Concurrent Session

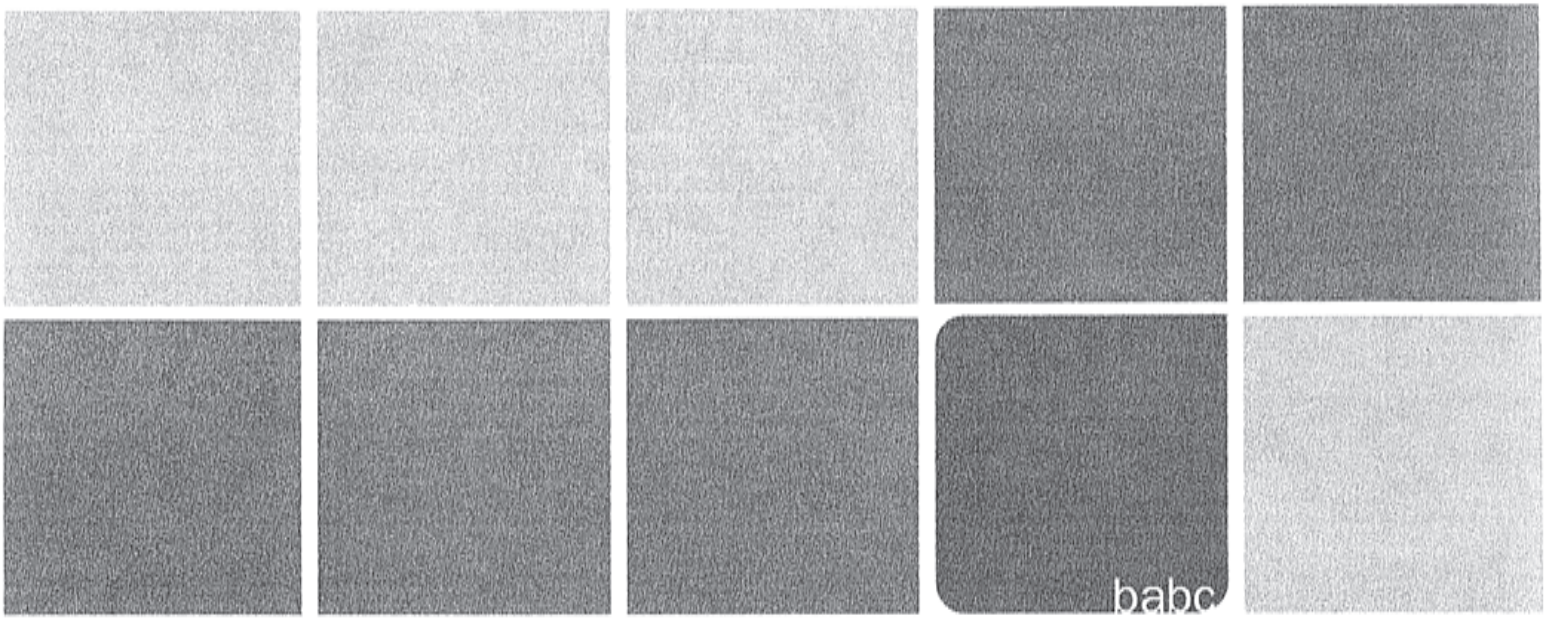
Consumer: Consumer Counsel Beware: Critical Issues in Representing Individual Chapter 11 Debtors after BAPCPA

William L. Norton, III, Moderator | Bradley Arant Boult Cummings LLP; Nashville, Tenn.

Hon. Dennis R. Dow | U.S. Bankruptcy Court (W.D. Mo.); Kansas City

J. Michael Morris | Klenda, Mitchell, Austerman and Zuercher, LLC; Wichita, Kan.

2010 Educational Materials



POST-BAPCPA ISSUES FOR ATTORNEYS REPRESENTING INDIVIDUAL CHAPTER 11 DEBTORS

WILLIAM L. NORTON III
bnorton@babc.com
(t) 615.252.2397

BRADLEY ARANT BOULT CUMMINGS LLP

I. Introduction

As noted by Judge Bruce Markell, in his article: *The Sub Rosa Sub Chapter: Individual Debtors in Chapter 11 after BAPCPA*,[1] flesh and blood individuals have had a hard and rocky path in Chapter 11. The passage of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") made this already dangerous path that much more treacherous by implementing many changes to how an individual must proceed in and confirm their Chapter 11 cases.[2]

II. Who (of What) is Your Client in an Individual Chapter 11?

As debtors' attorneys know, or should know, the vast majority of courts have held that counsel for Chapter 11 debtors represent the bankruptcy estate[3] and not the principals of the debtor.[4] While representing your actual client in a corporate Chapter 11 case is difficult, representing a debtor's bankruptcy estate in an individual Chapter 11 is almost an out of body experience. As noted by one of the leading scholars in Bankruptcy ethics, Nancy Rapoport:

> Representing a corporation can present numerous problems for Estate Counsel, but representing individual Debtors in chapter 11 is even trickier: "The complex fiduciary duties of a chapter 11 debtor-in-possession and its counsel can become even more confused when the debtor(s)-in-possession are individuals." Obviously, there is the metaphysical challenge of realizing that the human who hired you to file his chapter 11 petition is not your client in the bankruptcy case. Even though it's fairly easy, at least in theory, to understand that the president of a corporation or the managing partner of a partnership is not your client when you are representing the business entity itself, it stretches the bounds of legal fiction to comprehend the difference between the Bankruptcy Estate of an individual (your client) and the individual himself (not your client).

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1 2007 U.Ill.L.Rev. 67 (2007) noting that until the U.S. Supreme Court decision in Toibb v. Radloff, 501 U.S. 157 (1991) there was even a serious question as to whether individuals could even file Chapter 11 cases.

2 New issues arising from the changes made to Individual Chapter 11 practice by BAPCPA have been the subject of several scholarly articles and presentations including: Keach, Deadman Filing Redux: Is The New Individual Chapter Eleven Unconstitutional?, 13 Am. Bkr. Inst. L.R. 483 (Winter 2005); Warner, Garnishment Restrictions In A Means Test World, 13 Am. Bkr. Inst. L.R. 733 (Winter 2005); Williams and Todres, Tax Consequences of Post-Petition Income as Property of The Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure In Chapter 11, 13 Am. Bkr. Inst. L.R. 701 (Winter 2005).

3 *See generally, Everett v. Perez*, 30 F.3d 1209 (9th Cir. 1994); *In re Cenargo International PLC*, 294 B.R. 571 (Bkrtcy. S.D. N.Y. 2003); *In re ICM Notes, Ltd.*, 278 B.R. 117 (S.D. Tx. 2002); *In re Harp*, 166 B.R. 740 (Bkrtcy N.D. Ala. 1993); *In re Rusty Jones, Inc.*, 134 B.R. 321 (Bkrtcy. N.D. Ill. 1991); *In re Grabill, Corp.*, 113 B.R. 966 (Bkrtcy. N.D. Ill. 1990); *In re Storms*, 101 B.R. 645 (Bkrtcy. S.D. Cal. 1989). *See also*, Rapoport and Bowles, Has the DIP's Attorney Become the Ultimate Creditor's Lawyer in Bankruptcy Reorganization Cases?, 5 Am. Bkr. Inst. L. Rev. 47 (Spring 1997) (hereinafter "Rapoport & Bowles").

4 However at least two cases, *Hansen Jones & Lela P.C. v. Segal*, 220 B.R. 434 (D. Utah 1998) and *In re Sidco, Inc.*, 173 B.R. 194 (E.D. Col. 1994) have held that counsel owe duties to the Debtors-in-possession, not the estate.

Rapoport and Bowles at 70-71.

Two issues are critical to addressing the challenging ethical problems in individual Chapter 11 cases: (1) the individual debtor's fiduciary duty to creditors and (2) the estate counsel duties to the client in an individual Chapter 11.[5]

One of the most difficult concepts Chapter 11 debtors have to grasp, when they file their bankruptcy is that they owe a fiduciary duty to their creditors[6] to act in the best interests of their bankruptcy estate.[7] Courts have universally held that individual chapter 11 debtors owe these duties just like other debtors-in-possession.[8]

This means the individual Chapter 11 debtor must generally put the interests of his creditors ahead of his or her own interests and must actively work to benefit a bankruptcy estate even when that would disadvantage the individual himself. Two cases demonstrate the issues found in this standard.

In the case of *In re Bowman*,[9] a Chapter 7 debtor objected to the Chapter of Trustee's settlement of a lawsuit for an amount which would pay the debtor's creditors in full, but not produce any distribution to the debtor.[10] The debtor exercised her right[11] to convert her case to a Chapter 11 case. The Court granted the debtors' motion, but immediately reconverted the case to a Chapter 7 case finding the debtor's insistence on further litigation of her claim was a violation of her fiduciary duty as a Chapter 11 debtor in possession. The *Bowman* court held:

> Likewise, in this case when Debtor must weigh whether to accept a prompt settlement that would substantially pay her creditors or to wait and gamble on a potential to receive a greater recovery, her creditors' interests have a higher priority than the Debtor's own; and they must take precedence. Debtor's own statement that she "intends to proceed with litigation, through trial," indicates her unwillingness to examine other interests above hers. But there is more to the conflict than mere unwillingness, it is an inherent conflict of interest between her

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5 There are numerous other problems with individual Chapter 11 debtors, including attorney-client privilege issues, which are beyond the scope of this article. *See generally In re Bame*, 251 B.R. 367 (Bankr. D. Minn. 2000).

6 *Id.* at 53-55. *See also, Commodity Futures Trading Commission v. Wentraub*, 471 U.S. 343, 355 (1985).

7 *See* Rapoport & Bowles at 53-58 for a full discussion of the exact nature of these duties.

8 *See* generally *In re Hardy*, 319 B.R. 5 (Bankry. N.D. Fla. 2004) (Full disclosure of assets and of business transactions required); *In re Robino*, 243 B.R. 472 (Bankr. N.D. Ala. 1999) (compliance with Court orders); *In re Tornheim*, 181 B.R. 161 (Bankr. S.D. N.Y. 1995) (duty to pay fees and file required reports); *In re Bownan*, 181 B.R. 836 (Bankr. D. Md. 1995) (duty to put creditor interests first in settlement of a lawsuit); *In re Harp*, 166 B.R. 740 (Bankr. N.D. Ala. 1993) (duty to properly account for estate property and to properly use estate funds).

9 181 B.R. at 836.

10 *Id.* at 841.

11 *Id. citing In re Finney*, 992 F.2d 43, 45 (4th Cir. 1993).

> duty as a fiduciary to the estate and her desire to maximize the amount of money she may recover for herself.[12]

In a similar fashion, the Court in *In re Tel-Net Hawaii, Inc.*[13] removed the debtor in possession who was the corporation's controlling shareholder due to its failure to pursue preference actions which would have increased its exposure on guaranteed debts.[14] The Court found that in light of the conflicting interests of its controlling shareholder, an independent trustee had to be appointed.

Therefore, attorneys must be careful to advise potential Chapter 11 debtors of the full ramifications of a Chapter 11 filing. Further they must do this while being unable to give the individual (not in his role as debtor-in-possession) advice as to how he or she could improve their financial condition at the expense of the estate.[15]

III. Individual Chapter 11 and the Attorney Client Privilege

A problem which frequently arises in bankruptcy cases concerns the control of an individual's attorney client privilege. The issue of who holds a Chapter 11 debtor's attorney/client privilege has been often litigated[16] and has been largely resolved in the area of business entities by the Supreme Court's decision in Commodity Futures Trading Commission v. Weintraub[17]. However, while the Weintraub Court held that the debtor in possession or trustee held a Chapter 11 **corporate** debtors' attorney/client privilege[18] and could waive it even over the objection of the debtors' pre-bankruptcy management, the Weintraub Court refused to extend its reasoning to individual debtors' attorney/client privilege ruling:

> [O]ur holding today has no bearing on the problem of individual bankruptcy, which we have no reason to address in this case. As we have stated, a corporation, as an inanimate entity, must act through agents. When the corporation is solvent, the agent that controls the corporate attorney-client privilege is the corporation's management. Under our holding today, the power

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12 *Id.* at 845. However, courts do not automatically require trustees to settle claim where an offer is made to pay creditors' claims in full. *See generally, In re Central Ice Cream Co.*, 836 F.2d 1068 (7th Cir. 1987) (discussing settlement which included payments to equity owners and insiders).

13 105 B.R. 594 (Bankr. D. Haw. 1989).

14 *Id.* at 595.

15 *See In re Harp*, 166 B.R. at 747-48; It is not easy for a debtor-in-possession, corporate or individual, to serve two masters-juggling the personal needs and desires of the debtor itself, with its clear fiduciary responsibilities to unsecured creditors, other parties in interest and the court. Nor is the role any easier for the attorney who represents the debtor-in-possession.

16 See generally In re O.P.M. Leasing Services, Inc., 670 F.2d 383 (2d Cir. 1982); Citibank N.A. v. Andros, 666 F.2d 1192 (8th Cir. 1981).

17 471 U.S. 343 (1985).

18 Id. at 354.

> passes to the trustee because the trustee's functions are more closely analogous to those of management outside of bankruptcy than are the functions of the debtor's directors. An individual, in contrast, can act for himself; there is no "management" that controls a solvent **individual's attorney-client privilege**. If control over that privilege passes to a trustee, it must be under some theory different from the one that we embrace in this case.[emphasis added][19]

Lower courts have taken three general positions[20] with regard to who holds an individual Chapter 11 debtor's attorney/client privilege. One line of mainly older cases has held that an individual Chapter 11 debtor's attorney/client privilege (for both pre- and post-bankruptcy periods) remains with the individual debtor and does not pass to the bankruptcy estate or a subsequently appointed trustee.[21] These courts have generally held that due to the greater privacy concerns that arise when an individual holds an attorney/client privilege, there is no justification for the transfer of attorney/client privilege to either the bankruptcy estate or the individual debtor's trustee.[22]

Another group of cases, led by In re Williams[23], has held that the right to the attorney/client privilege does not change merely because a debtor is an individual and not a business entity.[24] These cases have generally held that an individual debtor in possession must exercise its attorney/client privilege in a manner consistent with its fiduciary duty to creditors and that includes the transfer or waiver of its attorney/client privilege for the benefit of the estate.[25] These courts have found that the individual Chapter 11 ebtor's attorney client privilege passes to his or her bankruptcy estate and does not remain in the hands of the individual.

The final[26] and largest line of authority concerning individual Chapter 11 debtor's attorney/client privilege has stated that courts must determine who holds the attorney/client privilege on a case

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19 Id. at 356-357.

20 In re Bame, 251 B.R. 367, 377-378 (Bkrtcy. D.Minn. 2000).

21 See In re Hunt, 153 B.R. 445 (Bkrtcy. N.D.Tx. 1992) (Trustee under confirmed plan not entitled to waive the attorney/client privilege); In re Silvio De Lindegg Ocean Dev. Of America, Inc., 27 B.R. 28 (Bankr. S.D. Fla. 1982) (same).

22 In re Hunt, 153 B.R. at 454. But See In re Fairbanks, 135 B.R. 717 (Bkrtcy. D.N.H. 1991) (Finding "other theory" to hold that trustee controlled debtor's attorney/client privilege).

23 152 B.R. 123 (Bkrtcy N.D.Tx. 1992); See also In re Smith, 24 B.R. 3 (Bkrtcy. S.D. Fla. 1982) (Pre Weintraub).

24 In re Williams, 152 B.R. at 128 (noting that under Toibb v. Radloff, 501 U.S. 157 (1991) (Individual Debtor had fiduciary responsibilities of a corporate debtor in possession).

25 Id.

26 There is also a group of cases involving the waiver of an individual debtor's attorney/client privilege in the context of legal malpractice claims against a debtor's attorney. In these cases bankruptcy courts have generally held that the trustee holds and has the right to waive the attorney/client privilege for the purpose of investigating the malpractice action. See In re Bazemore, 216 B.R. 1020 (Bkrtcy. S.D. Ga. 1998), In re Tomarolo, 205 B.R. 10 (Bkrtcy. D. Mass. 1997) But see McClarty v. Gudenau, 166 B.R. 101 (E.D. Mich. 1994) (Individual Chapter 7 debtor holds attorney/client privilege as to file involved in malpractice action).

by case basis by balancing the policies underlying the attorney/client privilege and the potential harm of disclosure to the individual against the trustee's duty to maximize the value of the estate.[27]

Under this line of reasoning, courts have generally determined that an individual debtor has no attorney/client privilege for any **post-petition discussions** the individual has with the estate counsel, holding that the estate counsel generally cannot give individuals legal advice, in their capacity as an individual, while acting as the estate's counsel.[28] These courts have also held that pre-bankruptcy discussions with attorneys are subject to an individual attorney/client privilege.

Under all of these lines of cases, the estate's counsel should carefully advise the individual as to who they represent in the chapter 11 (the bankruptcy estate generally) and the issues that may arise related to the individual attorney/client privilege (or lack thereof) when filing a Chapter 11 case.

IV. Credit Counseling for Individual Chapter 11 Debtors

Section 109 of the Bankruptcy Code establishes the criteria for becoming a debtor in a bankruptcy proceeding. Each Chapter (i.e., 7, 11, 12 or 13) has different standards for eligibility. "One of the primary amendments enacted by BAPCPA, was a new eligibility requirement for individual debtors." *In re Dixon*, 338 B.R. 383, 386 (8th Cir. BAP Mo. 2006); *see* 11 U.S.C. § 109(h).

Section 109(h)(1) of the Code provides:

> Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section, an individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

During the one year period since BAPCPA became effective, many courts have addressed §109(h). *See Dixon*, 338 B.R. at 386 ("Specifically, §109(h) states that, as a general rule, all individual debtors must receive an appropriate briefing during the 180 days preceding the date of filing).[29]

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[27] See generally In re Foster, 188 F.3d 1259 (10th Cir. 1999); In re Benum, 339 B.R. 115 (Bkrtcy. D.N.J. 2006); In re Eddy, 304 B.R. 591 (Bkrtcy. D. Mass. 2004); In re Miller, 247 B.R. 704 (Bkrtcy. N.D. Ohio, 2000).

[28] See In re Bame, 251 B.R. 367, 375-376 (Setting forth a 5 part test to see if individual received individual legal advice from estate counsel [which would be subject to the individual's attorney client privilege] or advice as debtor in possession [which would not be subject to the individual attorney client privilege, but to the bankruptcy estate's privilege]).

[29] For example, *see In re Rodriguez*, 336 B.R. 462, 477 (Bankr. D. Idaho 2005) (eligibility requirements of section 109(h)(1) were not met); *In re Talib*, 335 B.R. 417 (Bankr. W.D. Mo. 2005) (same); *In re Sukmungsa*, 333

While most of the cases address the credit counseling requirement in the context of Chapters 7 and 13 cases, § 109(h) does not except Chapter 11 debtors from its requirements.[30] Chapter 11 and Chapter 12 cases have also been dismissed due to a debtor's failure to comply with § 109(h).[31] The courts deciding these cases followed the same line of reasoning in the consumer cases cited *supra*, and dismissed them because the individual debtors did not obtain proper credit counseling.[32]

The failure to obtain credit counseling is a fatal flaw unless the debtor can satisfy one of two exceptions or an exemption in § 109(h)(2), (3) and (4), respectively. *See In re Hedquist*, 342 B.R. 295 (8th Cir BAP 2006) ("[T]he requirements of Section 109(h) are mandatory; failure to meet them is a 'fatal flaw' rendering an individual debtor ineligible for bankruptcy relief." (Footnote omitted.)).

These exceptions or the exemption exist if the debtor cannot complete the credit counseling requirement because: (i) the United States Trustee has determined that the credit counseling agencies for an entire district "are not reasonably able to provide adequate services" for the district (11 U.S.C. § 109(h)(2)(A)); (2) the debtor is granted a temporary deferral by the court due to exigent circumstances (11 U.S.C. § 109(h)(3)); or (3) the debtor is incapacitated, disabled, or in active military duty in a defined combat zone (11 U.S.C. § 109(h)(4)).[33] Subsections (h)(2) and (h)(4) are objective, so courts should have little difficulty determining whether a debtor satisfies their criteria. Subsection (h)(2) requires that the Office of the United States Trustee formally determine that credit counseling is not sufficiently available throughout the district. This occurred in areas ravaged by Hurricane Katrina.[34] Under subsection (h)(4), the

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B.R. 875 (Bankr. D. Utah 2005) (same). "). S*ee also In re Burrell*, 339 B.R. 664, 666 (Bankr. W.D. Mich. 2006) ("To be a debtor under Title 11 an individual must have received credit counseling within 180 days preceding the date of filing the bankruptcy petition.")

30 *See Dixon*, 338 B.R. at 386 ("It is the clear expectation of the statute that all individual debtors receive such a briefing *prior* to filing.") (Emphasis in original).

31 *See In re Hedquist*, 342 B.R. 295 (8th Cir. BAP 2006); *In re Watson*, 332 B.R. 740 (Bankr. E.D. Va. 2005); *In re Bogedain*, 2006 WL 2471939 (E.D. Mich. Aug. 24, 2006).

32 The problem faced by debtors whose cases are dismissed involves the application of the automatic stay. Section 362(c)(3) and (4) limit application of the automatic stay when a previous bankruptcy case was dismissed within one year of the new filing. 11 U.S.C. § 362(c)(3) and (4). To avoid the possible inequitable result the limitation on the automatic stay might impose on an unsuspecting debtor, bankruptcy courts have struck the case, rather than dismissing it. *See In re Elmendorf*, 345 B.R. 486 (Bkrtcy. S.D. N.Y. 2006). In *Elmendorf*, the bankruptcy court struck a Chapter 7 case and two Chapter 13 cases filed before the debtors sought credit counseling. The bankruptcy court determined it may decide, on case-by-case basis, whether to strike petitions filed in violation of the credit counseling requirement. *Id.* at p. 499-500. *But see In re Wilson*, 346 B.R. 59 (Bankr. N.D. N.Y. 2006) (the appropriate disposition, upon determination by bankruptcy court that debtors had not satisfied prepetition credit counseling requirement, was to dismiss, not strike, bankruptcy case).

33 *See generally, In re DiPinto*, 336 B.R. 693 (Bankr. E.D. Pa. 2006).

34 Section 109(h)(2) requires a review of the exception at least once a year. Based on information from the Office of the United States Trustee, it is understood this exception was not extended for areas affected by Hurricane Katrina when it came up for review.

requirements for incapacity and disability are set out in the statute, and military duty in a war zone seems relatively easy to prove.

Therefore, the cases that address § 109(h) discuss the exception for exigent circumstances in §109(h)(3). Section 109(h)(3) has two subjective prongs and one objective prong. *See Talib*, 335 B.R. at 421. "The subjective tests require that the Court find that there are exigent circumstances that 'merit a waiver' … and that the Certification is 'satisfactory to the Court.'" *Id.*; *see also* 11 U.S.C. § 109(h)(3)(A). "The objective requirement is that the Certification allege that the debtor requested credit counseling prior to the filing of the petition from an approved agency but was told that the services would not be available for more than five days subsequent to the date of the request."[35]

Most cases addressing §109(h)(3) were filed to prevent some imminent harm, such as a foreclosure sale. This argument is persuasive in some jurisdictions, but not others. *See, e.g, In re Hedquist* , 342 B.R. 295 (8th Cir. (BAP) (insufficient); *In re Burrell*, 339 B.R. 664 (Bankr. W. D. Mich. 2006)(sufficient); *In re Dixon*, 338 B.R. 383 (8th Circuit BAP) (insufficient); *In re DiPinto*, 336 B.R. 693 (Bankr. E.D. Pa. 2006)(insufficient).

A further requirement is that the Court must accept the arguments in the certification. 11 U.S.C. § 109(h)(3)(C). Although this section seems to mimic the requirement that the exigent circumstances "merit waiver" in subsection (h)(3)(A), one court recognized that under general rules of statutory construction, the court must give it meaning if possible.[36] The court, therefore, concluded that this subsection indicated Congress intended for the bankruptcy court to use its discretion when deciding issues under §109(h)(3).

It is also important to recognize that the exigency exception is only a temporary solution for the debtor. Unlike the subsection (h)(4) permanent exemption, a subsection (h)(3) exception requires credit counseling within thirty days, with one 15 day extension if allowed by the court. In *Burrell*, the debtor's failure to "cure" his or her lack of credit counseling within this period appeared to have some relevance in the court's refusal to recognize the exception. *Burrell*, 339 B.R. 666-67.

Recognizing that the statute makes pre-bankruptcy counseling mandatory except in the very restrictive circumstances discussed previously, the individual Chapter 11 debtors in *Hedquist* and *Watson* argued that the statute violated their constitutional right to equal protection and due process.[37] These arguments were rejected because the credit counseling obligation did not violate any fundamental right and was not devoid of a rational justification. *Id.* In fact, the court found the requirement "was well within the policy judgment of the legislature." *Hedquist*, 342 B.R. 300; *Watson*, 332 B.R. at 747.

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35 *Talib*, 335 B.R. at 421; *see also* 11 U.S.C. § 109(h)(3)(B).

36 *Dixon*, 338 B.R. at 387.

37 *Hedquist*, 342 B.R. 299-300; *Watson*, 332 B.R. at 746-47.

Another debtor failed attempt to avoid dismissal for lack of credit counseling involved an argument of excusable neglect.[38] The bankruptcy court discussed the requirements for excusable neglect, but would not grant relief from the dismissal order because the debtors could not prove they could satisfy the criteria of § 109(h)(3). *Id.* at 880.

The conclusion of the court in *In re Cleaver*[39] accurately describes the conclusions of the courts addressing §109(h): "Pursuant to the newly enacted changes to the Bankruptcy Code, an individual must receive credit briefing prior to filing for bankruptcy protection, or he must submit a certification to the court describing exigent circumstances and detailing the unavailability of the credit briefing during the five days after requesting it."[40] Therefore, Chapter 11 attorneys must ensure compliance with these provisions to ensure that Chapter 11 will not "die" shortly after its inception.

V. Property of the Estate

Section 1115 of the Code, added by BAPCPA, radically changed the definition of what constitutes property of the estate. Its most important provision is that an individual's "earnings from services performed" after the commencement of the case, but before the case is closed, constitute property of the estate.

> 11 U.S.C. § 1115 provides:
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> **(a)** In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541--
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> **(1)** all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and
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> **(2)** earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.
>
> **(b)** Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

Prior to the enactment of § 1115, Courts were bitterly divided as to what portion, if any, of an individual debtor's post-petition earnings were property of the estate under § 541. A majority of Courts held that under the earnings exception of § 541(c), post-petition earnings of a debtor were not property of the estate.[41] However, a sizeable minority of Courts found that at least a portion of post post-petition profits generated by professionals and sole proprietors were not earnings

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38 *See In re Sukmungsa*, 333 B.R. 875 (Bankr. D. Utah 2005).

39 333 B.R. 430 (Bankr. S.D. Ohio 2005).

40 *Id.*

41 *See, e.g., In re Habe*, 2006 WL262116 (6th Cir. 2006); *Roland v. UNUM Life Ins. Co. of Am.*, 223 B.R. 499 (W.D.N.Y. 1998); *In re Powell*, 187 B.R. 642 (Bankr. D. Minn. 1995).

subject to §541(a)(6) exception[42] and therefore were property of the individual chapter 11's bankruptcy estate.

While § 1115 resolves this split of authority, it leaves unanswered several practical questions of how an individual Chapter 11 debtor post-petition income will be treated in his or her Chapter 11.

VI. Chapter 11 personal expenses after BAPCPA.

One of the most vexing questions confronting both attorney and individual chapter 11 debtors is whether an individual debtor's "living expenses" can be paid as ordinary course of business expenses[43] under § 363(c)(1)[44] and § 1108[45] or whether notice and a hearing under § 363(b)(1) is required for living expenses to be paid.[46]

Prior to the enactment of § 1115, few cases addressed the issue of whether a debtor had to get court approval for the payment of living expenses. Some courts which considered the question held that normal living expenses of an individual Chapter 11 debtor did not need court approval,[47] while others indicated that some form of court approval would be necessary at least in cases of significant expenses.[48] Indeed one early pre-BAPCPA decision *In re Vincent*[49] held there was no authority for the payment of living expenses from the Chapter 11 estate for a Chapter 11 individual debtor and his family under the Bankruptcy Code. Given § 1115 and Chapter 11 debtors' fiduciary duty to creditors, individual debtors should give serious thought to

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42 *See, e.g., In re Harp*, 166 B.R. 740 (Bankr. N.D. Ala. 1993); *In re Heberman*, 122 B.R. 273 (Bankr. W.D. Tx. 1990); *In re Cooley*, 87 B.R. 432 (Bankr. S.D. Tx. 1984).

43 In re Webb, 262 B.R. 685 (Bkrtcy.Ed.Tx. 2001) (Discussing reasonable and necessary expenses in context of a Chapter 13).

44 11 U.S.C. § 363(c)(1) provides: If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

45 11 U.S.C. § 1108 provides: Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor's business.

46 11 U.S.C. § 363 (b)(1) provides in pertinent part that: "The Trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate."

47 *See In re Murray*, 216 B.R. 712 (Bankr. W.D. N.Y. 1998); *In re Keenan*, 195 B.R. 236 (Bankr. W.D. N.Y. 1996); *In re Bradley*, 185 B.R. 7 (Bankr. W.D. N.Y. 1995).

48 *See generally In re Harp*, 166 B.R. at 755 – 756 (discussing violation of fiduciary duties by paying for rental of vacation homes, sponsoring a large pre-game Alabama-Auburn brunch and taking a vacation to an exclusive resort in the Netherland Antilles).

49 4 B.R. 21 (Bankr. M.D. Tenn. 1979). See also In re Walter, 83 B.R. 14 (9th CAP 1988).

having a budget for living expenses approved by their Court in order to avoid challenges to the spending later in the case.[50]

A related problem concerns what constitutes "reasonable" living expenses for purposes of § 363? For example will judges take into account the debtor's standard of living in determining what constitutes reasonable living expenses.[51] Should Courts adopt a disposable income test similar to § 1325(b) or 1129(a)(15)[52] or will they impose the "minimal" standard of living tests imposed on parties seeking to discharge student loans.[53] While none of these questions have clear answers, some courts will expect lower standards of living during the pendency of their Chapter 11s.[54]

Finally, there is the question of whether individual Chapter 11 debtors can pay reasonable living expenses for members of their family. While this question almost seems to be the paranoid fears of a madman,[55] consider whether a bankruptcy court would permit a corporate Chapter 11 debtor to pay the living expenses of a president's son, brother-in-law or other relative, if they provided no value to the debtor's estate?

While spouses, former spouses, children of the debtor and other designated parties are entitled to first priority payments for their domestic support obligations[56] and Chapter 13 debtors are expressly authorized to pay for the support of their dependents[57] in their cases, there appears to be no similar direct and expenses authorization in Chapter 11 of the Bankruptcy Code permitting an individual Chapter 11 debtor to pay for his or her family's support from estate funds.[58]

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50 *See In re Harp*, 166 B.R. at 755; *see also In re Roland*, 223 B.R. at 506; *In re Weber*, 209 B.R. 793 (Bankr. D. Mass. 1997) (discussing expenditures of non-estate property in connection with determination of debtors' good faith).

51 While isolated cases have approved indirectly expenditures of an affluent nature, *see In re Bradley*, 18 B.R. at 11 (refusing to impose a budget on individual Chapter 11 debtor; *In re Rodriquez*, 41 B.R. 774 (Bankr. S.D. Fla. 1984) (approving personal expenses of $7,000 per month), most Courts have refused to consider status or lifestyle in determining what constitutes reasonable living expenses. *See generally In re Cardillo*, 170 B.R. 490 (Bankr. D.N.H. 1994); *In re Jones*, 55 B.R. 462 (Bankr. D. Minn. 1985).

52 *See generally In re Watson*, 403 F.3d 1 (1st Cir. 2005) (private school tuition not a reasonably necessary expense); *In re Gleason*, 267 B.R. 630 (Bankr. N.D. Iowa 2001) (recreation and gift expenses not reasonably necessary); *In re Dick*, 222 B.R. 189 (Bankr. D. Mass. 1998) (payment on non-income producing vacation home not a reasonably necessary expense).

53 *See generally In re Hornsby*, 144 F.3d 433 (6th Cir. 1998); *In re Clark*, 34 B.R. 238 B.R. 238 (Bankr. N.D. Ill. 2006); *In re Southard*, 337 B.R. 416 (Bankr. M.D. Fla. 2006).

54 *See generally In re Wood*, 68 B.R. 613 (Bankr. D. Hawaii 1986) (large expenditures on pet care demonstrated mismanagement of debtor's business affairs).

55 Consider the author, this just might be true.

56 *See* 11 U.S.C. §§ 101(14A); 507(a)(1) and 1112(b)(4)(P).

57 *See* 11 U.S.C. § 1325(b)(2).

58 *See U.S. v. Sutton*, 786 F.2d 1305 (5th Cir. 1986) (holding that an incarcerated individual Chapter 11 debtor was not permitted to have his estate pay living expenses of his wife and minor children).

Indeed in a pre § 1115 individual Chapter 11 case, *U.S. v. Sutton*, the Fifth Circuit overruled a lower court decision which allowed living expenses of the individual Chapter 11 debtor's spouse and minor children to be paid from estate funds. While Courts should be able to distinguish *Sutton* on its unique facts, it does illustrate the problems with new § 1115.

VII. Estate Exemptions of Post-Petition Earnings in Chapter 11 Cases

An area of possible confusion concerns an individual Chapter 11 debtors' right to claim exemptions both before and during their Chapter 11s. First, how do you claim exemptions in an individual Chapter 11 case? As a Chapter 11 debtor owes a fiduciary duty to his creditors, can he or she take assets "away" from the creditors by claims of exemptions? Also would Chapter 11 debtors have a duty to oppose their claimed exemptions?

A new issue arising under the BAPCPA is whether an individual Chapter 11 debtor can exempt a portion of his post petition earnings from services performed under applicable state exemption law. For example under Kentucky law[59] a significant portion of "disposable earnings" (which include earnings from services) are exempt from garnishment by creditors. While Kentucky law provides that this exemption does not apply to "[a]ny order of any court of bankruptcy under Chapter 13 of the Bankruptcy Code", it apparently still applies in individual Chapter 11 cases. The question which may shortly confront Courts and debtors is whether an individual Chapter 11 debtor can use state law to exempt from estate property, some or all post petition wages. In addition, since most such laws are time period based, can those exemptions be asserted for each applicable post petition time period and if so, how can they be asserted?

VIII. Bankruptcy Code vs. the Internal Revenue Code

One of the more difficult issues arising under the BAPCPA is how post-petition earnings will be treated for tax purposes under the Internal Revenue Code. In the leading article on this topic, "Tax Consequences of Post-Petition Income as Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11[60] ("Tax Consequences") by Jack Williams and Jacob L. Todres, the authors note several tax issues arising from § 1115.

- How are post-petition earnings paid to individual debtor's estates and reported?
- How are the post-petition earnings transferred from the estate to the individual (for use in personal expenses) treated for tax purposes?
- Will there be double taxation at the estate level and the individual level for amounts of post-petition earnings which are paid or used by debtors as individuals?

While there is no definitive answer to these issues, a detailed reading of Tax Consequences is highly recommended for a more complete understanding of these problems.

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59 KRS 427.010.

60 13 Am. Bankr. Inst. L. Rev. 701 (2005).

IX. Involuntary Chapter 11!?

Prior to the enactment of the BAPCPA, involuntary Chapter 11's of individuals were legally possible[61] but of little value as an individual's post-petition income was not property of the estate. However, with the enactment of § 1115 post-petition income is now property of the estate.[62] This, coupled with the liberal discovery provisions of Rule 2004, limitations our use of estate property and the debtor's inherent fiduciary duty to creditor,[63] involuntary Chapter 11 may become a more attractive creditor option.

By allowing an involuntary Chapter 11 against an individual, the provisions of the BAPCPA related to individual Chapter 11 may be unconstitutional as violating the Thirteenth Amendment's prohibition against Involuntary Servitude. The Thirteenth Amendment provides:

> Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.

Prior to the passage of the BAPCPA, the Supreme Court has found serious constitutional questions with forced assignment of future earnings, both in bankruptcy[64] and non-bankruptcy cases.[65] Indeed in a case involving the assignment of future wages, the Supreme Court stated:

> When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage earner, there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of ages assigned, may here be small, but the principle, once

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61 See Warner, Garnishment Restrictions and the Involuntary Chapter 11: Rethinking Kokoszka in a means test world, 13 Am. Bankr. Inst. L.R. 733, 735 (2005) (hereinafter "Garnishment"); Fagone, Involuntary Individual Chapter 11 Post-BAPCPA as a Collection Device 25 Am. Bankr. Inst. J. 28 (Dec/Jan. 2007) (hereinafter "Involuntary Chapter 11"). See also Toibb v. Radloff, 501 U.S. 157 (1991) (discussing involuntary Chapter 11 cases against the individuals.

62 However, as noted by Professor Roy Warner in Garnishment, there may be constitutional limitations on the amount of post-petition income which can become estate property in an involuntary individual Chapter 11.

63 See generally Involuntary Chapter 11.

64 *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) (prohibiting confirmation of "sweat equity" Chapter 11 Plan).

65 *See Pollock v. Williams*, 322 U.S. 4, 24 (1944) (holding states cannot "directly or indirectly command involuntary servitude, even if it was voluntarily contracted for."); *Taylor v. Ga.*, 315 U.S. 25, 29 (1942) holding that "peonage" is a form of involuntary servitude within the meaning of the Thirteenth Amendment); *Bailey v. Ala.*, 219 U.S. 219, 240, 241, 243-244 (1911) (noting that the Thirteenth Amendment prohibits all kinds of "slavery," including labor in payment of debt).

> established, will equally apply where both are very great. The new opportunity in life and the clear field for future effort, which it is the purpose of the Bankruptcy Act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.[66]

As noted by the scholarly article on this issue: "Dead Man Filing Redux: Is the New Individual Chapter Eleven Unconstitutional?" 13 Am. Bankr. Inst. L. Rev. 483 (2005) by Robert Keach, there are serious questions concerning the constitutionality of the individual Chapter 11 provisions of BAPCPA. While Congress clearly intended to make individual debtors' post-petition earnings a required part of creditors' potential repayment, there remains the question of whether those protections will remain.

X. Confirmation of Individual Chapter 11s after BAPCPA.

The most dramatic changes to Chapter 11 by the BAPCPA were the amendments affecting Chapter 11 individuals. By amending six sections in Chapter 11, Congress expanded reorganization options for individuals and forced Chapter 11 attorneys to learn more about Chapter 13 "projected disposable income" than perhaps they ever cared to. The six amended sections are summarized as follows:

1. Section 1115 was added to provide that in addition to the property of the estate specified in § 541, property of the estate for individual debtors under Chapter 11 shall include all property that the debtor acquires after the commencement of the case and all earnings from post-petition services performed by the debtor.

2. Section 1129(a)(15) was added to permit confirmation of a plan notwithstanding the objection of an allowed unsecured claim so long as the individual debtor pays either property valued as of the effective date of the plan in an amount equal to the creditor's allowed unsecured claim or the debtor distributes an amount equal to or greater than the projected disposable income of the debtor, as defined under § 1325(b)(2), during a five-year period beginning on the date the first payment is due under the plan or during the period for which the plan provides payments, whichever is longer. See § 1129(a)(15). The effect of this modification is to incorporate the Chapter 13 disposable income concept into Chapter 11 cases filed by individuals. This has been interpreted to allow the debtor to confirm a plan that is not limited by the commitment periods set forth in Chapter 13 cases. Section 1129(a)(15) refers to the projected disposable income of the debtor "during a five-year period," and fails to establish a time period under which such money should be paid to creditors.

3. The absolute priority requirements imposed by Code § 1129(b)(2)(B)(ii) were waived by permitting a debtor to retain property included in the estate under § 1115. Although § 1115 was added by BAPCPA to include post-petition property and earnings, it also incorporates property of the estate under § 541, and accordingly it is assumed that the debtor shall be entitled to retain property under § 541 as well. A more narrow interpretation would cause this amendment to have little effect. Nevertheless, a split exists among the Bankruptcy

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[66] *Local Loan Co. v. Hunt*, 292 U.S. 234,245 (1934).

Courts as to whether §1115 includes the broader property of the estate under §541. Compare In re Tegeder, 369 B.R. 477 (Bankr. D. Neb. 2007); In re Roedemeier, 374 B.R. 264 (Bankr. D. Kan. 2007); In re Shat, 424 B.R. 854 (Bankr. D. Nev. 2010)(holding that Congress intended to make individual Chapter 11 cases more like Chapter 13 and there is no "absolute priority rule in Chapter 13 cases), with In re Gbadebo, 2010 WL 1568609 (Bankr. N.D. Calif. 2010)(holding that §1129(b)(2)(B)(ii) is not ambiguous and means that the debtor may retain only the property added to the estate by §1115 and not all property under §541. This court concluded that to rule otherwise would make the voting of unsecured creditors meaningless and is contrary to the general purpose of BAPCPA to increase payouts to creditors.).

4. Section 1123(a)(8) was added to allow a plan to provide for the payment of creditors through post-petition earnings from personal services performed by the debtor. As it relates to individuals, this provision likely overrules the Supreme Court decision in In re Ahlers, 108 S. Ct. 963 (1988), which stated that the new value exception, if it exists at all, could not be satisfied by the contribution of post-confirmation personal services ("sweat equity") that a farmer may contribute in growing crops.

5. Section 1141(d)(5) was added to delay the granting of a discharge for an individual until the completion of all payments under the debtor's plan, provided after notice and a hearing, the court may grant a discharge to a debtor who has not completed its proposed plan payments as long as a modification under § 1127 is not practicable and the value of the payments that have been provided under the plan to allowed unsecured claims is equal to or exceeds the amount that such claims would have been paid if the debtor had been liquidated under Chapter 7. See § 1141(d)(5).

6. Finally, § 1127(e) was added to permit an individual debtor to modify his/her plan at any time after confirmation of the plan but before the completion of payments under the plan, notwithstanding the fact that the plan has been substantially consummated. This can be accomplished upon the request of the debtor, the trustee, the U.S. Trustee, or the holder of an allowed unsecured claim to increase or reduce the amount of payments of claims to a particular class, extend or reduce the time period for payments under the plan, or alter the amount of the distribution to a creditor to the extent necessary to take account of any payment of such claim made outside of the plan. Otherwise, Code §§ 1121 through 1128 and the requirements of § 1129 apply to any such modification, including the requirement of appropriate disclosure under § 1125. See § 1127(f).

XI. Chapter 11 v. Chapter 13

The following is a comparison of the differences that now exist between Chapter 11 and Chapter 13.

A. Advantages of Chapter 11

1. No secured or unsecured claim limit for eligibility under § 109(e).

2. The debtor does not have to have a regular income to be eligible to file.

3. The Chapter 11 filing creates a new estate that can be taxed as a separate entity under 26 U.S.C. § 1398. This may be an advantage to the individual who has capital gains upon the sale of an asset since the tax liability will be paid by the estate.

4. The value of purchase money secured claims is based on the value of the collateral and not the amount of the debt as required by the hanging paragraph following § 1325(a). See § 506(a)(2).

5. "Projected disposable income" determines the amount of funds that must be "distributed under the plan", whereas in a Chapter 13 case the "projected disposable income" must be paid monthly during the "applicable commitment period." See §1325(b)(1)(B) & (b)(4). Thus in a Chapter 11 case, the plan is not limited to 36-60 months.

6. "Projected disposable income" applies to the "value of the property to be distributed under the plan" in a Chapter 11 case, whereas in a Chapter 13 case the "projected disposable income" must be paid to unsecured creditors. Thus, in Chapter 11, the debtor may be able to use disposable income to pay all obligations under the plan which will include secured creditors. Compare § 1129(a)(15) with § 1325(b)(1)(B).

7. Chapter 11 debtors may not have to use the IRS standard deductions in determining "project disposable income," even though the debtor does not pass the means test under §707(b)(2). See § 1129(a)(15). See In re Roedemeier, 374 B.R. 264 (Bankr. D. Kan. 2007).

8. There is no subsequent discharge limitation under §1141. See §1328(f).

9. Chapter 11 does not require debtors to complete an instructional course before a discharge is granted. See §1328(g)(1).

B. Advantages of Chapter 13

1. Chapter 13 is exempt from an involuntary petition under § 303(b).

2. A co-debtor stay applies in Chapter 13 cases under §1307.

3. The filing fees are significantly cheaper for Chapter 13 cases ($1039 vs $274).

4. Priority claims may be paid without interest over the term of the plan. This may be particularly beneficial if the debtor has significant domestic support obligations. Compare §1129(a)(14) with § 1322(a)(2). Additionally, under § 1322(a)(4), less than full payments of domestic support obligations that have been assigned to the government is possible if all of the debtor's "projected disposable income" is applied to payments under the Chapter 13 plan for a five year period. No similar provision exists under Chapter 11.

5. Plan payments may be less than the "projected disposable income" over 60 months. See § 1325(b)(4). Also Chapter 13 plan payments are limited to 60 months, with the exception of long term debt payments. A similar exception does not exist in Chapter 11, and thus a long term mortgage may continue the obligation to pay "projected disposable income" until the long term debt is paid in full.

6. Debtor's counsel may be paid for services that may not benefit the estate. See §330(a)(4)(B).

7. The Chapter 11 debtor may be classified as a "small business debtor" and will have to follow the reporting and time restrictions imposed by BAPCPA on such debtors. Unless a representative unsecured committee is active, a debtor is a "small business debtor" if the debtor has aggregate noncontingent liquidated secured and unsecured debts less than $2 million. See § 101(51C) & (51D). BAPCPA added the following:

(i) Additional reporting and filing requirements under § 1116.

(ii) Stricter deadlines for filing and confirming a plan under § 1121(e) and 1129(e).

8. In a Chapter 11 case, the debtor may have to get court permission to use post-petition wages to pay personal expenses. Presumably the payment of post-petition personal expenses would not be in the ordinary course of "business" under § 363(b).

9. The following debts are dischargeable:

(i) Property settlement debts arising under a divorce decree are dischargeable. See § 523(a)(15).

(ii) willful and malicious injury to the property of another are dischargeable. See § 523(a)(6).

(iii) nonpecuniary tax penalties and debts incurred to pay a nondischargeable tax are dischargeable. See § 523(a)(7) & (a)(14), (a)(14A), (a)(14B).

(iv) other types of debts described in §§ 523(a)(10), (a)(11), (a)(12), (a)(16), (a)(17), (a)(18), and (a)(19).

10. The Debtor may dismiss a Chapter 13 case at any time. Compare § 1112(b) with § 1307(b). Furthermore, Chapter 13 debtors are not subject to the new standards for the appointment of a trustee or conversion or dismissal of cases under §1104 & 1112.

11. The Chapter 13 plan process is faster, cheaper and can be accomplished without an accepting class. For example, no disclosure statement is required and consequently no discussion of potential tax consequences is necessary. See § 1125(a)(1).

12. Upon conversion, the debtor is able to retain post-petition wages unless the debtor converts the case under bad faith. This also means that the liquidation value needed to confirm a Chapter 13 plan is less than in a Chapter 11 case because the debtor's post-petition wages are included in the Chapter 7 estate if the Chapter 11 case is converted. See § 348(f).

13. Payments under a Chapter 13 plan may be reduced by the actual amount expended by the debtor to purchase reasonable and necessary health insurance for the debtor and any dependent of the debtor.

14. The U.S. Trustee, in addition to the debtor, trustee, or the holder of an allowed unsecured claim, may request that a Chapter 11 plan may be modified. Compare § 1127(e) with § 1329(a).

C. Calculation of "Projected Disposable Income"

Pursuant to § 1129(a)(15), the "projected disposable income" test is imposed for the purposes of a Chapter 11 case in which the debtor is an individual when a "holder of an allowed unsecured claim objects to the confirmation of the plan." "Projected disposable income" of the debtor is defined in § 1325(b)(2) to require the following:

"Current monthly income" (defined in § 101(10A)) received by the debtor (other than child support payments, foster case payments, or disability payments for a dependent child);

less amounts reasonably necessary for:

(a) maintenance or support of the debtor or dependent,

(b) post-petition domestic support obligations;

(c) charitable contributions (not to exceed 15% of gross income of the debtor for the year in which the contributions are made); and

(d) if the debtor is engaged in business, the payment of expenditures necessary for the continuation , preservation, and operation of the business.

"Current monthly income" is to be calculated pursuant to Form B22B (copy attached), which is designed for Chapter 11 debtors. Although the purpose of the calculation is to determine "projected disposable income," note that the "current monthly income" is a six month average of the debtors prepetition income—thus it is not necessarily "current" or "monthly" and often will not be the "projected" income of the debtor during the term of the plan.

In Chapter 13 cases, the deductions to the "current monthly income" calculation depends on whether the debtor passes the "means test" under § 1325(b)(3) (see Form B22A attached). If the debtor passes the "means test," the calculation is determined in accordance with the wording of paragraph 1 above as interpreted by case law. If the debtor is over the median income, the debtor must apply amounts specified under § 707(b)(2), which applies the IRS National Standards and Local Standards and the debtor's actual monthly expenses for the Other Necessary Expense category. In summary, in Chapter 13 cases, the "reasonable necessary" calculation becomes a mathematical formula which deducts (without review for reasonableness or necessity) the amounts set forth in Form B22C, attached. Since § 1129(a)(15) only refers to the calculation of "project disposable income" in § 1325(b)(2), the more objective mathematical calculation under § 1325(b)(3) presumably was not intended to apply in Chapter 11 cases. The Committee Note to Form B22B supports this interpretation, and thus Form B22B does not include the mathematical calculation under § 1325(b)(3).

B 22B (Official Form 22B) (Chapter 11) (01/08)

In re _____
Debtor(s)

Case Number: _____
(If known)

CHAPTER 11 STATEMENT OF CURRENT MONTHLY INCOME

In addition to Schedules I and J, this statement must be completed by every individual chapter 11 debtor, whether or not filing jointly. Joint debtors may complete one statement only.

Part I. CALCULATION OF CURRENT MONTHLY INCOME

1	**Marital/filing status.** Check the box that applies and complete the balance of this part of this statement as directed. a. ☐ Unmarried. **Complete only Column A ("Debtor's Income") for Lines 2-10.** b. ☐ Married, not filing jointly. **Complete only Column A ("Debtor's Income") for Lines 2-10.** c. ☐ Married, filing jointly. **Complete both Column A ("Debtor's Income") and Column B ("Spouse's Income") for Lines 2-10.**		
	All figures must reflect average monthly income received from all sources, derived during the six calendar months prior to filing the bankruptcy case, ending on the last day of the month before the filing. If the amount of monthly income varied during the six months, you must divide the six-month total by six, and enter the result on the appropriate line.	**Column A** **Debtor's Income**	**Column B** **Spouse's Income**
2	**Gross wages, salary, tips, bonuses, overtime, commissions.**	$	$
3	**Net income from the operation of a business, profession, or farm.** Subtract Line b from Line a and enter the difference in the appropriate column(s) of Line 3. If more than one business, profession or farm, enter aggregate numbers and provide details on an attachment. Do not enter a number less than zero. a. Gross receipts $ b. Ordinary and necessary business expenses $ c. Business income Subtract Line b from Line a.	$	$
4	**Net rental and other real property income.** Subtract Line b from Line a and enter the difference in the appropriate column(s) of Line 4. Do not enter a number less than zero. a. Gross receipts $ b. Ordinary and necessary operating expenses $ c. Rent and other real property income Subtract Line b from Line a.	$	$
5	**Interest, dividends, and royalties.**	$	$
6	**Pension and retirement income.**	$	$
7	**Any amounts paid by another person or entity, on a regular basis, for the household expenses of the debtor or the debtor's dependents, including child support paid for that purpose.** Do not include alimony or separate maintenance payments or amounts paid by the debtor's spouse if Column B is completed.	$	$
8	**Unemployment compensation.** Enter the amount in the appropriate column(s) of Line 8. However, if you contend that unemployment compensation received by you or your spouse was a benefit under the Social Security Act, do not list the amount of such compensation in Column A or B, but instead state the amount in the space below: Unemployment compensation claimed to be a benefit under the Social Security Act Debtor $ _____ Spouse $ _____	$	$

9	**Income from all other sources**. Specify source and amount. If necessary, list additional sources on a separate page. Total and enter on Line 9. **Do not include alimony or separate maintenance payments paid by your spouse if Column B is completed, but include all other payments of alimony or separate maintenance. Do not include** any benefits received under the Social Security Act or payments received as a victim of a war crime, crime against humanity, or as a victim of international or domestic terrorism. a. _____ $ _____ b. _____ $ _____	$	$
10	**Subtotal of current monthly income.** Add Lines 2 thru 9 in Column A, and, if Column B is completed, add Lines 2 through 9 in Column B. Enter the total(s).	$	$
11	**Total current monthly income.** If Column B has been completed, add Line 10, Column A to Line 10, Column B, and enter the total. If Column B has not been completed, enter the amount from Line 10, Column A.	$	

Part II: VERIFICATION

12	I declare under penalty of perjury that the information provided in this statement is true and correct. *(If this a joint case, both debtors must sign.)* Date: _____ Signature: _____ (Debtor) Date: _____ Signature: _____ (Joint Debtor, if any)

COMMITTEE NOTE

A. Overview

Among the changes introduced by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 are interlocking provisions defining "current monthly income" and establishing a means test to determine whether relief under Chapter 7 should be presumed abusive. Current monthly income ("CMI") is defined in § 101(10A) of the Code, and the means test is set out in § 707(b)(2). These provisions have a variety of applications. In Chapter 7, if the debtor's CMI exceeds a defined level the debtor is subject to the means test, and § 707(b)(2)(C) specifically requires debtors to file a statement of CMI and calculations to determine the applicability of the means test presumption. In Chapters 11 and 13, CMI provides the starting point for determining the disposable income that must be contributed to payment of unsecured creditors. Moreover, Chapter 13 debtors with CMI above defined levels are required by § 1325(b)(3) to complete the means test in order to determine the amount of their monthly disposable income, and pursuant to § 1325(b)(4), the level of CMI determines the "applicable commitment period" over which projected disposable income must be paid to unsecured creditors.

To provide for the reporting and calculation of CMI and for the completion of the means test where required, three separate official forms have been created—one for Chapter 7, one for Chapter 11, and one for Chapter 13. This note first describes the calculation of CMI that is common to all three of the forms, next describes the means test as set out in the Chapter 7 and 13 forms, and finally addresses particular issues that are unique to each of the separate forms.

B. Calculation of CMI

Although Chapters 7, 11, and 13 use CMI for different purposes, the basic computation is the same in each. As defined in § 101(10A), CMI is the monthly average of certain income that the debtor (and in a joint case, the debtor's spouse) received in the six calendar months before the bankruptcy filing. The definition includes in this average (1) income from all sources, whether or not taxable, and (2) any amount paid by an entity other than the debtor (or the debtor's spouse in a joint case) on a regular basis for the household expenses of the debtor, the debtor's dependents, and (in a joint case) the debtor's spouse if not otherwise a dependent. At the same time, the definition excludes from the averaged income "benefits received under the Social Security Act" and certain payments to victims of terrorism, war crimes, and crimes against humanity.

Each of the forms provides for reporting income items constituting CMI. The items are reported in a set of entry lines—Part II of the Chapter 7 form and Part I of the forms for Chapter 11 and Chapter 13—that include separate columns for reporting income of the debtor and of the debtor's

spouse. The first of these entry lines includes a set of instructions and check boxes indicating when the "debtor's spouse" column must be completed. The instructions also direct the required averaging of reported income.

The subsequent entry lines specify several common types of income and are followed by a "catch-all" line for other income. The specific entry lines address (a) gross wages; (b) business income; (c) rental income; (d) interest, dividends, and royalties; (e) pension and retirement income; (f) regular contributions to the debtor's household expenses; and (g) unemployment compensation. Gross wages (before taxes) are required to be entered. Consistent with usage in the Internal Revenue Manual and the American Community Survey of the Census Bureau, business and rental income is defined as gross receipts less ordinary and necessary expenses. Unemployment compensation is given special treatment. Because the federal government provides funding for state unemployment compensation under the Social Security Act, there may be a dispute about whether unemployment compensation is a "benefit received under the Social Security Act." The forms take no position on the merits of this argument, but give debtors the option of reporting unemployment compensation separately from the CMI calculation. This separate reporting allows parties in interest to determine the materiality of an exclusion of unemployment compensation and to challenge it. The forms provide for totaling the income lines.

C. The means test: deductions from current monthly income (CMI)

The means test operates by deducting from CMI defined allowances for living expenses and payment of secured and priority debt, leaving disposable income presumptively available to pay unsecured non-priority debt. These deductions from CMI under are set out in the Code at § 707(b)(2)(A)(ii)-(iv). The forms for Chapter 7 and Chapter 13 have identical sections (Parts V and III, respectively) for calculating these deductions. The calculations are divided into subparts reflecting three different kinds of allowed deductions.

1. Deductions under IRS standards

Subpart A deals with deductions from CMI, set out in § 707(b)(2)(A)(ii), for "the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides." The forms provide entry lines for each of the specified expense deductions under the IRS standards, and instructions on the entry lines identify the website of the U.S. Trustee Program, where the relevant IRS allowances can be found. As with all of the deductions in § 707(b)(2)(A)(ii), deductions under the IRS standards are subject to the proviso that they not include "any payments for debts."

The IRS National Standards provide a single allowance for food, clothing, household supplies, personal care, and miscellany, depending on income and household size. The forms contain an entry line for the applicable allowance.

The IRS Local Standards provide one set of deductions for housing and utilities and another set for transportation expenses, with different amounts for different areas of the country, depending on the size of the debtor's family and the number of the debtor's vehicles. Each of the amounts specified in the Local Standards are treated by the IRS as a cap on actual expenses, but because § 707(b)(2)(A)(ii) provides for deductions in the "amounts specified under the . . . Local Standards," the forms treat these amounts as allowed deductions. The forms again direct debtors to the website of the U.S. Trustee Program to obtain the appropriate allowances.

The Local Standards for housing and utilities, as published by the IRS for its internal purposes, present single amounts covering all housing expenses; however, for bankruptcy purposes, the IRS has separated these amounts into a non-mortgage component and a mortgage/rent component. The non-mortgage component covers a variety of expenses involved in maintaining a residence, such as utilities, repairs and maintenance. The mortgage/rent component covers the cost of acquiring the residence. For homeowners with mortgages, the mortgage/rent component involves debt payment, since the cost of a mortgage is part of the allowance. Accordingly, the forms require debtors to deduct from the mortgage/rent component their average monthly mortgage payment (including required payments for taxes and insurance), up to the full amount of the IRS mortgage/rent component, and instruct debtors that this average monthly payment is the one reported on the separate line of the forms for deductions of secured debt under § 707(b)(2)(a)(iii). The forms allow debtors to challenge the appropriateness of this method of computing the Local Standards allowance for housing and utilities and to claim any additional housing allowance to which they contend they are entitled, but the forms require specification of the basis for such a contention.

The IRS issues Local Standards for transportation in two components for its internal purposes as well as for bankruptcy: one component covers vehicle operation/public transportation expense and the other ownership/lease expense. The amount of the vehicle operation/public transportation allowance depends on the number of vehicles the debtor operates, with debtors who do not operate vehicles being given a public transportation allowance. The instruction for this line item makes it clear that every debtor is thus entitled to some transportation expense allowance. No debt payment is involved in this allowance. The ownership/lease component, on the other hand, may involve debt payment. Accordingly, the forms require debtors to reduce the allowance for ownership/lease expense by the average monthly loan payment amount (principal and interest), up to the full amount of the IRS ownership/lease expense amount. This average payment is as reported on the separate line of the forms for deductions of secured debt under § 707(b)(2)(a)(iii).

The IRS does not set out specific dollar allowances for "Other Necessary Expenses." Rather, it specifies a number of categories for such expenses, and describes the nature of the expenses that may be deducted in each of these categories. Section 707(b)(2)(a)(ii) allows a deduction for the debtor's actual expenses in these specified categories, subject to its requirement that payment of debt not be included. Several of the IRS categories deal with debt repayment and so are not included in the forms. Several other categories deal with expense items that are more expansively addressed by specific statutory allowances. Subpart A sets out the remaining

categories of "Other Necessary Expenses" in individual entry lines. Instructions in these entry lines reflect limitations imposed by the IRS and the need to avoid inclusion of items deducted elsewhere on the forms.

Subpart A concludes with a subtotal of the deductions allowed under the IRS standards.

2. Additional statutory expense deductions

In addition to the expense deductions allowed under the IRS standards, the means test makes provision—in subclauses (I), (II), (IV), and (V) of § 707(b)(2)(A)(ii)—for six special expense deductions. Each of these additional expense items is set out on a separate entry line in Subpart B, introduced by an instruction that there should not be double counting of any expense already included in the IRS deductions. Contributions to tax-exempt charities provide another statutory expense deduction. Section 1325(b)(2)(A)(ii) expressly allows a deduction from CMI for such contributions (up to 15% of the debtor's gross income), and § 707(b)(1) provides that in considering whether a Chapter 7 filing is an abuse, the court may not take into consideration "whether a debtor . . . continues to make [tax-exempt] charitable contributions." Accordingly, Subpart B also includes an entry line for charitable contributions. The subpart concludes with a subtotal of the additional statutory expense deductions.

3. Deductions for payment of debt

Subpart C of the forms deals with the means test's deductions from CMI for payment of secured and priority debt, as well as a deduction for administrative fees that would be incurred if the debtor paid debts through a Chapter 13 plan. In accord with § 707(b)(2)(A)(iii), the deduction for secured debt is divided into two entry lines—one for payments that are contractually due during the 60 months following the bankruptcy filing, the other for amounts needed to retain necessary collateral securing debts in default. In each situation, the instructions for the entry lines require dividing the total payment amount by 60, as the statute directs. Priority debt, deductible pursuant to § 707(b)(2)(A)(iv), is treated on a single entry line, also requiring division by 60. The defined deduction for the expenses of administering a Chapter 13 plan is allowed by § 707(b)(2)(A)(ii)(III) only for debtors eligible for Chapter 13. The forms treat this deduction in an entry line requiring the eligible debtor to state the amount of the prospective Chapter 13 plan payment and multiply that payment amount by the percentage fee established for the debtor's district by the Executive Office for United States Trustees. The forms refer debtors to the website of the U.S. Trustee Program to obtain this percentage fee. The subpart concludes with a subtotal of debt payment deductions.

4. Total deductions

Finally, the forms direct that the subtotals from Subparts A, B, and C be added together to arrive at the total of allowed deductions from CMI under the means test.

5. Additional claimed deductions

The forms do not provide for means test deductions from CMI for expenses in categories that are not specifically identified as "Other Necessary Expenses" in the Internal Revenue Manual. However, debtors may wish to claim expenses that do not fall within the categories listed as "Other Necessary Expenses" in the forms. Part VII of the Chapter 7 form and Part VI of the Chapter 13 form provide for such expenses to be identified and totaled. Although expenses listed in these sections are not deducted from CMI for purposes of the means test calculation, the listing provides a basis for debtors to assert that these expenses should be deducted from CMI under § 707(b)(2)(A)(ii)(I), and that the results of the forms' calculation, therefore, should be modified.

D. The chapter-specific forms

1. Chapter 7

The Chapter 7 form has several unique aspects. The form includes, in the upper right corner of the first page, a check box directing the debtor to state whether or not the calculations required by the form result in a presumption of abuse. The debtor is not bound by this statement and may argue, in response to a motion brought under § 707(b)(1), that there should be no presumption despite the calculations required by the form. The check box is intended to give clerks of court a conspicuous indication of the cases for which they are required to provide notice of a presumption of abuse pursuant to § 342(d).

Part I of the form implements the provision of § 707(b)(2)(D) that excludes certain disabled veterans from all means testing, making it unnecessary to compute the CMI of such veterans. Debtors who declare under penalty of perjury that they are disabled veterans within the statutory definition are directed to verify their declaration in Part VII, to check the "no presumption" box at the beginning of the form, and to disregard the remaining parts of the form.

Part II of the form is the computation of CMI. Section 707(b)(7) eliminates standing to assert the means test's presumption of abuse if the debtor's annualized CMI does not exceed a defined median state income. For this purpose, the statute directs that CMI of the debtor's spouse be combined with the debtor's CMI even if the debtor's spouse is not a joint debtor, unless the debtor declares under penalty of perjury that the spouses are legally separated or living separately other than for purposes of evading the means test. Accordingly, the calculation of CMI in Part II directs a computation of the CMI of the debtor's spouse not only in joint cases, but also in cases of married debtors who do not make the specified declaration, and the CMI of both spouses in these cases is combined for purposes of determining standing under § 707(b)(7).

Part III of the form provides for the comparison of the debtor's CMI to the applicable state median income for purposes of § 707(b)(7). It then directs debtors whose income does not exceed the applicable median to verify the form, to check the "no presumption" box at the beginning of the form, and not to complete the remaining parts of the form. Debtors whose CMI does exceed the applicable state median are required to complete the remaining parts of the form.

Part IV of the form provides for an adjustment to the CMI of a married debtor, not filing jointly, whose spouse's CMI was combined with the debtor's for purposes of determining standing to assert the means test presumption. The means test itself does not charge a married debtor in a non-joint case with the income of the non-filing spouse, but rather only with contributions made by that spouse to the household expenses of the debtor or the debtor's dependents, as provided in the definition of CMI in § 101(10A). Accordingly, Part IV calls for the combined CMI of Part II to be reduced by the amount of the non-filing spouse's income that was not contributed to the household expenses of the debtor or the debtor's dependents.

Part V of the form provides for a calculation of the means test's deductions from the debtor's CMI, as described above.

Part VI provides for a determination of whether the debtor's CMI, less the allowed deductions, gives rise to a presumption of abuse under § 707(b)(2)(A). Depending on the outcome of this determination, the debtor is directed to check the appropriate box at the beginning of the form and to sign the verification in Part VIII. Part VII allows the debtor to claim additional deductions, as discussed above.

2. Chapter 11

The Chapter 11 form is the simplest of the three, 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. Section 1129(a)(15) requires payments of disposable income "as defined in section 1325(b)(2)," and that paragraph allows calculation of disposable income under judicially-determined standards, rather than pursuant to the means test deductions, specified for higher income Chapter 13 debtors by § 1325(b)(3). However, § 1325(b)(2) does require that CMI be used as the starting point in the judicial determination of disposable income, and so the Chapter 11 form requires this calculation (in Part I of the form), as described above, together with a verification (in Part II).

3. Chapter 13

Like the Chapter 7 form, the form for Chapter 13 debtors contains a number of special provisions. The upper right corner of the first page includes check boxes requiring the debtor to state whether, under the calculations required by the statement, the applicable commitment period under § 1325(b)(4) is three years or five years and whether the means test deductions are required by § 1325(b)(3) to be used in determining the debtor's disposable income. The check box is intended to inform standing trustees and other interested parties about these items, but does not prevent the debtor from arguing that the calculations required by the form do not accurately reflect the debtor's disposable income.

Part I of the form is a report of income to be used for determining CMI. Section 1325(b)(4) imposes a five-year applicable commitment period—rather than a three-year period—if the debtor's annualized CMI is not less than a defined median state income. For this

purpose, as under § 707(b)(4), the CMI of the debtor's spouse is required by the statute to be combined with the debtor's CMI, and there is no exception for spouses who are legally separated or living separately. Accordingly, the report of income in Part I directs a combined reporting of the income of both spouses in all cases of married debtors.

Part II of the form computes the applicable commitment period by annualizing the income calculated in Part I and comparing it to the applicable state median. The form allows debtors to contend that the income of a non-filing spouse should not be treated as CMI and permits debtors to claim a deduction for any income of a non-filing spouse to the extent that this income was not contributed to the household expenses of the debtor or the debtor's dependents. The debtor is directed to check the appropriate box at the beginning of the form, stating the applicable commitment period.

Part III of the form compares the debtor's CMI to the applicable state median, allowing a determination of whether the means-test deductions must be used, pursuant to § 1325(b)(3), in calculating disposable income. For this purpose, since § 1325(b)(3) does not provide for including the income of the debtor's spouse, the form directs a deduction of the income of a non-filing spouse that is not contributed to the household expenses of the debtor or the debtor's dependents. Again, the debtor is directed to check the appropriate box at the beginning of the form, indicating whether the means test deductions are applicable. If so, the debtor is directed to complete the remainder of the form. If not, the debtor is directed to complete the verification in Part VII but not complete the other parts of the form.

Part IV provides for calculation of the means-test deductions provided in § 707(b)(2), described above, as incorporated by § 1325(b)(3) for debtors with CMI above the applicable state median.

Part V provides for three adjustments required by special provisions affecting disposable income in Chapter 13. First, § 1325(b)(2) itself excludes from the CMI used in determining disposable income certain "child support payments, foster care payments, [and] disability payments for a dependent child." Because payments of this kind are included in the definition of CMI in § 101(10A), a line entry for deduction of these payments is provided. Second, a line entry is provided for deduction of contributions by the debtor to certain retirement plans, listed in § 541(b)(7)(B), since that provision states that such contributions "shall not constitute disposable income, as defined in section 1325(b)." Third, the same line entry also allows a deduction from disposable income for payments on loans from retirement accounts that are excepted from the automatic stay by § 362(b)(19), since § 1322(f) provides that for a "loan described in section 362(b)(19) . . . any amounts required to repay such loan shall not constitute 'disposable income' under section 1325."

The Chapter 13 form does not provide a deduction from disposable income for the Chapter 13 debtor's anticipated attorney fees. There is no specific statutory allowance for such a deduction, and none appears necessary. Section 1325(b)(1)(B) requires that disposable income contributed to a Chapter 13 plan be used to pay "unsecured creditors." A debtor's attorney who

has not taken a security interest in the debtor's property is an unsecured creditor who may be paid from disposable income.

Part VI of the form allows the debtor to claim additional deductions, as described above, and Part VII is the verification.

NOTICE TO BAR REGARDING INDIVIDUAL CHAPTER 11 CASES

There has been a recent spate of individual Chapter 11 cases filed by attorneys who have neither the experience nor the education nor the competence to venture into Chapter 11. I believe that there are very few bankruptcy lawyers other than State Bar certified specialists who should be contemplating representation of Chapter 11 debtors in possession.

I see rampant errors being made in issues relating to cash collateral, conflicts of interest, and compensation.

The use of cash collateral without permission, even for necessary expenses, is usually fatal to Chapter 11 cases. There are procedures in place to obtain emergency permission to use cash collateral. If you don't know them, you should not be taking Chapter 11 cases.

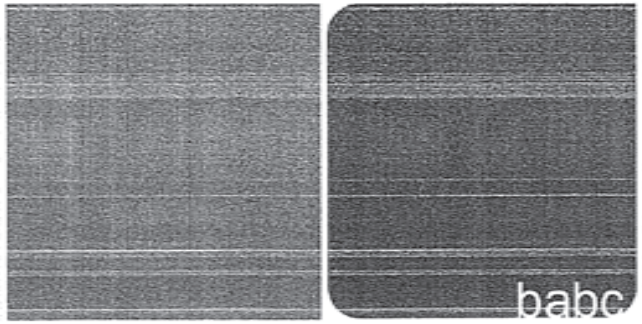
A Chapter 11 is not just a big Chapter 13. If you represent a Chapter 11 debtor in possession, your client is the *estate*, not the debtor personally. Failure to understand this results in serious liability exposure.

Forget about trying to fix your compensation. You will be paid what I allow, period. I suggest you not spend retainers until your fees are allowed to avoid having to return money you have already spent.

I see frequent malpractice in individual Chapter 11 cases and I am quick to note it on the record. Your employment will not be approved unless you have substantial current malpractice insurance. If you are going "bare," don't even think about taking a Chapter 11 case.

Dated: September 9, 2009

Alan Jaroslovsky
U.S. Bankruptcy Judge



Bankruptcy Code Sections Affecting Individuals in Chapter 11

Presented by

William L. Norton III

§521(b) Debtor Duties

- (b) In addition to the requirements under subsection (a), a debtor who is an individual shall file with the court –
  - (1) a **certificate from the approved nonprofit budget and credit counseling agency** that provided the debtor services under section 109(h) describing the services provided to the debtor; and
  - **(2)** a copy of the debt repayment plan, if any, developed under section 109(h) through the approved nonprofit budget and credit counseling agency referred to in paragraph (1).

Bankr. Rule 1007(b)(5) [Interim] Current Monthly Income

- (5) An individual debtor in a chapter 11 case shall file a statement of **current monthly income**, prepared as prescribed by the appropriate Official Form.

§101(51D) Small Business Debtor

- **(51D) The term "small business debtor"–**
  - **(A)** subject to subparagraph **(B)**, means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto) that has aggregate **noncontingent liquidated secured and unsecured debts** as of the date of the petition or the date of the order for relief in an amount not more than **$2,190,000** (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee **has not appointed under section 1102(a)(1) a committee of unsecured creditors** or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor;

§1115. Property of the Estate

(a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541 —

(1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first;

(2) **earnings from services performed by the debtor after the commencement of the case** but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.

§330 (a) Compensation of Officers

. . . .

(4)(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the **court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor** in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.