 refers to property of the estate under section 541, and because section 541 provides for some exclusions from property of the estate, and because sections 1115 and 1129 do not otherwise limit the debtor's ability to exempt from the estate property to which he claims an exemption; therefore, some courts have held that the Chapter 11 debtor may retain exempt property and comply with the provisions of 1129(b)(2)(B)(ii).⁶⁰ Other courts hold that the debtor may not retain *any* property, even if the property is exempted or excluded from the estate.⁶¹

Even if the language of section 1129(b)(2)(B) as amended by BAPCPA suggests that the absolute priority rule may not apply when the debtor is an individual, nevertheless to achieve confirmation of a plan that does not pay 100% to unsecured creditors, the debtor must show that the plan is proposed in good faith, meets the liquidation test and meets the disposable income

⁵⁸ An exception, developed by case law, is that if the debtor contributes "new value" he may overcome the absolute priority rule prohibition. It is referred to as the "new value exception" to the absolute priority rule.

⁵⁹ 11 U.S.C. Section 1115

⁶⁰ *In re Bullard*, 358 B.R. 541 (Bankr. D. Conn. 2007); *In re Tegeder*, 369 B.R. 477 (Bankr. D. Ne. 2007).

⁶¹ *In re Gosman*, 282 B.R. 45 (Bankr. S.D. Fla. 2002).

test. Retention of post petition property and earnings, even if of an exempt status, without paying claims in full, may yet trigger an objection on grounds of good faith or disposable income, or compel a finding by the bankruptcy judge that the plan is not “fair and equitable.” The Chapter 13 debtor does not have to worry about the absolute priority rule. The absolute priority rule does not exist in Chapter 13.

B. The Means Test and Disposable Income

1. Does the Means Test apply in Chapter 11?

In Chapter 13, if an unsecured creditor or the Chapter 13 trustee objects to confirmation, the plan cannot be confirmed unless the debtor is providing all of his projected disposable income to payments to unsecured creditors.⁶² If the debtor is over the median income for his state, his disposable income is determined pursuant to 707(b).⁶³ For plan confirmation, however, he must show that his *projected* disposable income is being paid to unsecured creditors.⁶⁴ Some courts hold that the projected disposable income is simply the product of the calculated disposable income times 60 (called the “mechanical approach”).⁶⁵ Other courts have found that “projected” is a term that connotes the future or is “forward looking” and therefore, *when there has been a change in the debtor’s financial condition during six month period preceding the petition or immediately after the petition and prior to confirmation*, the disposable income calculation under the means test is a starting point, and the court may consider other factors

⁶² 11 U.S.C. Section 1325(b).

⁶³ Id.

⁶⁴ Id.

⁶⁵ *Maney v. Kagenveama (In re Kagenveama)*, 541 F.3d 868 (9th Cir. 2008); *In re Alexander*, 344 B.R. 742 (Bankr. E.D. N.C. 2006).

when deciding plan confirmation.⁶⁶ This issue is currently pending before the United States Supreme Court in *Hamilton v. Lanning*.⁶⁷

A key distinction, however, between Chapter 13 and Chapter 11 is that in Chapter 13 only an unsecured creditor or the Chapter 13 trustee may object on net disposable income grounds. Under Chapter 11, the court is required to determine if the plan meets the requirement even in the absence of an objection. The courts differ however on how to arrive at such conclusion. The controversy in Chapter 11 is less about whether the disposable income test is “forward looking” or not, but instead whether the court must apply the means test allowance figures as set forth in section 707(b) or may use their discretion to consider “reasonable and necessary” expenses. The controversy stems from the language of section 1129(a)(15). This is a section that the court must consider, even if no unsecured creditor objects. Under section 1129(a)(15), if the debtor’s plan does not pay unsecured creditors in full, the plan must provide to unsecured creditors

not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the five year period beginning on the date that the first payment is due under the plan or during the period for which the plan provides for payments, whichever is longer.⁶⁸

The first obvious difference in this requirement from Chapter 13 is that in Chapter 11, the disposable income “to be received” begins as of the first payment date, rather than as of the petition date.⁶⁹ Yet the more significant distinction is the reference in section 1129(a)(15) to section 1325(a)(2) but not to section 1325(a)(3). The lack of a specific reference to section

⁶⁶ *In re Turner*, 574 F.3d 349 (7th Cir. 2009); *Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269 (10th Cir. 2008); *Coop v. Frederickson (In re Frederickson)*, 454 F.3d 652 (8th Cir. 2008).

⁶⁷ 130 S.Ct. 487 (2009).

⁶⁸ 11 U.S.C. section 1129(a)(15).

⁶⁹ *See infra* discussion of regarding plan payment start dates.

1325(a)(3) has led some to conclude that the means test allowances of section 707(b) do not apply in Chapter 11.⁷⁰ Indeed, the drafters of the Official Form 22B, and the Advisory Committee notes, suggest that Form 22B form merely establishes Current Monthly Income but not the calculation of disposable income.⁷¹ Yet, the language of section 1325(a)(3) defines (a)(2); the sections do not appear to be mutually exclusive. Thus, some courts have reasoned that the means test will apply in Chapter 11.⁷²

2. *Can the debtor keep the Mercedes, the Lincoln Navigator and the boat?*

If the means test does not apply, and the insolvent professional presents a plan that does not pay his unsecured creditors in full, he may fail confirmation if his expenses are not “reasonable” or “necessary.” Thus, if he wants to pay a debt for a luxury vehicle, a second home, or a recreational boat, those expenses may be rejected as unreasonable. On the other hand, if the court finds the means test may apply in Chapter 11, just as in Chapter 13, the debtor should be able to deduct the secured debt expenses for these items, notwithstanding the non-necessary nature or unreasonable expense, in his disposable income calculation. For many debtors, the scrutiny ends here. For others, however, even if the plan meets the calculated disposable income test, some courts may yet deny confirmation of a plan that allows either a Chapter 13 debtor or a Chapter 11

⁷⁰ *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); *In re Gray*, 2009 WL 2475017 (Bankr. N.D. W.Va. August 11, 2009).

⁷¹ The title of the form is Statement of Current Monthly Income yet the title of the Chapter 13 Form adds the phrase “and Calculation of Disposable income.” Section D.2 of 2005 Committee note to Official Form 22B states “the Chapter 11 form is the simplest of the three [22A, 22B, 22C], since the means-test deductions of § 707(b)(2) are not employed in determining the extent of an individual Chapter 11 debtor’s disposable income.” *See 3 Bankruptcy Practice Handbook* § 14:57 (2d ed).

⁷² *In re Bennett*, 2008 Bankr. LEXIS 13545 (Bankr. E.D. Va. April 23, 2008)(Mitchell, J.), n.6 (since the Chapter 11 debtor is an individual, the projected disposable income is calculated using methodology that applies in chapter 13 cases); *In re Johnson*, 399 B.R. 72 (Bankr. S.D. Cal. 2008)(because means test applies in Chapter 11, debtor may claim secured debt deductions regardless of whether reasonable); *In re Dumas*, 419 B.R. 704, 711 (Bankr. E.D. Tex. 2009)(“because 707(b)(2) applies in both Chapter 13 and Chapter 11, and because § 707(b)(2) has no cap on secured debt obligations for a primary residence, there is no greater ability to pay [realized] in a chapter 13 or 11 than in a Chapter 7”)(quoting *In re Johnson*, *supra* at 77 and denying 707(b) complaint to dismiss Chapter 7 petition).

debtor to retain luxury items on the grounds that the plan is not proposed in good faith.⁷³ The bankruptcy judge may raise a good faith *sua sponte*, even in the absence of an objection by the trustee or an unsecured creditor. Can the debtor keep the Mercedes, Lincoln Navigator and boat? If he pays claims in full, or enough to compensate the creditors for the amounts they would receive if he did not pay for those non-necessary items, yes, he should be able to keep them. Or if he can show that his plan meets the disposable income test as calculated under the means test, and is otherwise proposed in good faith.⁷⁴

V. Conclusion

An insolvent professional has an opportunity to reorganize under either Chapter 11 or Chapter 13. The confirmation requirements and plan drafting strategies will vary, but the ultimate result under either chapter will be an effective reorganization and fresh start. The individual insolvent professional has real choices.

⁷³ *Bennett, supra*, 2008 Bankr. LEXIS 1354,*4 (“even if a plan satisfies the liquidation test, it would not satisfy the good faith requirement if the debtor had the ability to pay a greater dividend”); *In re Martin*, 373 B.R. 731 (Bankr. D. Utah 2007)(Court denied confirmation of Chapter 13 plan of over median income debtor that met the calculated disposable income test but proposed to retain a recreational boat).

⁷⁴ Within districts, courts may differ on the extent that “ability to pay” may render a plan that otherwise meets the calculated disposable income test not confirmable on “good faith” grounds. See *In re Winokur*, 364 B.R. 204 (Bankr. E.D. Va. 2007)(plan that meets disposable income test cannot fail confirmation on good faith grounds even if debtor has greater ability to pay his unsecured creditors), and *In re Kelly*, 416 B.R. 232 (Bankr. E.D. Va. 2009)(plan not proposed in good faith even if meets calculated disposable income per means test when the debtor has the financial ability and circumstances to pay a greater dividend to his unsecured creditors).

**Chapter 13: The Better Bankruptcy Option for Insolvent
Professionals? (A Comparison with Chapter 11)**

The “Hanging Paragraph”/“910 Claims”

Discharge

Home Mortgages (The Creditor’s Perspective)

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The “Hanging Paragraph”/“910 Claims”

Language placed after §1325(a)(9) of the Bankruptcy Code has come to be known as the “hanging paragraph.” It provides:

For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day (*sic*) preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle . . . acquired for the personal use of the debtor , or if collateral for the debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

11 U.S.C. § 1325(a)(9). This provision prevents the application of 11 U.S.C. §506 and bifurcation of a claim secured by a motor vehicle acquired for the debtor’s personal use into secured and unsecured portions in a Chapter 13 case when the creditor has a purchase money security interest in the vehicle and the debt was incurred within 910 days of the filing of the petition. The “hanging paragraph” also precludes bifurcation of claims secured by a purchase money security interest in “any other thing of value” if the debt was incurred within one year prior to the date of the bankruptcy filing.

Most of the litigation under the “hanging paragraph” has dealt with “910 claims” and the applicability of the paragraph to vehicles—*i.e.* whether the creditor held a purchase money security interest, *see In re Horn*, 338 B.R. 110, 113 (Bankr. M.D. Ala. 2006)(Williams, J.); whether the existence of “negative equity” disqualifies these transactions from “910 claim” treatment, *see In re Mierkowski*, 580 F.3d 740 (8th Cir. 2009); *In re Callicott*, 580 F.3d 753 (8th Cir. 2009); *In re Graupner*, 537 F.3d 1295 (11th Cir. 2008); *GMAC v. Peaslee*, 373 B.R. 252 (W.D.N.Y. 2007), *question certified to state court at* 547 F.3d 177 (2nd Cir. 2008); *In re Valiquette*, ____ B.R. ____, 2010 WL 695991 (D.Or. Feb. 24, 2010); whether the inclusion of other charges in the contract preclude “910 claim” treatment, *see In re Townsend*, 2008 WL

920610 (Bankr. D.Kan. April 3, 2008); *In re Macon*, 376 B.R. 778, 781 (Bankr. D.S.C. 2007); whether the car was “acquired for the personal use of the debtor” see *In re Powell*, ____ B.R. ____, 2010 WL 582627 (C.D.Ill. Feb. 12, 2010); *In re Strange*, ____ B.R. ____, 2010 WL 320297 (Bankr. M.D.Ga. Jan. 20, 2010); *In re Press*, 2006 WL 2734335 (Bankr. S.D.Fla. July 26, 2006)(Olson, J.); *In re Pearson*, 2008 WL 687058 (Bankr. E.D.N.C. March 7, 2008)(Small, J.); whether the plan may provide for the surrender of a “910 vehicle” in full satisfaction of the “910 claim”, see *In re Miller*, 570 F.3d 633 (5th Cir. 2009); *In re Barrett*, 543 F.3d 1239 (11th Cir. 2008). If the requirements of the “hanging paragraph” are met, the bankruptcy court has no discretion to confirm any plan that provides for bifurcation of a “910 claim”. *Shaw v. Aurgroup Fin. Cr. U.*, 552 F.3d 447 (6th Cir. 2009). Further, the holder of the “910 claim” is entitled to be paid the present value of the allowed secured claim. *In re Dean*, 537 F.3d 1315 (11th Cir. 2008); *Drive Financial Services, L.P. v Jordan*, 521 F.3d 343 (5th Cir. 2008). Although there are very few reported decisions dealing with the “any other thing of value” provision of the hanging paragraph, these principles would be equally applicable to “big ticket” items purchased within one year prior to the bankruptcy filing.

Section 1129 of the Bankruptcy Code contains no counterpart to the “hanging paragraph”. Thus, a claim that would otherwise be a “910 claim” in a Chapter 13 case would be subject to having the collateral valued under 11 U.S.C. § 506 and “crammed down” under 11 U.S.C. § 1129(b)(2)(A) in a Chapter 11 case. The creditor would clearly prefer for the case to be under Chapter 13 instead of Chapter 11. From the debtor’s perspective, this difference in treatment would be one factor to consider in selecting the most advantageous chapter. While the debtor may obtain some benefit from not having to deal with the “hanging paragraph”, that benefit may be outweighed by other disadvantages of being in Chapter 11.

Individual Discharge—Chapter 13 v. Chapter 11

Section 1328(a) of the Bankruptcy Code provides that with certain exceptions, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 as soon as practicable after completion by the debtor of all payments under the plan. 11 U.S.C. § 1328(a). The exceptions to the Chapter 13 discharge are: unauthorized post-petition consumer debt--11 U.S.C. § 1328(d); long-term debt--11 U.S.C. § 1328(a)(1); priority taxes--11 U.S.C. § 1328(a)(2); debts excepted from discharge under 11 U.S.C. § 523(a)(1)(B) and (C)(taxes), (a)(2)(fraud), (a)(3)(unlisted), (a)(4)(fiduciary fraud or defalcation), (a)(5)(domestic support), (a)(8)(student loans), or (a)(9)(D.U.I.)--11 U.S.C. § 1328(a)(2); restitution of criminal fines--11 U.S.C. § 1328(a)(3); and civil restitution for willful and malicious injury--11 U.S.C. § 1328(a)(4). Section 1328(b) provides for a “hardship discharge” prior to the completion of payments under the plan if (1) the failure to complete the plan payments was not the debtor’s fault, (2) creditors have received at least what they would have received in a Chapter 7 distribution, and (3) modification of the plan is not practicable. 11 U.S.C. § 1328(b). The exceptions to the Chapter 13 “hardship discharge” are long-term debt and all nondischargeable debts under 11 U.S.C. § 523. 11 U.S.C. § 1328(c).

The case of *In re Young*, ____ B.R. ____, 2010 WL 696319 (Bankr. E.D.Tex. Feb. 16, 2010) is an interesting recent case illustrating some of the parameters of discharge in Chapter 13. In *Young*, debtor’s former attorneys obtained a prepetition default judgment against the debtor for services rendered in connection with her divorce proceedings. The firm contended that the debt owed to it was nondischargeable in debtor’s Chapter 13 case under 11 U.S.C. §§ 523(a)(2)(A), (a)(5), (a)(6), and (a)(15). The firm also contended that the debtor’s discharge should be revoked under 11 U.S.C. § 727(d) and (e).

In rejecting the law firm's nondischargeability claims under 11 U.S.C. §§ 523(a)(6), and (a)(15) the *Young* court stated:

Turning to the discharge in Chapter 13 cases, a Chapter 13 debtor receives what is sometimes referred to as a “super discharge.” A Chapter 13 debtor is entitled to discharge most, but not all types of prepetition debts upon completion of payments under a Chapter 13 plan—including many of the otherwise nondischargeable debts listed in § 523(a). *See* 11 U.S.C. §§ 1328 (a)(sic). Certain debts to a spouse, former spouse, or child of the debtor that are not domestic support obligations (§ 523(a)(15)) are among those that may be discharged in a Chapter 13 bankruptcy. *See* 11 U.S.C. § 1328 (a)(2). The Court, therefore, concludes that the debtor's request for summary judgment should be granted with respect to the plaintiff's § 523(a)(15) claim.

Section 1328 (a)(2) also provides that debts for willful and malicious injuries under § 523(a)(6) are dischargeable in a Chapter 13 case with one notable exception—when the debtor seeks a hardship discharge under § 1328 (b).

In re Young, ___ B.R. at ___, 2010 WL 696319. The *Young* court then noted that the law firm's § 523(a)(6) claim was not ripe for decision because the debtor had not sought a hardship discharge. After noting that the law firm's 523(a)(2)(A) claims based upon false representations and actual fraud are not included in the Chapter 13 “super discharge”, the court ruled that the law firm's assertion of those claims and its request for extension of the deadline to assert such claims were untimely. *Id.* (citing Fed. R. Bankr. P. 4007(c)). Next the *Young* court rejected the law firm's § 523(a)(5) claim holding that while the law firm's assertion of such claim was not subject to any time deadline, the debtor's indebtedness to her own attorneys was not in the nature of a domestic support obligation excepted from the debtor's discharge under §§ 523(a)(5) and 1328(a)(2) because the debt was not owed to a former spouse or child for alimony, maintenance, or support. *Id.* The *Young* court also rejected the law firm's objection to debtor's discharge under § 727(a) stating that the complaint failed to articulate an objection to discharge under that section and noting that the assertion that debtor's discharge should be revoked was premature since debtor had not received a discharge because she had not completed the plan payments. *Id.*

(citing 11 U.S.C. § 1328 (b)). The court noted that to the extent the law firm intended to object to the debtor's discharge, the complaint was untimely. *Id.* (citing Fed. R. Bankr. P. 4004(a)). Lastly, the court ruled that the law firm's request to revoke confirmation of debtor's Chapter 13 plan brought more than 180 days after entry of the confirmation order was untimely too. *Id.* (citing 11 U.S.C. § 1330 (a)). The court then set the matter for hearing on the debtor's request for an award of attorneys fees against the creditor pursuant to 11 U.S.C. § 523 (d). *Id.*

Prior to the passage of the 2005 amendments to the Bankruptcy Code, confirmation of a Chapter 11 plan automatically effected a discharge of all preconfirmation debts. *See In re Smith*, 419 B.R. 826 (Bankr. C.D.Cal. 2009); *In re Hunt*, 415 B.R. 637 (Bankr. E.D.Tenn. 2009). As with discharge under 11 U.S.C. § 1328 under current law, a Chapter 11 discharge of an individual debtor is effective after the completion of all payments under the plan. *In re Young*, ___ B.R. ___, 2010 WL 696319 (Bankr. E.D.Tex. Feb. 16, 2010); 11 U.S.C. § 1141(d)(5)(A). Similar to Section 1328(b), an individual Chapter 11 debtor may also receive a "hardship discharge" under Section 1141(d)(5)(B) if creditors have received at least what they would have received in a Chapter 7 distribution and modification of the plan is not practicable. 11 U.S.C. § 1141(d)(5)(B). Note that the Chapter 11 "hardship discharge" section omits the requirement that the debtor's failure to complete the plan payments is due to circumstances for which the debtor should not be held accountable. *Id.*

Section 1141(d)(3) limits confirmation as effecting a discharge in liquidating Chapter 11 cases if the plan is a liquidating plan, the debtor does not engage in business after the confirmation of the plan, and the debtor would be denied a discharge under Section 727(a) of the Bankruptcy Code. 11 U.S.C. § 1141(d)(3). While these limitations would seem to be inapplicable to individual Chapter 11 debtors in light of 11 U.S.C. § 1141(d)(5), the Tenth

Circuit BAP took a different view in *In re Berg*, ____ B.R. ____, 2010 WL 537566 (10th Cir. BAP Feb. 16, 2010). The *Berg* bankruptcy court denied Mr. Berg's discharge in his individual Chapter 11 case based upon his failure to maintain business records and thereby meeting the requirements of 11 U.S.C. § 1141(d)(3)(C). After determining that the bankruptcy court's order was a final appealable order, the Tenth Circuit BAP reversed and remanded the case back to the bankruptcy court for findings as to whether the requirements of 11 U.S.C. § 1141(d)(3)(A) and (B) were met *i.e.* whether the plan provided for the liquidation of all or substantially all of the property of the estate and whether the debtor will engage in business after the consummation of the plan.

The exceptions to a Chapter 11 discharge of an individual include any debt excepted from discharge under section 523 of the Bankruptcy Code. 11 U.S.C. § 1141(d)(2). Thus the Bankruptcy Code provides more flexibility to an individual Chapter 11 than to a Chapter 13 debtor to deal with debts which would otherwise be excepted from discharge in Chapter 13. For instance, holders of long-term debt which would otherwise be excepted from a Chapter 13 discharge could be bound by the provisions of a confirmed Chapter 11 plan pursuant to 11 U.S.C. § 1141(a); however, they would have the protections provided in the Chapter 11 confirmation process.

The addition of Section 1129(a)(15) in the 2005 Amendments to the Bankruptcy Code also bears on discharge in Chapter 11. Section 1129(a)(15) permits confirmation of a plan notwithstanding the objection of a holder of an allowed unsecured claim so long as the plan proposes to pay the claim in full or to distribute debtor's disposable income as defined in Section 1325(b)(2) during the first five years of the plan. 11 U.S.C. § 1129(a)(15). Thus, the concept of Chapter 13 disposable income is incorporated into Chapter 11 and coupled with new Section

1141(d)(5) sets the standard for a debtor to obtain a Chapter 11 discharge. See 11 U.S.C. §§ 1129(a)(15) and 1141(d)(5). As an aside, note that new Section 1123(a)(8) allows an individual Chapter 11 debtor to provide for the payment of creditors from post-petition earnings. 11 U.S.C. § 1123(a)(8). This new section effectively overrules *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 96 (1988) in which the Supreme Court ruled that the “new value exception” (if it existed at all) to the absolute priority rule (if it existed at all) could not be satisfied by post-confirmation personal services or “sweat equity”. *Id.*

Lastly, Section 1141 of the Bankruptcy Code has no counterpart to 11 U.S.C. § 1328(f) which limits the availability of subsequent discharges. A Chapter 13 debtor may not receive another discharge if the debtor received a discharge in Chapters 7, 11, or 12 within four years prior to the filing of the instant Chapter 13 case or if the debtor received a discharge in a Chapter 13 case within two years prior to the filing of the instant Chapter 13 case. 11 U.S.C. § 1328(f).

Home Mortgages—Chapter 13 v. Chapter 11 (The Creditor’s Perspective)

Section 1322(b)(2) of the Bankruptcy Code prohibits a debtor’s Chapter 13 plan from modifying the rights of holders of claims secured “only by a security interest in real property that is the debtor’s principal residence”—i.e. home mortgages. 11 U.S.C. § 1322(b)(2). The parameters of this section have been extensively litigated. See *In re Reinhardt*, 563 F.3d 558 (6th Cir. 2009)(Cramdown permitted on debt secured by unattached mobile home even where creditor held mortgage on underlying real property); *In re Ennis*, 558 F.3d 343 (4th Cir. 2009)(same); *In re LaFata*, 483 F.3d 13 (1st Cir. 2007)(modification permitted where principal residence straddled property line and lay mostly on parcel abutting mortgaged parcel); *In re Scarborough*, 461 F.3d 406 (1st Cir. 2007)(modification permitted where mortgaged property was multi-unit dwelling purchased in part as an investment).

Section 1123 of the Bankruptcy Code contains no counterpart to the Section 1322(b)(2) prohibition on modification of home mortgages; and the treatment of such claims is, therefore, subject to negotiation and modification in the Chapter 11 confirmation process. Here again, the creditor would prefer for the case to be under Chapter 13 instead of Chapter 11; and this difference in treatment would be another factor for a debtor to consider in selecting the most advantageous chapter.

Prior to the 2005 Amendments to the Bankruptcy Code, individual Chapter 11 debtors had to satisfy the “absolute priority rule” of 11 U.S.C. §1129(b)(2)(B)(ii) in order to keep their residences if their plans were confirmed nonconsensually in a cramdown. 11 U.S.C. § 1129(b)(2)(B)(ii). This requirement is abrogated under the current version of the Bankruptcy Code which specifically permits an individual debtor to retain property included in the estate under Section 1115. 11 U.S.C. § 1129(b)(2)(B)(ii). Section 1115 was added by the 2005 Amendments to the Bankruptcy Code and provides that in addition to property of the estate under Section 541 of the Bankruptcy Code, property of the Chapter 11 estate includes all such property acquired postpetition and earnings from services performed postpetition. 11 U.S.C. § 1115. This change makes the Chapter 11 bankruptcy estate coextensive with the Chapter 13 bankruptcy estate. *Compare* 11 U.S.C. § 1115 *with* 11 U.S.C. § 1306. The more narrow interpretation that the reference to individual debtor’s retention of property included in the estate under Section 1115 in the current version of Section 1129(b)(2)(B)(ii) permits debtors to retain only postpetition earnings payable after the fifth anniversary of plan confirmation has been considered and rejected. *See In re Shat*, ____ B.R. ____, 2010 WL 702443 (Bankr.D.Nev. Feb. 22, 2010)(Individual debtors permitted to retain their dry-cleaning business in cram down). The *Shat* decision contains an excellent discussion of this issue, and a copy of the opinion is included

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in these materials. Under this rationale, individual Chapter 11 debtors will be able to retain their residences in cram down confirmations.

As an aside, note that new Section 1123(a)(8) allows an individual Chapter 11 debtor to provide for the payment of creditors from post-petition earnings. 11 U.S.C. § 1123(a)(8). This new section effectively overrules *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 96 (1988) in which the Supreme Court ruled that the “new value exception” (if it existed at all) to the absolute priority rule (if it existed at all) could not be satisfied by post-confirmation personal services or “sweat equity”. *Id.*

**Chapter 13: The Better Bankruptcy Option for Insolvent
Professionals? (A Comparison with Chapter 11)**

US Trustee Fees

Conversion

Personal Injury Claims Against the Debtor

Hon. Steven Rhodes
United States Bankruptcy Judge
Eastern District of Michigan

American Bankruptcy Institute
2010 Annual Spring Meeting

I. US Trustee Fees in Chapter 11 Cases

A. Under 28 U.S.C. § 1930(a)(6), a quarterly fee is imposed on each chapter 11 debtor until the case is converted or dismissed. In a confirmed case, this requires payment of the quarterly fees until the entry of a final decree closing the case. 11 U.S.C. § 350(a) states that “[a]fter an estate is fully administered . . . , the court shall close the case.” Bankruptcy Rule 3022, which implements § 350(a) in chapter 11 cases, provides, “After an estate is fully administered in a chapter 11 reorganization case, the court, on its own motion or on the motion of a party in interest, shall enter a final decree closing the case.”

The fee is based on the debtor’s disbursements during the quarter, as follows:

<u>Disbursement Range</u>	<u>Quarterly Fee</u>
\$0 to \$14,999.99	\$325
\$15,000 to \$74,999.99	\$650
\$75,000 to \$149,999.99	\$975
\$150,000 to \$224,999.99	\$1,625
\$225,000 to \$299,999.99	\$1,950
\$300,000 to \$999,999.99	\$4,875
\$1,000,000 to \$1,999,999.99	\$6,500
\$2,000,000 to \$2,999,999.99	\$9,750
\$3,000,000 to \$4,999,999.99	\$10,400
\$5,000,000 to \$14,999,999.99	\$13,000
\$15,000,000 to \$29,999,999.99	\$20,000
\$30,000,000 or more	\$30,000

B. Issue: Does “disbursement” include lawsuit settlement funds that a personal injury attorney receives into a client trust account and then pays to a client?

See In re Danny’s Market’s, Inc., 266 F.3d 523 (6th Cir. 2001) (“Accordingly, all of these payments, including the debtor’s day-to-day, post-confirmation operating expenses, must be

accounted for in the calculation of the trustee's quarterly fee. They are all "disbursements" under the statute, and the statute is quite unambiguous that all disbursements, whenever made, drive the fee amount."); *In re Cash Cow Services of Florida LLC*, 296 F.3d 1261 (11th Cir. 2002) (Consumer loans made by debtor as part of its business, from funds constituting part of Chapter 11 estate, were in nature of "disbursements," that had to be included with other disbursements in calculating United States Trustee's quarterly fees.); *In re Jamko, Inc.*, 240 F.3d 1312 (11th Cir.2001) (the fee includes all disbursements, including those made in the ordinary course of business and not limited to payments made to creditors or those made pursuant to a debtor's confirmed plan); *In re N. Hess' Sons, Inc.*, 218 B.R. 354 (Bankr. D. Md. 1998) ("disbursements" include all post-confirmation expenditures by debtor until the case is dismissed, converted, or closed, including monies disbursed in the ordinary course of the Debtor's business); *In re Postconfirmation Fees*, 224 B.R. 793 (E.D. Wash. 1998) (holding that disbursement means all funds paid out, citing *St. Angelo v. Victoria Farms*, 38 F.3d 1525 (9th Cir.1994), and that funds paid out include all operating expenses and post-confirmation expenditures of the reorganized debtor); *In re Pars Leasing*, 217 B.R. 218 (Bankr. W.D. Tex. 1997) (where sole source of revenue for debtor-in-possession came from payments received under vehicle leases for truck tractors owned by debtor, "disbursements" includes not only actual cash disbursements made by debtor, but also those cash disbursements for expenses made by common carriers pursuant to lease agreements with debtor); *In re Flatbush Assoc.*, 198 B.R. 75 (Bankr. S.D.N.Y. 1996) (payment of rents directly from debtor's subtenants to co-op constitute "disbursements" because the rents were property of the debtor's estate and were being used to offset an expense of the estate); *In re HSSI, Inc.*, 193 B.R. 851 (N.D. Ill. 1996) (construing disbursement to mean a transfer of money by the debtor in possession where the debtor has some interest in that money); *In re Meyer*, 187 B.R. 650 (Bankr. W.D. Mo. 1995) (money paid out by an escrow agent

as the proceeds in which the debtor had an interest are disbursements subject to quarterly fees); *St. Angelo v. Victoria Farms*, 38 F.3d 1525 (9th Cir.1994) (“disbursements” include all payments from the bankruptcy estate, i.e. all funds paid out, and do not exclude payments to a secured creditor from the sale proceeds of the secured party); *In re Hays Builders, Inc.*, 144 B.R. 778 (W.D. Tenn. 1992) (a disbursement is any payment, and that all disbursements, whether direct or through a third party, are included of the calculation of fees); *In re Wernerstruck, Inc.*, 130 B.R. 86 (D.S.D. 1991) (debtor’s payment to bank are disbursements whether or not they are the required annual payment or prepayment on the loan); *In re Ozark Beverage Co., Inc.*, 105 B.R. 510 (Bankr. E.D. Mo. 1989) (refusing to limit “disbursements” to post-petition payments made to pre-petition creditors; disbursements encompass all expenses paid by debtor in possession); *In re Huff*, 270 B.R. 649 (Bankr. W.D. Va. 2001) (Payments that Chapter 11 debtor made in connection with loan refinance were “disbursements.”). *See also* Robert J. Landry, III, Individual Chapter 11 Cases after BAPCPA: Can You Still Close the Case Early?, ABI Journal, Vol. XXV, No. 6, p. 10, July/August 2006.

But see In re Shotkoski, 420 B.R. 479, 483 (8th Cir. BAP 2009):

As indicated, we believe that the decision as to whether an estate is “fully administered” is one that falls within the discretion of the bankruptcy judge. To be clear, by affirming the bankruptcy court in this case, we are not holding that every individual Chapter 11 case must remain open until such time as all long-term plan payments have been completed and a discharge is entered. In fact, since the Bankruptcy Code expressly contemplates the reopening of cases and the exercise of continuing jurisdiction by the bankruptcy court (see 11 U.S.C. § 350(b)), we do not disagree with those courts choosing, for purposes of convenience and efficiency, to close individual Chapter 11 cases prior to completion of payments and entry of discharge. Again, we believe it is a case-by-case analysis best left to the discretion of the bankruptcy judge.

C. What might these fees total? Under 11 U.S.C. § 1129(a)(15), the debtor is likely required to

propose a five year plan. In these circumstances, *In re Crawley*, 412 B.R. 777, 786. 786 n.12 (Bankr. E.D. Va. 2009) calculated the total fee as follows:

The debtors' current take-home income is \$7,017. If the entirety of that were disbursed each month-either to pay necessary living expenses or to pay creditors under a plan-the U.S. Trustee fee would be \$650 per quarter based on \$21,051 in quarterly disbursements. *Id.* Assuming four months to get to confirmation, and a 60-month plan, the minimum U.S. Trustee fee would be 21 quarters times \$650, or \$13,650.

II. Debtor's Voluntary Conversion of Chapter 11 and Chapter 13 Cases

A. Conversion of Chapter 11 Case to Chapter 7. Section 1112(a) allows a voluntary conversion from chapter 11 to chapter 7. Under Bankruptcy Rule 1017(f)(2), voluntary conversion from chapter 11 to chapter 7 is by motion under Rule 9013.

B. Conversion of Chapter 11 Case to Chapter 13. Section 1112(d) allows a voluntary conversion from chapter 11 to chapter 13 if the debtor has not received a discharge. Also section 1112(f) requires that the debtor be eligible. See section 109(e), establishing debt limits for a chapter 13 debtor. Under Bankruptcy Rule 1017(f)(2), voluntary conversion from chapter 11 to chapter 13 is by motion under Rule 9013.

C. Conversion of Chapter 13 Case to Chapter 7. Section 1307(a) allows conversion from chapter 13 to chapter 7 at any time. *But see Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 127 S.Ct. 1105 (2007). Under Bankruptcy Rule 1017(f)(3), voluntary conversion to chapter 13 to chapter 7 is by notice.

D. Conversion of Chapter 13 Case to Chapter 11. Section 1307(d) allows a voluntary conversion from chapter 13 to chapter 11, but only if a plan has not been confirmed. Under Bankruptcy Rule 1017(f)(1), voluntary conversion from chapter 13 to chapter 11r 13 is by motion under Rule 9014.

E. What does post- confirmation conversion of a chapter 11 case to chapter 7 or chapter 13 mean, especially if confirmation of the plan revested property in the debtor? Under 11 U.S.C. §1141(b), “[e]xcept as otherwise provided in the plan [of reorganization] or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.”

Accordingly, some courts have held that the conversion of the case from chapter 11 to chapter 7 does not revest property of the reorganized debtor in the chapter 7 estate. See, e.g., *In re Toy King Distributors Inc.*, 256 B.R. 1, 103-104 n. 116 (M.D. Fla. 2000) (when chapter 11 plan is confirmed, all of the debtor’s property reverts in the debtor and, therefore, the bankruptcy estate administered by chapter 7 trustee has no assets); *In re Winom Tool and Die, Inc.*, 173 B.R. 613, 621 (E.D. Mich. 1994) (“property which vests in the debtor under §1141(b) does not revest in the estate upon conversion to chapter 7”); *In re H.R.P. Auto Center*, 130 B.R. 247, 256 (post-confirmation conversion does not create a new estate or convert property of the debtor into property of the estate); *T.S.P. Industries*, 117 B.R. at 377-78 (“Once property has been vested in the debtor, conversion will not revest that property in the estate.”). The result of this position is that the chapter 7 trustee may have no assets to administer or sell, making the post-confirmation conversion a pointless exercise, and leading some courts to view dismissal as the only option (unless a new case is filed by the reorganized debtor or an involuntary filed against it).

Other courts disagree. See *In re Smith*, 201 B.R. 267, 274 (D. Nev. 1996), *aff’d* 141 F.3d 1179 (9th Cir. 1998) (Congress specifically made both inability to effectuate substantial

confirmation of a confirmed plan and material default by a debtor with respect to a confirmed plan grounds for conversion of a chapter 11 case to chapter 7. 11 U.S.C. §1112(b)(7), (8), (9). These provisions make no sense if there is no point to chapter 7 administration.); *In re Consolidated Pioneer Mortgage Entities*, 248 B.R. 368, 379-83 (9th Cir. BAP 2000) (upon conversion the chapter 7 estate consists of all remaining assets held for the benefit of creditors.); *Abbott v. Blackwelder Furniture Co of Statesville Inc.*, 33 B.R. 399 (W.D.N.C. 1983); *In re Calania Corp.*, 188 B.R. 41 (Bankr. M.D. Fla. 1995); *Benzner v. United Jersey Bank (In re Midway Inc.)*, 166 B.R. 585 (Bankr. D. N.J. 1994); *In re Pauling Auto Supply Inc.*, 158 B.R. 789 (Bankr. N.D. Iowa 1993); *In re NTG Industries Inc.*, 118 B.R. 606 (Bankr. N.D. Ill. 1990).

III. Personal Injury Claims Against the Debtor

A. 28 U.S.C. § 157(b)(5) provides:

The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

B. 28 U.S.C. § 157(b)(2)(B) provides:

(2) Core proceedings include, but are not limited to--

* * *

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 *but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;*

C. Is a professional negligence or malpractice claim a “personal injury tort” claim?

As observed in *In re Ice Cream Liquidation, Inc.*, 281 B.R. 154, 160 (Bankr. D. Conn. 2002):

The term “personal injury tort claim” appears in 28 U.S.C. § 157(b). The term is not expressly defined either in title 28 or in title 11. There is almost no helpful legislative history. As a result, there is disagreement in the courts as to what constitutes a “personal injury tort claim.” Some courts adopt a “narrower” definition of the term. Those courts hold that a tort without trauma or bodily injury is not within the statutory exception for a “personal injury tort claim” under Section 157(b). *See, e.g., In re Atron Inc. of Michigan*, 172 B.R. 541 (Bankr. W.D. Mich. 1994); *Perino v. Cohen (In re Cohen)*, 107 B.R. 453 (S.D.N.Y. 1989). Other courts adopt a “broader” view that the term “ ‘personal injury [tort claim]’ [arises out of] ... ‘any injury which is an invasion of personal rights ...’ “, *Leathem v. von Volkmar (In re von Volkmar)*, 217 B.R. 561, 566 (Bankr. N.D. Ill. 1998) (endorsing “broader” view as the “better view”). *Accord, e.g., Thomas v. Adams (In re Gary Brew Enters. Ltd.)*, 198 B.R. 616 (Bankr. S.D. Cal. 1996).

In re Dow Corning Corp., 215 B.R. 346, 353-54 (Bankr. E.D. Mich. 1997) (“[M]any personal injury attorneys confronted the bankruptcy process, some for the first time, in the course of Johns-Manville and other asbestos bankruptcy cases. Not enjoying the process, these attorneys lobbied to exempt to the extent possible, personal injury claims from adjustment in bankruptcy. Result: 28 U.S.C. § 157(b)(2)(B), (O), § 157(b)(5) and § 1411(a).”)

See In re Simon, 2008 WL 2953471, *4 (Bankr. E.D. Va. 2008) (“Personal injury [medical malpractice] claimants are entitled to have their claims determined by a jury in the United States District Court. This Court does not have the jurisdiction to liquidate the Tort Claims.”);

But see Lee-Benner v. Gergely (In re Gergely), 110 F.3d 1448, 1453-54 (9th Cir.1997) (a debtor-physician’s purported misrepresentation as to the necessity for amniocentesis, followed by negligent performance of the procedure, gave rise to a debt deemed to be properly the subject of an exception to discharge adversary proceeding per 523(a)(2)(A) including personal injury damages from misperformed procedure). *See also Britton v. Price (In re Britton)*, 950 F.2d 602, 604-05 (9th

Cir. 1991) (cosmetic surgeon's employee, misrepresenting himself as the physician and thus inducing surgery, was subject to the fraud exception to discharge adversary proceeding, including personal injury damages when surgery by the actual physician was negligently performed); *Church v. Hanft (In re Hanft)*, 274 B.R. 917, 921-23 (Bankr. S.D. Fla. 2002) (physician failing to disclose that he was practicing with a terminated license and without malpractice insurance or equivalent escrow of assets was subject to the fraud exception to discharge adversary proceeding including personal injury damages for failure to diagnose a tumor).

See also In re Santos, 304 B.R. 639, 647 (Bankr. D.N.J. 2004):

[T]his court is constrained to stop short of liquidating the personal injury aspects of the plaintiff's claim. First, liquidation is best left to the district court or a state court proceeding, where there is greatest expertise in evaluating damages caused by specific surgeries. See 28 U.S.C. §§ 157(b)(5) and 1334(c)(1) and (2). Second, liquidation of Shaw's personal injury claim in bankruptcy would either actualize or too closely approximate the liquidation of a "personal injury tort" as that term is used in 28 U.S.C. §§ 157(b)(2)(B) and (b)(2)(O). And, such liquidation might, along with a determination of fraud liability, become the trial of a "personal injury tort claim" under 157(b)(2) and (5). Those trials are beyond the subject matter jurisdiction of this court.

See also In re Sanez, 1993 WL 99286 (Bankr. N.D. Ill. 1993) (same).

In re CBI Holding Co Inc., 529 F.3d 432, 461 (2d Cir. 2008) (Bankruptcy court has jurisdiction to determine accountant malpractice as a defense to the accountant's proof of claim.)

In re The VWE Group, Inc., 359 B.R. 441 (S.D.N.Y. 2007) (Creditor's committee's legal malpractice claim against the debtor's attorneys is a noncore proceeding.). *Contra, In re Stockert Flying Service, Inc.*, 74 B.R. 704, 707-708 (N.D. Ind. 1987) (creditors' malpractice claim against debtor's attorney for mishandling debtor-in-possession's estate assets was a core proceeding); *In re SPI Communications & Marketing, Inc.*, 112 B.R. 507 (Bankr. N.D.N.Y. 1990) (Chapter 7 trustee's

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malpractice action against debtor's Chapter 11 attorney is core proceeding).

**Chapter 13: The Better Bankruptcy Option For Insolvent
Professionals? (A Comparison with Chapter 11)**

Fees

Debtor Eligibility – Entity & Debt Limits

Privacy Protections

Privacy Protections

PETER C. FESSENDEN, ESQ.
STANDING CHAPTER 13 TRUSTEE – DISTRICT OF MAINE

CHAPTER 13:
THE BETTER BANKRUPTCY OPTION
FOR INSOLVENT PROFESSIONALS

American Bankruptcy Institute
28th Spring Meeting
Washington, D.C.
May 1, 2010

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STANDING CHAPTER 13 TRUSTEE – DISTRICT OF MAINE

With the advent of BAPCPA in 2005, above-median individuals are less likely to qualify for relief under Chapter 7. High-income clients must choose between Chapter 11 relief – with all of its costs and complexity – and the relatively streamlined provisions of Chapter 13.

Chapter 13 provides for the adjustment of debts of an individual with regular income. Eligibility is limited to “living, breathing persons” who owe, on the date of the filing of the petition, noncontingent, liquidated unsecured debts of less than \$360,475 and noncontingent, liquidated secured debts of less than \$1,081,400. (Those amounts are not doubled for joint debtors.) 11 U.S.C. § 109(e). These eligibility figures apply to all cases filed on or after April 1, 2010, and until the levels are addressed again in 2013 pursuant to 11 U.S.C. § 104. The tri-annual increase in eligibility limits makes Chapter 13 more available to high-income individuals who need to seek bankruptcy protection to deal with their financial troubles.

This portion of the materials addresses some of the issues and problems presented to and by professionals filing and prosecuting a Chapter 13 case. For the purposes of our discussion, a “professional” is an individual engaged in a licensed white-collar practice, such as a physician, chiropractor, dentist, pharmacist, attorney, accountant and the like.

A. Fees

Generally, Chapter 13 counsel receives a “no look” fee and must apply for any additional compensation. The “no look” fee is the amount to debtor’s counsel for which the bench and the Chapter 13 trustee will not usually demand a fee application. Usually some part of the amount will be paid directly by the debtor to his or her lawyer, and the balance is paid by the trustee from estate funds. Total amounts vary from place to place, ranging loosely from \$2,000 to \$3,500 for a plain vanilla consumer case to \$3,000 to \$5,000 for a self-employed business filing. Counsel may seek additional compensation, but the fee application must account for all of the work, charges and expenses included in the no-look figure. In a few districts, the “no look” fee is the presumptive maximum; elsewhere, applications for additional fees are permitted but not well received; in other districts, fee applications are a routine part of the program.

The assumption regarding fees in Chapter 13 cases is, “Think small.” Debtors who work as professionals, however, often present complex legal, structural, financial and psychological problems that require extra effort by counsel. Professional debtors often prefer to deal with full service silk-stocking law firms rather than a bankruptcy clinic. On the other hand, there are many small firms and solo practitioners with the necessary skill and experience to handle a difficult Chapter 13 case. Chapter 13 fees in excess of \$25,000 tend to create client discomfort, invite scrutiny from the bench and creditors, and prompt objections from the Chapter 13 trustee or the United States Trustee. Nonetheless, the combination of big problems and highly skilled counsel means that the fee paradigm usually associated with individual debt adjustment cases may not apply.

Good lawyers doing good work deserve good money. Fee awards should never be bloated, but they should be fair. Cases involving professionals commonly require more extensive and sophisticated services. If a Chapter 13 case can be completed for a modest fee, no one will complain. If significant time and effort must be devoted and substantial fees are sought, no one should complain. The problem for counsel is how to overcome – or, better yet, avoid – such complaints.

No one likes surprises, least of all clients, trustees and judges. Counsel should make a careful assessment at the beginning of a case of the amount of fees that may be necessary to meet the debtor's legal needs. All parties in interest need to have an understanding of the sums that may be required. They need to have that understanding early in the case.

The client – soon to be the debtor – needs to know the potential size of his or her legal bill as a matter of courtesy and counsel's professional responsibility. The trustee, the United States Trustee and the court need to be informed as a matter of acculturation; debtor's counsel does not want any of those parties to be thinking too small. Creditors should be informed for both acculturation and reassurance that counsel is taking pains to avoid administrative insolvency. The Chapter 13 plan – like the disclosure statement in a Chapter 11 case – should give fair warning of the potential burden of legal fees on the course and conduct of the case.

The best advice is always to aim high. If fees are projected at \$50,000 and they come in at \$40,000, counsel will be congratulated for efficiency and economy. If fees are projected at \$25,000 but \$35,000 is charged, parties in interest will look askance.

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The professional client certainly needs to know her or his lawyer's hourly rate, and counsel needs to receive as substantial a retainer as possible. That being said, bankruptcy counsel should refrain from making fee estimates too early. Nonetheless, Chapter 13 deadlines are short and counsel will have to act quickly. The Chapter 13 plan must be filed with the original petition, schedules and statements, or within 14 days thereafter. Fed.R.Bankr.P. 3015(b). Extensions are often sought and frequently granted for short periods, but seldom for longer than an additional 28 days.

Even in the face of local practice for a standard 'no look' amount, it is advisable to push the envelope a little. The full amount of the local 'no look' fee should be sought through trustee payments in addition to whatever amount has been received as a retainer. (This is likely to raise local eyebrows and may not be possible in every district.) Unless one is confident of one's abilities – or generous to one's client, it is wise to build in a contingency for additional fees, as well.

Even locally prescribed forms of Chapter 13 plans include space for non-uniform provisions. Counsel should include an "administrative reserve" in every case that might demand extra effort. The administrative reserve is an unallocated amount – not a sinking fund – available to counsel for professional compensation earned during the travel of the case. If fees are not sought or approved in the amount of the reserve, the surplus is added to the dividend for unsecured creditors. (It is a poor idea to return any surplus to the debtor. He or she should be devoting best efforts to the plan. Unsecured creditors may be last in line, but they are deserving of the full measure of those best efforts.) The only case addressing the structure and administration of a Chapter 13 administrative reserve is *In re Bosse*, 407 B.R. 444 (Bankr.D.Me. 2009), in which Judge James Haines held that

judicial estoppel prevented counsel fees from trumping fixed monthly distributions to secured creditors under the debtors' confirmed plan.

Direct payment of post-petition fees paid by the debtor is poor practice, and is likely to be opposed by the Chapter 13 trustee. Chapter 13 requires a debtor to devote all of his projected available disposable income to the plan. Having to pay legal bills directly as they fall due creates a cash crunch for the debtor, and deprives the trustee of his or her statutory fees on payments to creditors and administrative claimants. The former presents an ethical conundrum since the pressure to keep counsel happy may interfere with the debtor's ability to fulfill the plan. And a happy Chapter 13 trustee is always more pleasant than one who sees substantial payments being diverted from the usual payment process.

B. Debtor Eligibility – Entity & Debt Limits.

Few professionals choose to operate as sole proprietors. Most work under the guise of a limited liability corporation, professional association, Subchapter S corporation or the like. Although the individual may have co-signed most or all of the debt, tangible and intangible assets are frequently owned by the practice for tax or liability reasons. Chapter 13, however, is available only to individuals. Artificial entities of any stripe are not eligible for Chapter 13 relief.

An individual corporate professional who wants to reorganize in Chapter 13 may “disincorporate” by transferring all of the assets of the practice to the individual in exchange for the assumption by the individual of all of its liabilities, accompanied by a near-simultaneous Chapter 13 filing. The transfer is not fraudulent under state law or §

548 since full value in the form of assumption of debt is given (indeed, there is frequently extra value given if debt exceeds the fair market value of the assets). Assumption of additional debt is not fraudulent to the professional's consumer creditors since the transfer is "reasonably equivalent" by enabling the debtor to maintain cash flow, especially where the professional already co-signed all of the business obligations. The result is an empty corporation of no interest to creditors, and a fresh start under Chapter 13 for the professional.

Counsel should be mindful of a few caveats. First, this is not a maneuver to employ with a Subchapter C corporation or with any other entity where the transfer of assets would result in a taxable event. One never wants to add to a client's burdens. Second and for the same reasons, if the professional has not personally guaranteed the debts of the artificial entity, s/he should not pick up an additional load that cannot be put down. Finally (as more fully discussed below), it is critical to know how much the client is assuming. Taking on additional debt that one cannot shed if it turns out to be too much is a bitter pill, indeed.

As mentioned in the opening paragraphs of this portion of the materials, debtor eligibility for Chapter 13 is limited by debt levels. After April 1, 2010, noncontingent, liquidated unsecured debts of more than \$360,475 or noncontingent, liquidated secured debts of more than \$1,081,400 disqualify an individual for Chapter 13 relief. If a debtor fails either test, s/he may not proceed in Chapter 13.

High-income professionals are prone to higher debt levels. Equipment costs for medical, dental and chiropractic offices can be significant. Credit cards or lines of credit may be overused by many professionals as informal bridge loans when cash flow is

scanty. Professionals are frequently in tax difficulties, either through nonpayment or failure to file returns. Penalties and interest – even if not yet assessed – are part of the mix. Professionals in financial trouble are often embarrassed by their plight. They frequently minimize or deny its extent. Counsel should be scrupulous in determining the nature and extent of the client’s asset and debt structure.

Malpractice liabilities, known and unknown, must be addressed forthrightly. A professional whose consultation with bankruptcy counsel is prompted by an actual claim will discuss it without hesitation. A malpractice defendant with insurance doesn’t need bankruptcy counsel unless a trial produces damages in excess of policy limits, in which case Chapter 13 is seldom available. The uninsured professional who has just received a notice of claim – or a summons – presents a more complicated problem if Chapter 13 is being considered.

The fact that a court judgment has not been rendered does not necessarily make a malpractice claim either contingent or unliquidated. In modern commercial practice, a loan “guarantee” is rarely anything other than a misnamed co-obligation. It is not a contingent debt. *In re Taylor*, 2008 WL 2945621 (Bankr.D.Idaho 2008). A debt is noncontingent if all of the events that would give rise to a finding of liability have occurred, even if the debtor disputes liability. *U. S. v. Verdunn (In re Verdunn)*, 89 F.3d 799 (11th Cir. 1996); *In re Perez*, 400 B.R. 879 (Bankr. SD Fla. 2008). Similarly, a debt is liquidated if the amount is “readily determinable,” even if the debtor disputes liability. *Kanke v. Adams (In re Adams)*, 373 B.R. 116, 120-22 (10th Cir. BAP 2007). “Special” damages in a tort action or a lost investment in a contract case are usually capable of

ready determination. Of course, pain and suffering or lost future profits are general damages which are commonly considered to be unliquidated.

Claims in bankruptcy are defined broadly under § 101(5). The professional may know of possible malpractice claims that haven't surfaced, but which should be considered. In all events, bankruptcy counsel must determine if there are real numbers that should be considered when evaluating a professional debtor's bankruptcy options.

Finally, as discussed above, the "disincorporation" option should be considered only in the context of eligibility. There are subtleties under UCC Article 9 that must be considered. For instance, an LLC may own an expensive piece of equipment in which the bank has taken a security interest. If the debt is \$400,000 and the equipment is worth \$400,000, it is a secured debt. However, since the security interest is granted only by the LLC. If the property is transferred to the professional in his individual capacity in exchange for the assumption of the debt, it becomes an unsecured obligation of the individual. If the professional already guaranteed the debt, it would not add to his or her burden (since it is the same obligation), but the debt was unsecured as to the individual from the outset; the fact that the bank received a security interest from the LLC would make no difference to the individual's eligibility under Chapter 13. As a result, "disincorporation" is a less useful tool than it might appear at first blush. Even where it could be of benefit to the debtor, it should be undertaken only after careful research. If a professional debtor assumes the debts of his or her artificial entity and Chapter 13 turns out not to be an option, bankruptcy counsel will have violated another profession's basic tenet: "First, do no harm."

C. Privacy Protections

Professionals are entrusted with society's most private matters. If privacy is breached, it can produce hideous embarrassment or substantial financial loss or both. Bankruptcy cases are filed in the courts of the United States. Records are public. Nonetheless, Congress, the courts, and the United States Trustee Program are aware of the tension and have done their best to balance it.

BAPCPA added §§ 112, 332 and 333 to the Bankruptcy Code in 2005 to address various privacy concerns. The first is a simple prophylactic effort to ensure that minor children's names are not made public in any bankruptcy proceeding. The second and third focus on the business activities of a debtor. Although conceived in the context of Chapter 11 proceedings involving large corporations, they apply to Chapter 13 cases, as well.

Section 332 attempts to ensure that sales of financial data and information do not result in the release of third persons' personal identifiers that could be misused. Any transfer by a Chapter 13 debtor of financial data and information that includes personal identifiers of clients may require the appointment of a consumer privacy ombudsman. The need may arise in the event of a professional's retirement or incapacity during the course of a Chapter 13 case, or in the event of his or her decision to sell a practice before the case is concluded. Section 333 addresses the rights of a medical professional's patients, both as to the integrity of their personal records and the quality of their care. Again, Congress determined that a patient care ombudsman may be of benefit to the process.

This program is not the occasion to provide a detailed analysis of these statutes. Nonetheless, there is already a case addressing a patient care ombudsman in a Chapter 13 case, *In re Shattuck*, 411 B.R. 378 (10 Cir. BAP 2009). *Shattuck* is also the subject of an excellent article in the February 2010 AMERICAN BANKRUPTCY INSTITUTE JOURNAL, Vol. XXIX, No. 1, p. 14, "Patient Care Ombudsman: What About Counsel?"

D. Reporting Requirements

As with Chapter 11, Chapter 13 debtors engaged in self-employment are required to submit monthly financial reports to the trustee. Reports are submitted in compliance with local procedures that vary from district to district; there are no national standards in place at this time. The trustee reviews those reports for four purposes: 1/ to determine if the debtor is still engaged in self-employment; 2/ to determine if the debtor is operating in the black, is paying his or her bills on time, and is not incurring additional trade debt under the protection of the bankruptcy court; 3/ to determine if the debtor's plan fairly provides that his or her available disposable income is being paid for the benefit of creditors; and 4/ to ensure that the debtor complies with all tax filing and payment requirements during the term of the plan. (By way of reassurance, it is the very rare Chapter 13 trustee who attempts to squeeze the last nickel out of a debtor. Trustees are themselves sophisticated actors, and realize that self-employed debtors – and especially professionals – require a cash cushion to protect against the ups and downs of a cyclical economy. At the same time, quantum variances from the debtor's original projections should prompt the trustee to seek additional contributions.)

Debtors' monthly reports are not private. Experienced creditors' counsel knows that such reports are routine and frequently ask for copies. Whether or not the trustee sends them out (and most do so), there are few grounds on which the debtor or debtor's counsel can refuse to share them. To the extent that an inquiring creditor is also a competitor, the debtor may move for a protective order from the court. Such motions are not favored by most judges, especially where the debtor sought voluntary bankruptcy relief and full disclosure of his or her financial affairs is the centerpiece of bankruptcy procedure.

Debtors are also required to provide the trustee with copies of federal and state tax returns as they are filed. Copies should be redacted to prevent the disclosure of social security numbers and the names of any non-debtors. UST policy, reflected in the Chapter 13 Trustee Handbook governing trustee operations, is that tax returns should not be released by the trustee absent court order. Nonetheless, the trustee's office reviews all tax returns to determine if they are consistent with the monthly reports. In addition, most trustee operations require some or all of any income tax refunds to be turned over as additional contributions to the Chapter 13 plan for the benefit of creditors. (The turnover of any excess refund does not diminish the debtor's obligation to make full plan payments.)

Unlike Chapter 11 cases, there are no fees that need to be paid to the United States Trustee's office.